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Guide to Enterprise Restructuring and Competitiveness:

A Labor and Human Resource Approach

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FORWARD

The purpose of this guide is to set forth some of the tools and strategies that successful USDOL and WSI adjustment projects have introduced and used in CEE countries. Beginning in 1991, USDOL professional staff and consultants, including this author, began using a variety of enterprise restructuring and competitiveness (ERAC) enhancing tools and techniques developed in the United States to facilitate recently privatized state-owned enterprises in Poland and Hungary. It soon became clear that competitiveness in many businesses enterprises had to be strengthened to preserve jobs and enable them to make a successful transition to a market economy. The continued need and demand for these services subsequently led to the recognition that ERAC should be an important component of the USDOL/WSI Integrated EWC Adjustment Program developed in 1997.

While most of the original USDOL/WSI projects have been completed, this author believes that many of the tools contained in this guide have application for use in future restructuring projects in Central and Eastern Europe, and other areas of the world where economic or enterprise restructuring is occurring, and perhaps even in North America.

Why a labor and human resource approach to restructuring? As the subtitle of this guide indicates, it focuses on labor and human resource approaches to restructuring and competitiveness for two reasons: (a) successful USDOL projects have emphasized these approaches; and (b) almost all USAID restructuring programs and technical assistance efforts and other international funding agencies have focused almost entirely on the financial and/or legal aspects of restructuring at the enterprise level without addressing the labor and human resource dimensions of enterprise restructuring in a significant way. During his eight years of working in six CEE countries, this author found that, except for ILO projects and a handful of USDOL projects, most other projects either ignored the labor and human resource dimensions of enterprise restructuring or gave them only a cursory glance.

What is the genesis of ERAC tools in this guide? Some years ago, under the auspices of the SEED program passed by the U. S. Congress in 1989, the U.S. Department of Labor began providing a variety of labor market related training and technical assistance activities to several Central and Eastern European countries seeking to restructure their economies. One of the objectives of their Labor Market Transition Program was to help managers and labor leaders in state-owned and other enterprises mitigate the impacts of economic restructuring on enterprises and workers. To accomplish this objective it drew on the experiences of the USDOL's Bureau of Labor-Management Relations and Cooperative Programs (BLMRCP) staff--John Fiscella, Bob Johnson, Larry Adams and James Perlmutter--who helped pilot test some of the labor-management tools in Poland and Hungary during the mid-1990s. It also drew on the experiences of private industry in the United States during the same period.

This guide could not have been written without the help and contributions of many people, including those mentioned above. It is impossible to mention all of them by name, or to formally acknowledge the contributions of those whose previous work provided much of the information and material used in this guide, but several people who made unique contributions to the project or provided materials specifically for use in this publication deserve special mention. First and foremost, Maria Heidkamp, USDOL 1994-99 Rapid Response Project Direct in Hungary; and Virginia Stacey, Executive Director of WSI . Also deserving special mention for their contributions to this guide and especially to Chapters 3 and 9 are my good friends and colleagues, Marion T. Bentley and Frank T. Adams.

Other people who shared their valuable experiences and knowledge with me include present or former USDOL personnel Leona Sibelman, Kate Dorrell and William Batt, Jr.; and Utah State University faculty Gary Stewardson and Kirt Becker. Several people at the ILO, including Jim Windell and Michael Henriques, made it possible for me to carry out related work that contributed to this guide directly and indirectly, as did Arvind Nande whose work in Bulgaria contributed to Chapter 10.

Continuing support and opportunities to pilot test some of the tools in this guide were provided by James Perlmutter, first as USDOL's Deputy Director and subsequently as Director of the Office of Foreign Relations (OFR), Steve Marler, an OFR CEE program manager, Gedeon Werner and Sydney Smith Heimbrock, former OFR CEE program managers in the early 1990s and now associated with WSI.

It is my sincere hope that the USDOL, USAID, ILO, and other major international development agencies will continue to provide leadership and funding so that this guide can be used in future restructuring and adjustment projects around the world.

Dr. Gary B. Hansen
North Logan, Utah
January 2003

Table of Contents

Chapter 1

Overview of the integrated enterprise, worker, and community adjustment program

1.1 Introduction

Experience gained during the early 1990s by United States Department of Labor ((USDOL) technical assistance experts working in Central and Eastern Europe (CEE) to help workers and communities severely impacted by economic restructuring led to the development of a comprehensive adjustment "model" comprised of four components. The objectives of this program and strategy are to overcome or reduce the serious worker and community adjustment problems caused by the privatization and restructuring of state-owned (SOEs),.and to strengthen the competitiveness of all remaining enterprises in order to preserve and create jobs in the community. When governments adopt this program and use it in a systematic and integrative way with other active labor market measures, it reduces the economic and social costs of adjustment, shortens the time required and facilitates the transition to a market economy, and provides a framework for achieving economic renewal and job generation at the local level.

Four very important lessons were learned from the USDOL technical assistance experts' work in CEE countries over a five-year period.

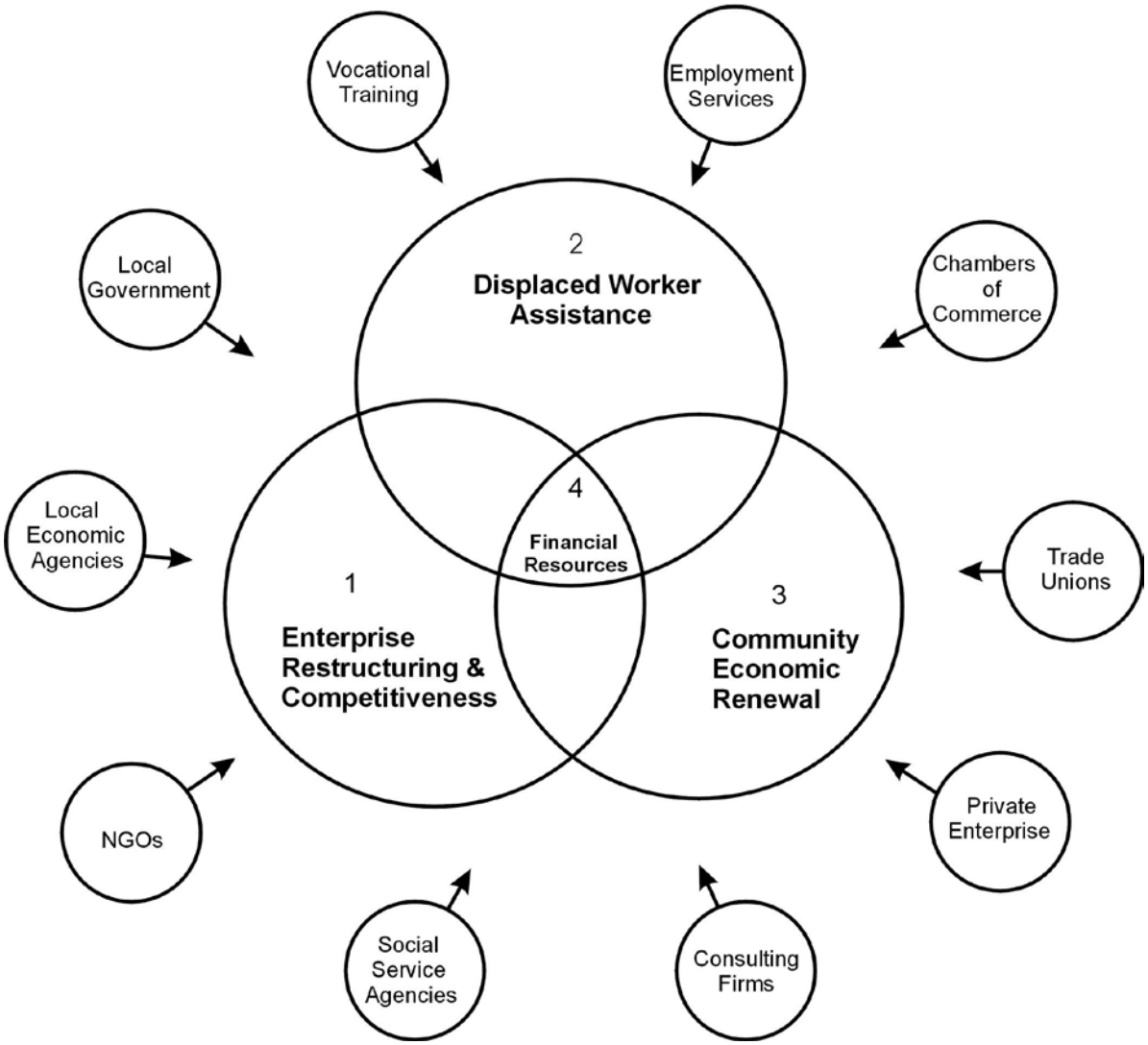
- First, the delivery of such basic labor market measures as employment services, unemployment compensation and severance pay are important and necessary, but not sufficient to achieve successful worker adjustment.
- Second, projects using discrete or separately administered adjustment programs (e.g., displaced worker assistance, vocational training, financial restructuring of enterprises, business incubators, or local economic development planning) to facilitate enterprise restructuring are less successful than projects using a more comprehensive, integrated approach—one that addresses enterprise, worker, *and* community, adjustment needs in a systematic and holistic way.
- Third, successful restructuring requires the active participation of employers and other interest groups (i.e., workers, community leaders, social service agencies, NGOs, etc.).
- Fourth, the most successful alleviation of the negative impacts of economic and enterprise restructuring and privatization on managers, workers and their communities requires the effective use of four adjustment components and the full participation of community leaders. These four components constitute the key elements of the integrated community adjustment program (ICAP) are described below.

1.2 Components of the integrated enterprise, worker and community (EWC) adjustment program

Chart 1-1, graphically presents the interrelationship between the four components of the integrated enterprise, worker and community adjustment program. Each of the components is described in greater detail on the subsequent pages.

Chart 1.1

Integrated Enterprise, Worker and Community Adjustment Program in Central and Eastern Europe



The integrated community adjustment program is comprised of the following four components:

- **I.** an ***Enterprise Restructuring and Competitiveness Component*** to strengthen local enterprises in order to (a) make them more competitive, and (b) preserve and create jobs;
- **II.** *a* ***Rapid Response Displaced Worker Assistance Component*** to plan, organize and facilitate the transition of displaced or redundant workers to new jobs;
- **III.** a ***Community Economic Renewal Component*** to stimulate local economic development efforts and generate new jobs in communities impacted by enterprise restructuring; and
- **IV.** a ***Financial Resources Component*** to provide funds to implement the worker, community and enterprise adjustment components.

Beginning in 1995 with the introduction and testing of the Rapid Response DWA Component in Hungary, and elements of the ERAC component in Poland, this integrated worker, community and enterprise adjustment program has been developed and successfully used by the USDOL and Worldwide Strategies to implement adjustment projects in six countries, Hungary, Romania, Bulgaria, Poland, Macedonia and Ukraine.

1.2.1 Enterprise Restructuring and Competitiveness Component

The enterprise restructuring and competitiveness (ERAC) component helps state-owned enterprises undergoing restructuring and downsizing, as well as other privately-owned business enterprises in the impacted communities or region, to become more productive and competitive in the national and global economies. Healthy enterprises provide more secure jobs for their managers and workers, and generate additional jobs in the community.

IA Specialists help enterprises, workers and their communities accomplish these objectives by providing information to enterprise managers and worker representatives about innovative tools and techniques that they can use or that can be made available to help them strengthen their enterprises. IA Specialists also help enterprise managers and worker representatives assess their situation, and by arranging for or delivering selected ERAC training and technical assistance services. Chart 1-2 outlines the tools that IA Specialists are able to make available to employers and workers as part of the Enterprise Restructuring and Competitiveness Component. Chart 1-3 outlines the basic steps used by IA Specialists to implement the ERAC component in a community, and to provide assistance to threatened and restructuring enterprises. :

Chart 1-2
Essential Tools of the Enterprise Restructuring and Competitiveness Component

Enterprise managers and worker representatives, with the assistance of Project IA Specialists and using some basic analytical tools, conduct an assessment of their firm's competitiveness problems and needs, evaluate the various restructuring strategies available to them, select a suitable strategy, develop some restructuring guidelines, and implement one or more enterprise strengthening elements, including:

- **Understanding the hierarchy of enterprise restructuring**, and the strategies and practical tools available to help managers improve enterprise competitiveness
- **Using socially sensitive restructuring techniques to strengthen enterprises and preserve jobs**. This is done by helping restructuring enterprises establish plant-level productivity improvement and cost saving (PI/CS) projects to reduce costs and increase productivity, and by helping restructuring enterprises to develop and implement strategies that improve human resource utilization to preserve jobs
- **Using socially sensitive measures to diminish workforce reductions and facilitate the transition of displaced workers to new jobs**
- **Improving labor-management relations** by providing "Training for Partnership," "Interest-based Negotiations," and "Group Problem-Solving" workshops that teach managers, workers, and union officials in affected enterprises and communities the techniques that can be used to solve problems, build cooperative partnerships, and generate high-performance workplaces
- **Upgrading workers' skills** by helping restructuring SOEs and other private enterprises increase their competitiveness or expand their operations by using Quick Start Training to upgrade their existing workers' skills or to train new workers
- **Maximizing joint competitive advantage of small enterprises** by assessing the need and opportunity for inter-firm cooperation and collaborative networks of small companies in communities or regions to help them maximize their joint competitive advantage in the global marketplace
- **Making ownership changes and using innovative group entrepreneurship approaches** to strengthen enterprises and preserve or create jobs in the community.
- **Providing managers and workers with economic education**. In order for an enterprise to be more competitive, its managers and workers must understand the basic fundamentals of the market economic system and private enterprise. They must also learn basic concepts such as "open book management" to better understand a financial statement and how their enterprise can become a "least cost producer."

Chart 1-3
Steps used by IA specialists to implement the enterprise restructuring and competitiveness component

1. **Establish an early warning network** at the community or regional levels and make continuing assessments of enterprises and industries that are subject to or undergoing economic restructuring
2. **Meet with enterprise managers and worker representatives in threatened and restructuring enterprises** to assess their situation and introduce them to the technical assistance and other services that can be made available
3. **Determine the size, complexity and urgency of the existing or potential enterprise adjustment and competitiveness problems and issues**
4. **Assess the employer interest and willingness to participate in an ERAC program**
5. **Help interested employers identify their specific ERAC needs and determine whether any individual elements of the ERAC program can facilitate the adjustment process**, **strengthen the competitiveness of the enterprise, and preserve or create jobs**
6. **Gain the approval of enterprise managers and worker representatives** to (a) participate in specific project-sponsored ERAC training and technical assistance services, and/or (b) to introduce socially sensitive restructuring and competitiveness techniques in their enterprises:
7. **Identify resources (financial and technical assistance) needed and available** (through the ERAC program and other resources) to support ERAC strengthening programs at the enterprise level
8. **Prepare and have the parties sign a written agreement** spelling out the roles, responsibilities and resources that will be committed to the project, setting out what will be accomplished and how the project will be organized
9. **Coordinate with local RRDWA and CER teams and economic development agencies** to link enterprise adjustment and competitiveness programs with worker adjustment and economic renewal efforts
10. **Coordinate the delivery of services and work of ERAC partners**, in providing technical assistance and services to the participating enterprise
11. **Monitor the project** to make sure that it is carried out in a fiscally responsible way and according to the terms of the agreement,
12. **Evaluate the results** of the project and determine whether any changes that should be made in subsequent projects based on the experience gained in the project

1.2.2 Rapid Response Displaced Worker Assistance Component

1 The Rapid Response Displaced Worker Assistance (RRDWA) Component is implemented by a small group of highly skilled industrial adjustment (IA) specialists who function as an *industrial adjustment unit* or *rapid response (RR) team*. These individuals are carefully selected and trained by experienced international trainers in the most advanced techniques of worker adjustment. This unit or team can be located within the regional or local offices of the MOL or national employment service, attached to another government agency (such as a restructuring or regional development agency), or set up as a separate non-governmental organization (NGO).

IA specialists facilitate the timely organization and implementation of a systematic worker adjustment process in enterprises and communities undergoing economic and enterprise restructuring. They work with restructuring enterprise managers and worker representatives to develop and implement plans to provide adjustment services and programs to transition large groups of workers to new employment as quickly as possible. They also meet with community leaders and enterprise managers to assess how the restructuring will impact the community and enterprise, and provide technical assistance to help them develop and implement effective community economic renewal and enterprise competitiveness strategies (outlined below).

Chart 1-4 outlines eight steps IA Specialists and RR Teams use to help local communities and business managers start a rapid response worker adjustment program for restructuring SOEs:

Chart 1-4
Steps used by IA Specialists to start a Rapid Response Displaced Worker Assistance Program

1. **Establish early warning networks** and make continuing assessments of enterprises and industries subject to economic restructuring and downsizing; identify threatened employers
2. **Initiate direct contact with the threatened employers and labor organizations representing workers**; and meet with them about the impending restructuring or closing
3. **Make a preliminary assessment to determine the size and complexity of the potential labor displacement**
4. **Assess the ability of those affected to cope with the anticipated change**
5. **Set up a mechanism to manage the displaced worker assistance program** (Reemployment Assistance Committee (RAC), or Community Displaced Worker Assistance (DWA) Team)
6. **Provide technical assistance to the RAC** or Community DWA Team as they conduct a survey of workers to determine the most vulnerable employees and their needs
7. **Provide training and technical assistance to the RAC** or Community DWA Team as they develop and implement an action plan, establish a transition center and peer support program, and arrange for needed services
8. **Monitor the progress and results**, and assess the relevance of the assistance strategies and tools used

RACs or Community DWA Teams play a significant role in facilitating worker adjustment in restructuring enterprises. The RAC is an ad hoc in-plant group of workers and managers that organizes and coordinates the delivery of adjustment services with the help of an IA specialist and other stakeholders. (When it is not possible to establish a RAC, because of employer opposition or other reasons, a Community RR or DWA Team may be established to carry out these functions. It is made up of community members and stakeholders who perform many of the functions of an RAC to provide assistance to displaced workers.) IA specialists work with enterprise managers and worker representatives to organize a RAC whenever possible. The RAC becomes the primary mechanism to:

- conduct surveys to determine worker needs

- plan, organize and implement "in-plant" pre-layoff services
- establish a transition or worker assistance resource center (WARC) at or near the plant if one is needed and start a peer support program if appropriate, and
- arrange for the delivery of pre- and post-layoff employment and training services to workers being dislocated, including job search training, job development, job fairs, job clubs, job placement, self-employment help, vocational counseling, retraining, financial planning, remedial education, entrepreneurship training, and other forms of employment assistance

Twenty years of experience in North America and Western Europe, and more recently in Hungary and five other CEE countries, has demonstrated that when an IA Specialist or community Rapid Response Team is involved and RACs are organized to provide the leadership for worker adjustment efforts in a restructuring enterprise and community they substantially increase the reemployment rates and reduce the length of unemployment of the dislocated workers. They also reduce the financial costs to the public treasury and the social costs to the workers and their families.

1.2.3 Community Economic Renewal Component

The community economic renewal (CER) component of the Integrated EWC Adjustment Program helps communities and regions experiencing economic restructuring, enterprise downsizing or closures to develop and use a systematic business growth, job retention and job creation strategy to begin or expand local economic development efforts.

IA specialists work with government, business, and labor leaders in communities experiencing economic restructuring and privatization to help them better understand the essential local economic development (LED) principles and processes required to improve the business climate and revitalize their economies. Implementing the three phase CER process creates a new sense of "community," and greater purpose and direction to the community's response in the face of serious economic threats. Chart 1-5 outlines how the CER Component is implemented

Phase I of the CER process starts with IA specialists inviting local government, community and business leaders and other people in affected communities to participate in a series of four grassroots participatory workshops. The economic development workshops help the members of this ***Community ER Team*** learn how to systematically assess their situation, design definite blueprints for local economic renewal, generate project ideas, and select suitable projects for further development and implementation.

Phase II. Communities completing the four Phase I CER workshops are invited by the IA Specialist and USDOL/WSI Adjustment Project Country Director to participate in Phase II of the CER process. Workshop E is the first step in Phase II. The ***Community ER Team*** is provided training and technical assistance to help them complete their strategic plan, refine their project design and then implement a CER project

Four steps are taken by community team members as part of Phase II during and after they complete Workshop E: (1) complete the strategic plan for the community and write a formal

CER project proposal, (2) develop an project implementation structure and select an "**action or implementation team**" to carry out the approved project, (3) implement the project, and (4) document and evaluate the results of their efforts.

Phase III. While the ***Action Team*** is implementing the approved CER project, the broader ***Community ER Team*** participates in Workshop F, the first step in achieving sustainability. During Workshop F, the ***Community ER Team*** is provided training and technical assistance to help them (a) conduct a sustainability analysis, which includes making an assessment of the community vision, goals, organizational capacity, structure, financial support and sustainability; (b) consider organizational changes and financial support needed to continue CER; (c) consider what is needed to attract donor/investor financial support for their continued activity, and (d) prepare a summary report of their findings. The second step is to revise and update their strategic plan. The third step is to develop new project proposals. The fourth step is to obtain the skills and training needed to continue their ER efforts on a long term basis.

Chart 1- 5
Steps used by IA Specialists to implement a CER program in a community

1. **Complete planning, organizing and other preparations** for program start up at the community level
   - ⇒ Contact prospective communities and complete site selection process
   - ⇒ IA staff selection and training
   - ⇒ Community organization and training
   - ⇒ Facilitator selection and training
   - ⇒ Preparation of community profile
   - ⇒ Preparation and arrangements for Workshop "0"
2. **Conduct Workshop "0" –** CER orientation workshop
3. **Organize and conduct Workshops A-D -** Discovering business opportunities
   - ⇒ The factors analysis
   - ⇒ ER principles and strategies analysis
   - ⇒ Generating project ideas
   - ⇒ Evaluating project ideas
4. **Organize and conduct Workshop E –** Designing and implementing ER projects
   - ⇒ Strategic plan and project proposal development
   - ⇒ Project organization and management
   - ⇒ Project implementation
   - ⇒ Project evaluation
5. **Provide technical assistance and monitor project implementation**
6. **Organize and conduct Workshop F --** Sustaining economic renewal and development
   - ⇒ Complete sustainability analysis
   - ⇒ Review and update strategic ER plan
   - ⇒ Develop and market new project proposals
   - ⇒ Identify skills training needed to strengthen and continue ER efforts
7. **Provide technical assistance and skills training for sustainability**
8. **Monitor implementation of sustainability plan and skills training**
   - ⇒ Complete final report

1.2.4 Financial Resources Component

The Integrated EWC Adjustment Program's financial resources component provides the money to pay for the above three essential adjustment components. The financial component can be organized and implemented in several ways:

- **USAID or Congressionally appropriated funds** that are allocated for adjustment projects in CEE countries are normally placed under the control of the Integrated EWC Adjustment Project (such as the USDOL Rapid Response Project in Hungary, the USDOL/WSI Labor Redeployment Project in Romania, the USDOL/WSI PLEDGE Project in Bulgaria, and the USDOL/WSI Poland Workforce Development Program in Katowice, Poland.
- **Salaries of IA Specialists and operating costs of Industrial Adjustment units are normally provided by the partner CEE government** from funds budgeted to the ministry of labor (MOL), employment service (ES) or national labor office, or through other appropriate agencies. Some resources may also come from the proceeds of grants or loans provided by international agencies and donors.
- **Special appropriations made using World Bank loans by CEE governments** to provide retraining and other services for workers displaced by enterprise restructuring, or proceeds from World Bank loans earmarked for this purpose, are usually disbursed by existing procedures (as has been done with World Bank loan funds in Romania).
- **Alternatively, the CEE government money or World Bank loan may be placed in a special fund** with its own administrative structure and procedures for disbursement. For example, in some countries a semi-autonomous Social Investment Fund has been created to disburse World Bank or other loan funds for community economic renewal projects.

If the CEE government intends to make available funds to pay for retraining programs or other worker adjustment services, or for community economic renewal projects, formal bidding, contracting and monitoring procedures must be established. These should be established by the MOL, Employment Service or other government agency assigned to solicit bids, award contracts, and monitor the contracts made to vocational training centers, NGOs, and other organizations that provide adjustment services.

Chart 1-6 shows the types of adjustment activities typically supported by the financial resources component when the USDOL and USAID assist a CEE government to implement an Integrated WCE Adjustment Program.

1.3 A practical toolkit for accomplishing economic restructuring and strengthening competitiveness

When the four-component Integrated EWC Adjustment Program described above has been embraced by progressive business, labor and community leaders seeking to restructure their economies and enterprises, and has been implemented in a systematic way by a team of skilled

Industrial Adjustment Specialists trained by international experts and led by capable project directors, the results have been impressive. This innovative approach can provide countries undergoing economic restructuring with a powerful tool to restructure and modernize their economies and facilitate the successful adjustment of workers, communities and enterprises.

It is the challenge of Industrial Adjustment Specialists to make this happen in a timely, effective way.. The remaining sections of this guide have been developed to help you accomplish this objective when implementing the Enterprise Restructuring and Competitiveness Component.

Chart 1-6

Adjustment activities supported by the IEWCAP financial resources component

Adjustment component	Source of Funding	
	USDOL/USAID WCE Adjustment Project	CEE government, international lenders and/or employers
General	--USDOL Project office and operating costs --USDOL CTA salary and costs of International TA --International TA to MOL/ES to implement adjustment program --Training of IA specialists, including study tours --International TA to establish data base and monitoring system --International TA to establish a public relations campaign to promote the program	--IA specialists salaries and benefits --IA unit offices, and operating costs
Rapid Response Displaced Worker Assistance	--International TA to help IA specialists conduct pre-layoff planning and deliver basic adjustment services in pilot sites --RAC operating expenses at pilot sites, costs of quarterly IAS in-service staff training --International TA to train transition center staff and conduct pilot projects (e.g., transition workshops, job clubs, and establish resource centers etc.)	-SOE on-site transition centers -Vocational training programs -Employment services (labor market information, registration of job seekers, job development, listing and display of available jobs, referral of job applicants, follow-up, etc.) -Vocational counseling -Job clubs -Public works programs -Adjustment compensation schemes
Community Economic Renewal	--International TA to train IA specialists in CER --International TA to help IA specialists conduct Phase I pilot CER workshops Phase I CER workshop expenses --Financial incentives and TA to implement Phases II and III CER projects	-Business incubator feasibility studies -Large scale CER projects -Small business TA -Entrepreneurship training programs -SME loan funds -Tourism development programs -Business promotion & support centers -LEDO financing
Enterprise restructuring and competitiveness	--International TA to train IA specialists in ERAC techniques --International TA to help IA specialists organize ERAC orientation and training workshops, for employers and worker representatives in selected communities and enterprises --Costs of organizing, conducting, monitoring and evaluating selected pilot ERAC projects	--Vocational training programs for dislocated workers—beyond pilot Quick start projects --Productivity improvement/cost saving (PI/CS) projects--beyond pilot projects --On-going costs for organizing and maintaining small business networking programs—beyond pilot projects --On going costs for Interest-based L-M training beyond pilot projects

Chapter 2

Role of IA Specialists in organizing and implementing the enterprise restructuring and competitiveness component

In addition to the responsibilities of addressing worker adjustment and economic renewal issues and problems in a community or region, IA Specialists are responsible for helping the employers, managers and worker representatives address the enterprise restructuring and competitiveness (ERAC) issues that result from economic restructuring in a community or region.

With unique knowledge and expertise, IA Specialists must be able to successfully market all four components of the Integrated Community Adjustment Program (ICAP) model, including the underlying principles and objectives of each of the components, and how they are all essential to achieving successful economic restructuring. First, IA Specialists must be able to explain what role the EC component plays in successful economic restructuring and why it is just as important as the other three components of the model. Second, they must mobilize all concerned partners, especially restructuring employers, their employees and union representatives, as well as appropriate national, regional and local agencies, local elected officials, community organizations and others as the circumstances require. Third, IA Specialists must also be able to help employers identify and assess their EC needs and facilitate the delivery of technical assistance and training to assist them to successfully restructure their enterprises and make them more competitive.

2.1 General responsibilities of IA Specialists

Before assuming your ERAC responsibilities it is necessary and important that you understand the framework and objectives of the enterprise restructuring and competitiveness component of the integrated community adjustment program. The basics of this understanding can be obtained from reading the brief overview of the ERAC component provided in Chapter 1. The next step is to get the picture of the ERAC model by reviewing the Chart 2-1, below, which provides a framework to see the IA Specialist's role in implementing the ERAC program.

The ERAC program is carried out in four phases, with the first phase being carried out primarily by the country Project Office ERAC Specialists international consultant/trainers, assisted by IA Specialists at the regional or local level. IA Specialists will have primary responsibility for implementing the remaining three Phases, with the help and assistance of Project Office staff and international consultant/trainers.

Chart 2.1

Framework for IA Specialist role in Implementing the Enterprise Restructuring and Competitiveness Component

Phase I Startup: Develop early warning network, MIS and ERAC strengthening capacity	**Phase II Market and implement the ERAC assessment process**	**Phase III Select restructuring strategy and implement ERAC strengthening tools**	**Phase IV Sustain ERAC capacity in community and nation**	**Outputs** ↓
Startup: assessment of ERAC need and potential, project planning and organizing, pilot site selection and orientation meetings held ERAC training workshop conducted for partner ERAC staff and Project IA Specialists Establishment of early warning networks and MIS Assessment made of ERAC strengthening resources, nationally and locally	Identify "at risk" enterprises Conduct preliminary assessment of ERAC problems and need Sign an agreement with enterprise to authorize ERAC project Organize and conduct an ERAC restructuring **Workshop R** for participating enterprise managers and worker representatives Begin planning for Phase III	Help participating enterprises :(1) develop ERAC strategy, (2) select restructuring tools, and (3) access and implement ERAC strengthening tools within enterprises IA Specialist Coordinates enterprise-level ERAC process and activities with other ICAP components IA Specialist monitors the implementation of ERAC tool(s) After ERAC project(s) have been completed a final report is prepared	Organize and conduct **Workshop S** Review of Phases I-III Assessment of ERAC goals, achievements, and organizational capacity Answer question: *Where are we now and where do we want to go from here*? Develop action plan to continue ERAC work Training and TA are provided to help national and local partners maintain ERAC capacity	1. Competent, committed and well-trained ERAC IA Specialists in communities and nations 2. An effective early warning system to identify "at risk" enterprises 3. ERAC strengthening capacity and effective tools to help enterprise managers and worker representatives of "at risk" employers identify their needs 4. Timely access and delivery of ERAC training and TA to "at-risk" enterprises 5. A significant reduction in business failures and job loss

Some of the general ERAC responsibilities of Industrial Adjustment Specialists are:

- Market the integrative USDOL/WSI (worker, community and enterprise) adjustment model objectives, concepts and tools to employers, workers, and potential community partners; communicate the role of IA Specialists, the process of implementing program components and the benefits that can be gained by participating

- Assist communities facing the prospect of economic restructuring to establish and operate a proactive business retention /layoff aversion (BR/LA) program, including an early warning, monitoring, reporting and management information system to identify enterprises in need of restructuring and assistance (See Chapter 2 in *A Guide to Worker Displacement*, ILO, April 2001)
- Introduce and promote enterprise adjustment and competitiveness concepts and techniques to the business community and worker organizations, and provide training and technical assistance to help employers and worker representatives learn the most effective concepts of restructuring enterprises—while using socially sensitive worker retention and displacement techniques

- Introduce and promote the use of RRWA programs and CER workshops in communities undergoing enterprise restructuring and assist the employers and community leaders to obtain access to all available worker adjustment and economic renewal assistance to generate replacement jobs and economic growth

- Ensure that the proper government agencies and service providers are informed of the need for enterprise restructuring and competitiveness strengthening in restructuring communities so they can discuss the need for services with enterprise managers and obtain, develop or provide the needed services

- Collect, disseminate, and exchange information with public and private agencies in the community concerning technical assistance and training needs of those groups impacted by economic restructuring

- Communicate information to the regional and national levels concerning worker, community and enterprise restructuring needs and planned adjustment activities that are or will be carried out in the local and regional areas

- Make sure that essential training and technical assistance services included as part of the RRWA, CER and EC components are available to workers, communities and enterprises in a timely and coordinated manner

2.2 IA Specialist responsibilities for promoting and implementing the ERAC component

IA Specialists have the responsibility to work proactively with managers and workers of threatened and restructuring enterprises in their community or region to help them understand and use socially sensitive enterprise restructuring tools and techniques to strengthen their

competitiveness. The basic actions that IA Specialists should take in support of ERAC programs are::

- ❑ Introduce and promote labor-management partnerships and interest based negotiations (IBN) and group problem solving (GPS) techniques among employers and labor organizations as tools to strengthen their competitiveness and prevent or reduce the impact of worker displacement

- ❑ Introduce and promote the concept of Quick Start training as a targeted, cost-effective means of strengthening enterprise competitiveness while preserving and/or creating jobs

- ❑ Encourage managers and employee representatives in threatened and restructuring enterprises to set up specialized approaches (called PI/CS teams) to reduce business costs and improve productivity, and thereby strengthen the competitiveness of these businesses and preserve jobs

- ❑ Assist small firms to organize and use inter-firm collaboration and networking to strengthen their competitiveness in national and international markets

- ❑ Demonstrate how group entrepreneurship and ownership changes can be used by enterprises to strengthen enterprise competitiveness and preserve jobs

- ❑ Provide economic education to managers and workers to help them better understand free enterprise and the market economy

IA Specialists have a number of specific responsibilities and steps to follow when implementing the ERAC component in a community or region. The basic implementing steps are:

1. ***establish an early warning network*** at the community or regional levels and make continuing assessments of enterprises and industries that are subject to or undergoing economic restructuring to determine their situation, level of competitiveness, prospects for survival, potential loss of employees, etc..

2. ***meet with employers and enterprise managers in threatened and restructuring enterprises*** to assess their situation and introduce them to the technical assistance and services that can be made available through the ERAC component

3. ***determine the size, complexity and urgency of the existing or potential enterprise adjustment and competitiveness problems and issues***

4. ***assess the employer interest and willingness to to participate in and ERAC program***, the potential costs and benefits of establishing a enterprise adjustment and competitiveness program in the enterprise, and whether it is something that comes within the expertise and purview of the ERAC program

5. ***help interested employers identify their specific ERAC needs and determine whether any individual elements of the ERAC program can facilitate the adjustment process***, strengthen the competitiveness of the enterprise, or preserve or create jobs, e.g., forming a PI/CS team, learning to use L-M problem-solving, .starting a Quickstart training

program, developing an inter-firm network among small firms, educating managers and workers in concepts of market economics and free enterprise,

6. ***gain the approval of enterprise managers and worker representatives*** to (a) participate in specific project-sponsored ERAC training and technical assistance services, and/or (b) to introduce socially sensitive restructuring and competitiveness techniques in their enterprises:

7. ***identify resources (financial and technical assistance) needed and available*** (through the ERAC program and other sources) to support ERAC strengthening programs at the enterprise level

8. ***prepare and have the parties sign a written agreement*** spelling out the roles, responsibilities and resources that will be committed to the project, setting out what will be accomplished and how the project will be organized

9. ***coordinate with local RRDWA and CER teams and economic development agencies*** to link enterprise adjustment and competitiveness programs with worker adjustment and economic renewal efforts

10. ***coordinate the delivery of services and work of ERAC partners***, including enterprise owners and managers, trade unions officials, employment service representatives, vocational training agencies, social service organizations and economic development institutions, in providing technical assistance and services to the participating enterprise

11. ***monitor the project*** to make sure that it is carried out in a fiscally responsible way and according to the terms of the agreement,

12. ***evaluate the results*** of the project and determine whether any changes that should be made in subsequent projects based on the experience gained in the project

2.3 IA Specialist responsibilities for implementing ERAC tools

There are a number of important functions and activities that must be carried out by IA Specialists when assisting restructuring enterprises to implement the specific project-sponsored EC tools

2.3.1. Socially sensitive enterprise restructuring support activities

IA Specialists should promote socially sensitive enterprise restructuring. They should do this by explaining to employers and worker representatives what are the nature and objectives of this process and provide them with support and encouragement to use it. They should explain:

- what socially sensitive enterprise restructuring is and how it can be used to preserve jobs and increase competitiveness:

- why enterprises need to restructure
- what restructuring strategies are available to them
- what is the hierarchy of enterprise restructuring
- what different approaches can be used to diagnose an enterprise's health
- what questions employers should ask before starting the restructuring process
- what tools can be used to reduce non-human costs and improve enterprise competitiveness
- what human resource measures can be used to minimize or mitigate the impacts of layoffs
- what steps socially responsible employers can take to help displaced workers obtain new jobs as quickly as possible

Once the enterprise managers understand these issues and agree to use socially sensitive enterprise restructuring tools and techniques, IA Specialists help them identify projects and obtain the training and technical assistance needed to implement the approaches selected.

2.3.2 PI/CS study team promotion and support activities

The primary objectives of ERAC projects are to strengthen the economic viability of enterprises and preserve jobs. To help restructuring employers accomplish these objectives, the IA Specialist introduces employers to ERAC techniques like the use of PI/CS study teams. Technical assistance and financial support to set up a PI/CS project may be provided to those enterprises that qualify and to employers and workers willing to use this approach as part of their enterprise adjustment process. As part of their promotion work, IA Specialists:

- educate employers, workers and their organizations about the availability of USDOL/WSI Project-sponsored adjustment services—including ERAC programs—for enterprises facing or having difficulties.
- develop information gathering channels to learn about enterprises facing or having difficulties that could lead to mass layoffs and plant closings—and that could benefit from the creation of Project-sponsored PI/CS study teams
- establish criteria for approving and funding PI/CS projects

Upon learning about specific enterprises having problems that can be resolved by using the PI/CS team process, IA Specialists

- contact these employers to inform them and their trade unions (if applicable) about the PI/CS study team process
- help the parties assess their problems and determine if the PI/CS approach is appropriate, and, if so, help them identify the project objectives, set up a PI/CS team, find a neutral chair (if needed) and identify specialized consultants to help the team carry out the study (if needed)
- draw up an agreement specifying the responsibilities and obligations of each party
- arrange for or provide the PI/CS team training
- clarify the roles of team members
- monitor the progress of the team and its work
- assure that a final report is completed to document the work of the study team and that it is disseminated to all partners

- follow-up to determine whether the recommendations are adopted and what the outcomes are—in terms of solving the problem being addressed, strengthening competitiveness and preserving jobs, etc.

2.3.3 Interest-based negotiations, group problem-solving and partnership-building activities

The objective of the IBN, GPS training and Training for Partnership workshops in the ERAC component is to change the labor-management relationships that are based on confrontation and conflict to one based on cooperation and joint problem solving, and it is focused on strengthening enterprise competitiveness. When used at the enterprise level these problem-solving and partnership approaches can provide a framework for adopting other ERAC techniques and tools for strengthening competitiveness and preserving jobs.

IA Specialists function as promoters, facilitators and implementers of the IBN and group problem solving processes and Training For Partnership organizing tools. They:

- educate employers, workers and their organizations about the availability and purpose of USDOL/WSI Project-sponsored IBN, group problem-solving and Training for Partnership programs
- develop information gathering channels to learn about enterprises facing or having labor-management difficulties or conflicts that could lead to reduced competitiveness—including mass layoffs and plant closings—and that could benefit from the establishment of Project-sponsored IBN, group problem-solving and partnership programs (specifically IB negotiations, IB dispute resolution, generic IBn, group problem-solving, and Training for Partnership)
- establish criteria for approving and funding IBn, group problem-solving and partnership building training projects
- contact employers and enterprise managers to inform them and the leaders and organizations representing their workers about the IBN, group problem-solving training and Training For Partnership programs
- help the parties assess the nature and severity of their labor-management relations problems and determine if adopting the IBN and group problem-solving approach or Training for Partnership workshops would help them improve their relationships and strengthen their competitiveness
- draw up an agreement specifying the responsibilities and obligations of each party (labor and management) that will participate in the training program(s)
- arrange for or provide the appropriate IBN, GPS training or partnership building workshops
- monitor the progress of the training
- follow-up to determine (a) whether the recipient have benefited from the training and are using the IBN, GPS approach and partnership tools, and (b) what the outcomes for them are—in terms of reducing labor-management conflict, building partnerships, strengthening enterprise competitiveness and preserving jobs, etc.

2.3.4 Quick Start training support activities

A critical element of successful enterprise restructuring is obtaining and keeping workers with the skills and expertise necessary to make privatized business enterprises more competitive in national and international markets. Quick start is a systematic, structured method to provide short-term, customized and intensive industrial training that is specifically designed for a new, expanding or restructuring company that must retrain or upgrade its existing workforce, or recruit and train new workers, because of expansion opportunities, changing products, technology or production processes.

IA Specialists function as promoters, organizers and facilitators of Quick Start training programs. They:

- educate employers, workers and their organizations about the use, availability and purpose of USDOL/WSI ICAP sponsored Quick Start training programs
- contact government agencies (e.g., employment service agencies and vocational training institutions to determine if suitable partners are available and willing to work with the USDOL/WSI ERAC Project in developing an effective Quick start program in the community or region
- develop information gathering channels to learn about enterprises facing or having training-related needs (for existing workers or for new workers) that are affecting their ability to operate successfully or competitively in producing existing products or new products.
- establish criteria in concert with the ICAP Country Project staff and partner vocational training institutions for approving and funding Quick Start training projects
- contact employers undergoing restructuring or having training or competitiveness problems to inform them and their trade unions about the Quick Start training program for strengthening enterprise competitiveness
- help the parties assess their industrial training problems and needs and determine if the Quick start approach could make a significant contribution to resolving their problems (upgrade training for existing workers, recruiting and providing training for new workers, etc.)
- draw up an agreement specifying the responsibilities and obligations of each party that will participate in the Quick Start training program
- arrange for or provide the appropriate Quick Start training
- monitor the progress of the training program
- follow-up to determine whether the recipients of the training were actually hired or upgraded and remained in their jobs for a significant period of time (e.g., 90 days or six months); and what the employment and competitiveness outcomes for them are—in terms of improving productivity and quality, strengthening enterprise competitiveness and preserving or creating obs, etc.

2.3.5 Small business networking promotion and support activities

Flexible inter firm cooperative networks can contribute significantly to improving the competitiveness of small enterprises in a community or region. They can lead to expanded

export markets, new jobs and a stronger and more vibrant business sector. Collaborative networks of small businesses are formed for a variety of reasons and are structured in may different ways.

Starting an EC program to promote inter firm cooperation by organizing networks of small businesses can be carried out under the auspices of a local government, regional economic development agency, chamber of commerce, or other suitable institutions that are interested and capable of launching and promoting the program. The question is, how are these networks started. What is needed is someone to promote the use and benefits of these networks to businesses at the community or regional level. That is where the IA Specialist comes in.

It is the responsibility of the IA Specialist to promote the inter-firm networking concept and facilitate the organization of such network if needed and desired by the small businesses in a community or region. The IA Specialist:

- Promotes and publicizes the concept and objectives of inter-firm cooperation among the small business community
- Help groups of interested businesses determine what type of network they need and want to organize and understand the key concepts of building a successful inter firm collaborative network
- Help the organizing group determine the organizational structure and, if appropriate, recruit a competent network broker
- Provide training and technical assistance to help the organizing group and broker effectively develop and sell the concept among their peers
- Monitor the startup and work of the network
- Evaluate the success of the network in accomplishing its objectives: e.g., strengthening the competitiveness of the member firms, maintaining or creating jobs in the community, etc.

2.3.6 Support for feasibility studies to facilitate changes in enterprise ownership to save jobs

One of the tools available to managers and workers in threatened or restructuring enterprises seeking to save their jobs and strengthen the competitiveness of their enterprise is a change in ownership. A change in ownership might be appropriate when either of the following situations occur: (a). State privatization agencies or absentee corporations purchasing SOE assets no longer find a local plant compatible with their overall financial or product plans even though the plant or facility may be profitable or viable, and (b). the owner of an enterprise is reaching retirement age without a logical successor to carry on the business

The IA Specialist has the responsibility to help the managers and workers of the enterprise, and the leaders in the community in which the facility is located:

- actively seek a new owner to produce the existing products or to produce a new product or service; or
- investigate the possibility of local management and/or workers acquiring the enterprise through an employee stock ownership plan (ESOP) or the formation of a worker-owned cooperative.

In order for those most directly effected (the enterprise managers and workers) to consider the various alternatives for saving their jobs, and for community leaders to help them in this endeavor, they must have sufficient advance notice of any downsizing or restructuring plans known to or being considered by the existing owners, and access to sufficient information and technical assistance to realistically consider the alternatives that might be available to them. It is the responsibility of the IA Specialist to help them find and obtain this information and technical assistance. IA Specialists should:

- help interested communities create an early warning network to help identify "at risk" enterprises
- assist the interested parties facing downsizing or plant closure to establish an action team to consider what actions might be needed or most appropriate to save the threatened enterprise and jobs, e.g., changes in the business climate and infrastructure improvements, management, skills training and technical assistance needs, financial assistance, ownership transition assistance, and direct intervention to facilitate a successful ownership transfer
- monitor the progress of the action team and subsequent enterprise restructuring, and evaluate the results achieved

2.3.7 Support for economic education about market economics and free enterprise

Successful enterprise restructuring and achieving competitiveness in a market economy requires that both enterprise managers and workers understand how a market economy functions and what are the basic principles of a free enterprise system. It is the responsibility of IA Specialists to

- explain the importance of having basic knowledge of free market economics is to achieving successful enterprise restructuring and improving competitiveness.
- Identify or develop the organizational capacity to deliver this type of education to managers and workers in restructuring enterprises
- facilitate the delivery of courses on these topics for restructuring enterprise managers and workers.

2.4 On-going ERAC responsibilities of IA Specialists

Once the IA Specialist has promoted and facilitated the start up of an active ERAC program, there are a number of on-going responsibilities and activities that must be continued. These include:

- identifying "at risk" enterprises and critical partners to participate in local ERAC programs

- providing coordination for enterprise adjustment and competitiveness efforts within the community and region

- working with country ICAP Project staff in developing and improving ERAC activities and programs

- organizing schedules and keeping records of IA activities carried out as part of the ERAC component
- participating in quarterly IA meetings and training sessions dealing with ERACC topics
- continuing public advocacy orientation training for enterprises managers, trade union leaders and community officials on ERAC program elements (socially responsible enterprise restructuring projects, PI/CS study teams, IBN training, group problem-solving training and TFP groups, inter-firm networks, and extramural free enterprise and market economy familiarization programs
- delivering training on ERAC topics to new IA Specialists
- functioning as ERAC facilitators and problem-solvers
- providing monitoring and follow-up support to ongoing ERAC projects and those that are mature and continuing to operate after ERAC funding has ended
- participating in task forces and making recommendations to guide development of ERAC program and services at the national and regional level
- preparing necessary reports, writing up case studies, and documenting unique ERAC activities and experiences for dissemination in country and internationally

Chapter 3

Assessment and analytical tools to identify, diagnose and solve enterprise restructuring and competitiveness problems

3.1 Introduction

Achieving and maintaining enterprise competitiveness is or should be a primary goal of any business enterprise. In CEE countries many state-owned and private enterprises are not competitive. Many are in serious need of restructuring or privatizing if they are to survive or achieve economic viability in a market economy. Helping these enterprise managers and workers to assess their present situation, identify their problems, develop good strategies and take whatever steps are appropriate to restructure and strengthen their competitiveness—while minimizing or ameliorating the impact of the changes on their workers and communities—is the objective of the Enterprise Competitiveness Component.

Two essential tools can be used to help employers and workers identify and solve enterprise restructuring and competitiveness problems. These are (1) ***an assessment or diagnostic process*** that can be used to determine an enterprise's competitiveness, and (2) ***a problem solving process*** and the skills that can help workers and managers work together more effectively to undertake the assessment process and solve the problems they identify while conducting their organizational assessment. This chapter will discuss each of these two tools.

3.2 Conducting assessments of enterprise restructuring and competitiveness needs

Organizational diagnosis or assessment is a systematic approach to understanding and describing the present state of an organization. The purpose of this diagnostic phase is to gather information to specify the nature of the problem(s) requiring solution, to identify the underlying causal forces if possible, and to provide a basis for selecting effective change strategies and interventions. The result of a lack of diagnosis, or of a weak, faulty or inaccurate assessment will be a costly and ineffective intervention, no change at all or worse—negative change.

Effective organizational diagnosis then, involves the systematic collection and analysis of adequate and accurate data regarding or relating to the enterprise's processes and culture—with the intention of discovering problems and drawing conclusions about possible action programs

for improvement. In particular, IA Specialists engaged in ERAC projects are interested in helping the parties collect data and analyze the following systems and functions within an enterprise.:

MANAGEMENT

- ❑ Structure and Organization
- ❑ Strategy
- ❑ Business Model
- ❑ Business Plan
- ❑ Operations and Activities
- ❑ Strengths and Weaknesses
- ❑ Opportunities and Threats

OPERATIONS

- ❑ Current Activities
- ❑ Human Resources
- ❑ Quality and Productivity
- ❑ Strengths and Weaknesses
- ❑ Opportunities and Threats

HUMAN RESOURCES

- ❑ Systems and Functions
- ❑ Strategic Capacity and Capability
- ❑ Empowerment
- ❑ Work and Performance Standards
- ❑ Strengths and Weaknesses
- ❑ Opportunities and Threats

PRODUCTS

- ❑ Cost of Services Provided
- ❑ Quality Assurance
- ❑ Customer Service
- ❑ Delivery

MARKETING

- ❑ Customer Analysis
- ❑ Competition – Profile and Analysis
- ❑ Market Share and Analysis
- ❑ Advertising and Promotion
- ❑ Sales Management
- ❑ Strengths and Weaknesses
- ❑ Opportunities and Threats

OTHER BUSINESS FUNCTIONS

- Accounting – Receivables and Payables
- Finance – Cash Flow, Profitability, Return on Investment
- Purchasing
- Maintenance
- Strengths and Weaknesses
- Opportunities and Threats

ENVIRONMENT AND CLIMATE

- Opportunity for Growth
- Continuous Improvement
- Enthusiasm, Commitment to Goals
- Shareholders and Stakeholders
- Quality of Work Life

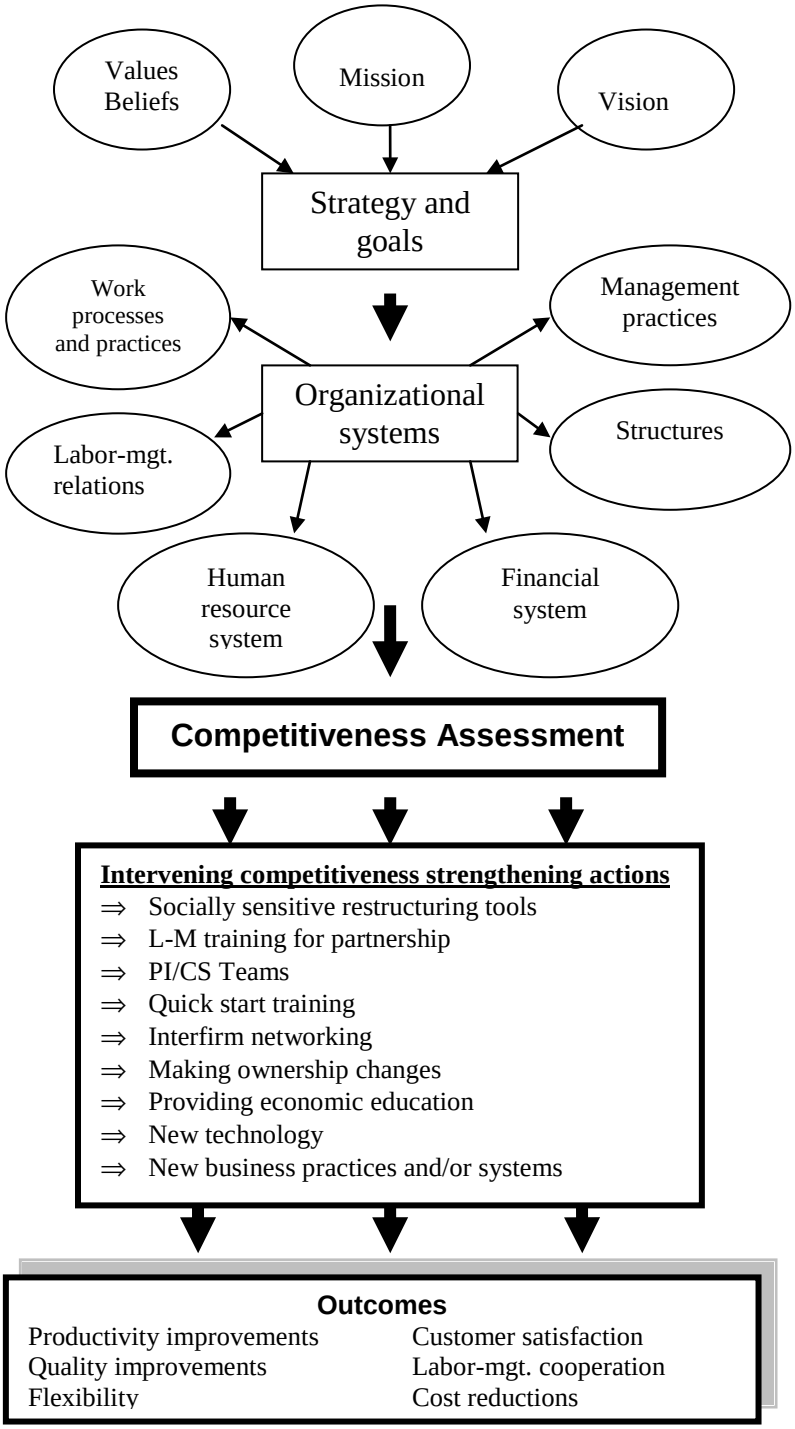
3.2.1 The ERAC Program logical framework for assessing restructuring needs and strengthening enterprise competitiveness

The competitiveness assessment framework used by IA Specialists and partners in the USDOL/WSI ERAC Program to collect and analyze data from the work environment to diagnose problems, and to use this information as a basis for taking appropriate steps or actions to strengthen an enterprise, is presented in Chart 3.1.

This ERAC assessment framework is particularly useful in looking at, analyzing, and discussing the organization's alignment among strategic, organizational and internal goals. Strategic goals are identified by examining the organization's mission statement, vision, values and beliefs, strategic plan, business model, its stakeholders and customers, and by conducting SWOT (strengths, weaknesses, opportunities, threats) analysis. Organizational goals are explored by analyzing the enterprise's business plan, marketing plan, production goals, staffing plan and organizational chart. Internal goals are understood by examining the integration of business support systems, productivity measures, quality measures, customer satisfaction measures, and labor management cooperation.

Chart 3.1

Enterprise Restructuring and Competitiveness Framework



3.2.2 The ERAC assessment process

Using the ERAC framework as a guide, the competitiveness assessment process includes three phases:

Phase 1: Pre-site visit activities

Preparation and planning. The Pre-site visit phase includes assessment team selection, briefing, and data analysis of such sources and materials as annual reports, industry reports, analyst reports, consumer reports, and data collected from search engine reports.

Phase 2: Site visit(s)

Interviewing and data collection. The site visit phase includes a company or organizational presentation of the company, its products and performance; a tour of the facility, interviews with key or representative company personnel, and the collection of other on-site data.

Initially, a cross section of management and representative workers are interviewed or surveyed for their perceptions and observations of their organization as a place to work; its possibilities, opportunities and limitations. Management, directors and deputy directors, heads of marketing, operations and other departments; representatives of human resources, trade union leaders and rank and file workers are interviewed, generally over a two or three-day period. These initial interviews are followed by additional clarifying interviews, site visits, and requests for documents, reports and other materials to analyze and review.

Phase 3: Post-site visit activities

Analysis, report and recommendations. The post-site visit or activities includes follow-up questions from the earlier diagnostic phases, the interpretation and analysis of data collected, discussion and further analysis of data by participating ERAC staff, an early preliminary report, and a final report documenting findings and recommendations.

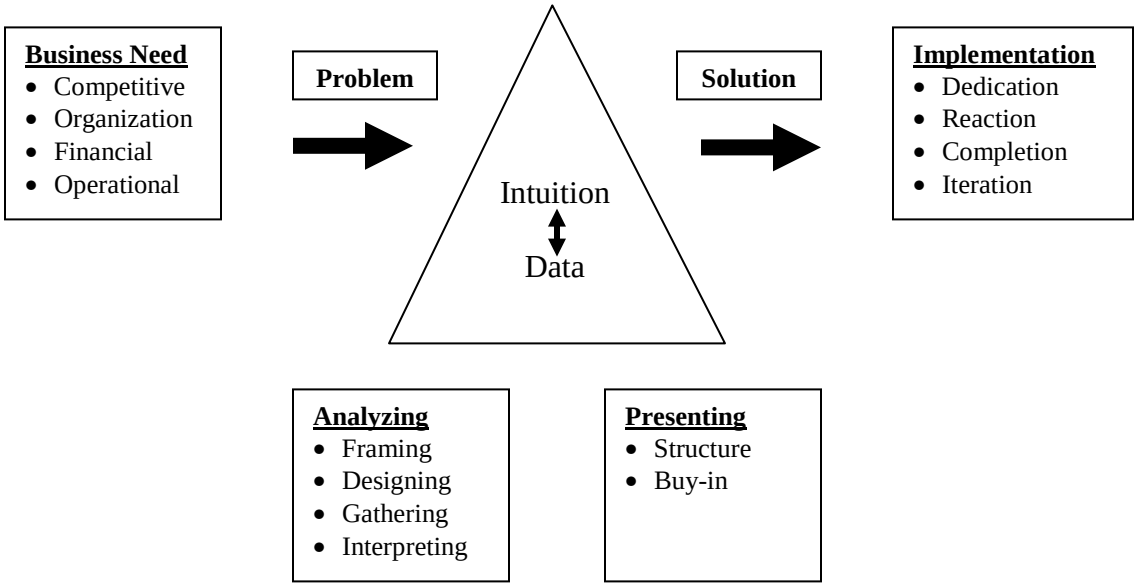
3.2.3 Other competitiveness assessment models

It should be noted that there are a number of models or approaches to competitiveness assessment, in addition to the one presented above. Any of these can be used to collect, analyze and use organizational data for diagnostic purposes. Three well know examples of enterprise assessment models are: the McKinsey Consulting Model shown in Chart 3.2, the Shingo Prize for Excellence in Manufacturing model, shown in Chart 3.3, administered by Utah State University, and the Malcolm Baldridge National Quality Award model administered by the National Institute of Standards and Technology. All three of these models are useful but different ways to look at an organization's performance.

The McKinsey Model. The McKinsey model is basically a consulting model. The ERAC model is quite similar to the McKinsey model, but the ERAC model places greater emphasis on involving workers and managers in the problem-solving process and uses some structured

problem-solving tools to assist them. It also places emphasis on finding socially responsible solutions that minimize the impact of restructuring on workers and communities.

Chart 3.2
The Mckinsey assessment model

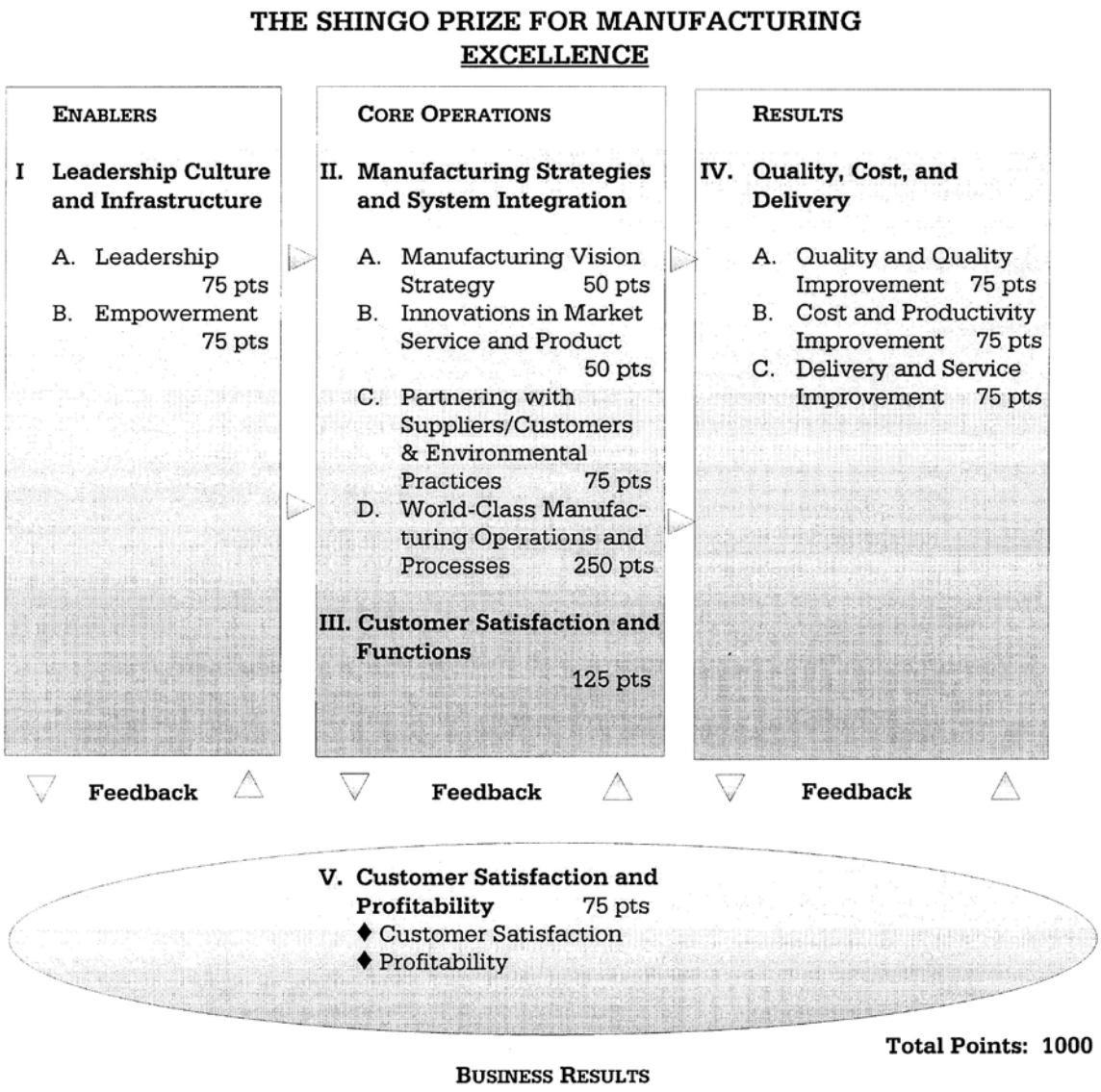


The Shingo Prize. The Shingo Prize for Excellence in Manufacturing in North America evolved out of the work of Shigeo Shingo, the Japanese manufacturing expert who designed the system of manufacturing adopted by Toyota and other world-class enterprises. It has become the American equivalent to the Deming Prize awarded in Japan for quality control. In 1986, the Shingo Prize was first awarded. The object of the Shingo Prize is to foster the adoption of better manufacturing systems. In the words of Dr. Shingo, "In the final analysis, national prosperity depends on improved productivity, and conversely, it is only on a foundation of increased productivity that we can build a wealthy nation and happy citizens." According to *Business Week*, the Shingo Prize is now "considered the Nobel prize of manufacturing…awards for businesses…" It is awarded annually to enterprises in North America (USA, Canada, and Mexico) that have achieved the highest level of excellence in manufacturing.

The Shingo Prize includes 11 key elements of world-class manufacturing. These elements are grouped into five categories, signifying that is necessary to integrate them into a complete system to achieve world-class results. The Shingo Prize criteria do not prescribe specific methods, techniques, practices or processes. Rather, for each element the criteria identify practices and techniques that might be incorporated to achieve world-class level of quality, cost and delivery. These practices and techniques may not apply in every organization. It is accepted that "one single" best method system, process, or route to attaining excellent-to-world status does not exist.

The Shingo Prize recognizes organizations that use world-class manufacturing strategies and practices to achieve world-class results. The achievement criteria provide a framework for identifying and evaluating manufacturing competence and performance. The criteria comprise a business system model for manufacturing excellence, organized into five principle sections as pictured in Chart 3.3.

Chart 3.3



Malcolm Baldridge National Quality Award. The Baldridge Award is given annually by the President of the United States to businesses—manufacturing and service, small and large—and to education and health care organizations that apply and are judged to be outstanding in seven areas: leadership, strategic planning, customer and market focus, information and analysis, human resource focus, process management, and business results.

The United States Congress established the Baldridge award program in 1987 to recognize U.S. organizations for their achievements in quality and performance and to raise awareness about the importance of quality and performance excellence as a competitive edge. The Baldridge Award is named after former Secretary of Commerce Malcolm Baldridge, who served in that capacity from 1981 until his accidental death in 1987. Baldridge was a proponent of quality management as a key to American prosperity and long-term strength. The award is administered by the U.S. Commerce Department's National Institute of Standards and Technology (NIST), in close cooperation with the private sector. Additional information, award criteria and application forms for the Baldridge Award can be found on the NIST website at: www.nist.gov/

3.2.4 Example of an assessment made using the ERAC process

The following material has been abstracted from an ERAC assessment conducted at a business enterprise in a CEE country under the auspices of the USDOL/WSI ICAP project. Some of the information and the name of the business enterprise have been changed to maintain the privacy of the people and business involved.

ERAC assessment of the XYZ Company

Assessment methods and procedures

This enterprise, a privatized former state owned company, was struggling to become profitable and competitive in its industry. The company was identified as "at risk" by the WSI/USDOL project director, and subsequently approached to see if they would be interested in having an ERAC team conduct an assessment of their situation. The managing director agreed to participate, and arrangements were made to have the team visit the enterprise and conduct a preliminary ERAC assessment.

Initially, a cross section of management and representative workers were interviewed for their perceptions and observations of XYZ Company as a place to work; its possibilities, opportunities and limitations. The Director, Deputy Director, Heads of Marketing, Operations and other Departments; representatives of Human Resources, the Trade Union and rank and file workers were interviewed over a three-day period. These initial interviews were followed by additional interviews, site visits, and requests for documents, reports and other materials to analyze and review.

Preliminary Findings

These findings and observations are preliminary in nature, and should be seen as a vehicle or opportunity for further research and discussion.

1. There is value in this kind of assessment activity at XYZ Company, both from our perspective as third-party consultants, and from the feedback and input we received from managers, staff and workers at the facility. Almost without exception the people we talked with appeared open, receptive and interested in improving their work and the performance outcomes of the company. We also felt the interview data we collected was helpful in understanding problems, issues, and the nature of work performed at the firm.

2. The preliminary financial plans adopted by (or imposed upon) the company appear to be extremely unrealistic. Without examining cash flow, balance sheet and other financial records, it still appears highly unlikely that any kind of break- even position would be achieved this past spring, or even this year. More realistic financial and budgeting projections seem to be required, and perhaps the process of those projections examined.
3. It also appears unlikely that the company will meet its outplacement employment goals (the original reason for its creation) for the dislocated nuclear workers from the plant without substantially increasing its markets and increasing its services.
4. XYZ Company does not appear ready or able yet to enter, penetrate and expand new markets or to increase significantly services provided to existing markets and customers.
5. The primary company goals of financial break-even and outplacement source for XYZ workers may, at least currently, be incompatible.
6. It is difficult to shift a bureaucratic culture to an entrepreneurial culture; so far that shift has not occurred, and there is evidence of risk-aversion, and perhaps a lack of understanding of what is required of managers and workers to successfully compete in a worldwide business environment.
7. The management concern expressed regarding psychological adjustment of workers from a traditional to competitive work environment was not reflected in discussions with workers and trade union representatives, nor with recorded incidents of psychological trauma at work – excessive drinking, depression, violence and related work and personal behaviors. Perhaps this merits additional research and attention.
8. We would also like to acquire additional information to validate the claim that training and performance meets European (and international) standards. This is a critical element in any serious marketing campaign, and one that needs to be documented, and if valid, highlighted and promoted in marketing the skills and capacity of company workers.
9. Other potential strengths of XYZ Company, and there are many, include the previously mentioned skills of professional workers, modern technologies and equipment, the existing captive market for services, the support of the nuclear industry and the government, and potentially, a motivated workforce.
10. The weaknesses perceived, and again there are many, include the unrealistic financial expectations of a transitional company, the weak current financial position, lack of quality benchmarks and performance standards, questions of downtime and billable versus un-billable hours, and in general, the problems not only of starting a new enterprise, but building it on the foundation and culture of a bureaucratic, state-owned model.
11. Very difficult. But we do see opportunities and potential for stabilization, growth and expansion. We have proposed recommendations for consideration and discussion that we think will help move the company toward a more competitive posture.

Recommendations

We would like to mention again that these recommendations serve as a starting point for discussion and perhaps, further analysis. They should not be seen as fully developed, ready for implementation recommendations, but rather as opportunities with potential.

1. The WSI/USDOL regional CEE ERAC component appears to have some potential value and application for XYZ Company. Specifically, we think that Quick start training will be helpful in retraining workers for enhanced performance in new and perhaps in some existing jobs.
2. We also think that ERAC Program can provide assistance with establishing and training Labor-Management PI/CS Teams, strengthening Training Center management and activities, and other training and work force development initiatives, including implementing a peer counseling program for displaced workers.

3. We recommend seeking competent and professional consulting assistance in constructing a marketing strategy and plan with training for management and company executives.
4. We also recommend competent and professional consulting assistance in developing a quality control and continuous quality improvement system.
5. The Human Resource function at the XYZ Company needs professional assistance in reviewing and developing systems of job classification, job descriptions, payroll accounting for idle time and billable hours, and other basic functions.
6. We also recommend continued assessment of the structure, management and work-related performance at XYZ Company, perhaps including a company-wide questionnaire or survey to better understand worker and management issues and attitudes.

3.2.5. Use the ERAC assessment process to assess enterprise problems and needs

ACTION MODULE: Steps to assess enterprise competitiveness problems and implement strengthening tools

Pre startup. The competitiveness assessment process starts with the assumption that the ERAC Project in a country has, as part of its start up activities, completed a preliminary assessment within the target regions and communities within the participating country to identify several pilot enterprises needing and wanting enterprise competitiveness training and technical assistance. Regional or local IA Specialists, assisted by Project staff (and International consultant/trainers during the pilot phase), have met with managers and worker representatives in prospective enterprises in pilot regions or communities to determine whether they may have restructuring problems, whether they meet the criteria established for selecting enterprises for assistance, and whether they are interested in participating in the ERAC Program.

Step 1:. Sign an agreement is with the prospective enterprise(s) to authorize the conduct of an ERAC project in the enterprise.

If the preliminary assessment carried out during the pre-startup phase indicates that the enterprise meets the criteria established for participation, and resources are available to proceed, the IA Specialist prepares and has the enterprise management sign an agreement spelling out the terms of participation, all commitments that have been agreed to by the enterprise and the Project, and a timetable for conducting the ERAC project.

Step 2: Conduct an enterprise competitiveness strengthening workshop.

The IA Specialist schedules and organizes an enterprise competitiveness workshop to be held for the managers and worker representatives from the participating enterprise. The objectives of this workshop are: : to teach the participants the fundamentals of socially responsible restructuring and how it can be used to strengthen enterprise competitiveness; the range of restructuring

strategies available to them; the hierarchy of enterprise restructuring; and some assessment approaches to diagnose an enterprise's health. Participants will also learn some of the questions that should be asked before they undertake enterprise restructuring; and what are some practical tools that can be used to reduce the human and non-human costs of restructuring.

Step 3: Select an advisory and support committee or council.

The managers and worker representatives in the participating enterprise select an advisory committee or council to work closely with and provide assistance to the Competitiveness Assessment Team during the assessment and intervention phases of the project.

Step 4 Conduct a competitiveness assessment in the enterprise

Using the ERAC framework as a guide, the Assessment Team—made up of the IA Specialist, Project staff ERAC specialists, and others (such as national or international ERAC consultants) as needed—conduct a. competitiveness assessment of the business. The ERAC assessment is typically carried out in three phases:

Phase 1: Pre-site visit activities. The Pre-site visit phase consists of preparation and planning—including identifying available data on the enterprise, and planning for the site visits needed to carry out the assessment. It includes assessment team briefing, and data analysis of such sources and materials as annual reports, industry reports, analyst reports, consumer reports, and data collected from search engine reports.

Phase 2: Site visit(s) The site visit phase is also used for interviewing and data collection. It typically includes a company or organizational presentation of the company to the team covering its products and performance; a tour of the facility, interviews with key or representative company personnel, and the collection of other on-site data.

Initially, a cross section of management and representative workers are interviewed or surveyed for their perceptions and observations of their organization as a place to work; its possibilities, opportunities and limitations. Management, directors and deputy directors, heads of marketing, operations and other departments; representatives of human resources, trade union leaders and rank and file workers are interviewed, generally over a two or three-day period. These initial interviews are followed by additional clarifying interviews, site visits, and requests for documents, reports and other materials to analyze and review.

Phase 3: Post-site visit activities. The post site visit activities focus on completing the assessment work—especially drawing conclusions from the data analysis, and writing a report and recommendations resulting from the assessment. This phase includes answering follow-up questions from the earlier

diagnostic phases, the interpretation and analysis of data collected, discussion by the team members. It all includes further analysis of data by participating ERAC Program staff, preparation of an early preliminary report, and writing a final report documenting findings and recommendations.

Step 5: Deliver the competitiveness assessment report and recommendations to the participating enterprise.

A meeting is scheduled by the Competitiveness Assessment Team with the enterprise management and worker representatives to deliver and discuss the assessment results and recommendations.

Step 6: Determine what follow up interventions are needed to address or solve identified competitiveness problems

IA Specialists and Project staff hold follow-up consultations with the enterprise managers and worker representatives to determine what, if any, additional ERAC interventions may be needed in the enterprise, and which ones will be provided with the ERAC Project's help.

Step 7: Implement selected training or technical assistance activities

Based on the needs, interests and resources of the parties, one or more of the six available ERAC Program tools are authorized for use in the enterprise. IA specialist and Project staff will arrange for or provide the training or technical assistance services.

Step 8: Monitor the implementation of ERAC tools and evaluate the outcomes of the training and technical assistance activities

Using the Project's ERAC management and monitoring plan, the IA Specialist and Project Office staff monitor the progress and results achieved using the competitiveness strengthening tools. When the enterprise-level project is completed, a final report, covering all aspects of the implementation and outcomes achieved by using ERAC tools, will be prepared by the IA Specialist.

3.3 Using group problem-solving to strengthen enterprise competitiveness

3.3.1 Introduction to group problem solving model

A number of the intervention strategies for set out in Part II of this guide to strengthen an enterprise's competitiveness rely on the use of teams or groups of managers and workers to work

together to solve enterprise competitiveness problems. These approaches have been a critical element in productivity improvement and cost saving programs successfully implemented by enterprises and worker organizations in North America and Western Europe.

The problem-solving model presented in this section was developed by the U.S. Department of Labor's Bureau of Labor-Management Relations and Cooperative Programs and included as Module 3 in the publication *Committee Effectiveness Training: Skill Building for Labor Management Groups*. The model was designed to assist labor and management established problem-solving teams or committees that are set up to help the parties identify and solve competitiveness or restructuring problems affecting the health and viability of their enterprises. The group problem-solving model developed for this purpose is a generic model that works well for dealing with productivity and cost problems, as well as other issues of importance to workers and managers, especially those related to an enterprise's survival and the saving of workers' jobs.

3.3.2 Tools used in group problem solving

In addition to the basic group problem-solving model, Module 3 contains four tools to help groups accomplish their primary objective of solving competitiveness problems. These are: brainstorming, cause and effect analysis, Pareto analysis, and force-field analysis. The training materials in the appendix at the end of the guide include all of the handouts, worksheets, and other explanatory materials needed to understand and use these tools. .

Brainstorming. Brainstorming is one of the basic tools of group work. It is used to generate fresh ideas and help participants think "outside the box." Brainstorming is a technique that helps a group to "break set," that is, to go beyond familiar boundaries and associations to develop new and creative ideas. This idea-generation technique is successful to the extent that group members follow five guidelines to brainstorming: (1) don't criticize ideas; (2) use freewheeling imagination; (3) build on others ideas; (4) aim for quantity; and (5) record each idea.

Cause and effect analysis. Cause and effect analysis is a systematic way of looking at effects and the causes that create or contribute to those effects. Generally, effects are statements about the way things are—descriptions of a problem needing correction. But effects may also be desired results—that is, how you want things to be when the problems have been solved. Cause and effect analysis can be useful at two stages in the problem-solving process: diagnosing a problem, and implementing a solution. Groups using cause and effect analysis use a "fishbone" diagram to help diagnose a problem.

Pareto analysis. Pareto analysis is a technique that separates the "vital few" from the trivial many. In solving problems, a group can use Pareto analysis: to narrow a list of potential causes, and to determine the priority causes that should be addressed first. Once a group has collected some data about possible problems or causes, a Pareto diagram lets them examine those data in a systematic way. Pareto analysis ranks data, presenting them in a bar graph. By revealing which problems are the greatest or which causes are the most important, a Pareto analysis can help a group set it priorities for action.

Pareto analysis, named for 19th-century economist Vilfredo Pareto, is designed to point out inequalities. The familiar 80-20 rule—that 80 percent of our business comes from 20 percent of our customers—is n example of Pareto analysis.

There are three steps to Pareto analysis:

1. Data gathering and computation. The first step in analyzing the causes of a problem is to plan the data gathering. Who will gather the data? Using what methods? For how long? How will you quantify the information? To gather meaningful data, examine the possible causes to determine standard units of measure that will let you compare causes.
2. Tallying and transferring data. Once the data have been totaled, the next step is to rewrite the list of causes in order from most frequently occurring to least frequently occurring.
3. Graphing the data. The third step is displaying the data in a Pareto diagram. .

Force-field analysis. Solving problems in business enterprises involves changing the status quo, closing the gap between the problem and the solution, between the present state and some desired future state. Though a group may have been set up to help an organization make a change, there nevertheless may be organizational and individual needs and forces hindering that change. Force field analysis, a tool developed by organizational researcher Kurt Lewin, can be used to identify the forces that help and those that hinder a change.

Force field analysis is a method of addressing both the driving and the restricting forces coming into play when a group attempts to implement a solution to a problem. It thus provides a tool for troubleshooting various solutions and the strategies for putting these solutions in place. The analysis is done with a diagram, a graphic technique that helps to trigger ideas, record brainstormed ideas, illustrate the strategies of driving and restraining forces, reveals any need to amend a proposed solution, and consider driving and restraining forces in developing implementation strategies.

3.3.3 General considerations for the IA Specialist

As noted above, this section only includes the basic problem-solving model. It has been taken from *Module 3: Group Problem Solving*, in the *Committee Effectiveness Training* manual. When organizing a workshop to improve a joint management and worker group's ability to identify, diagnose and solve problems effectively, the Industrial Adjustment Specialist should use Module 3 (included as an appendix to this guide) as a resource for this purpose. Some of the questions that the IA Specialist should ask when planning to organize and conduct Group Problem-Solving training in an enterprise are:

- Does (or will) the particular group have substantial responsibility for identifying and solving problems?
- How much time is available to deliver a workshop?
- Has the group been set up to address a specific problem, or to assess a variety of problems, e.g., conduct a competitiveness assessment, function as a PI/CS team, etc.?

- Does the nature of the group and the enterprise competitiveness problems it plans to address indicate an acute need for broad-based training in problem solving? (See the indicators listed under each exercise summary included in Module 3..)

3.3.4 The six-step group problem solving model

A problem solving model is a conceptual framework for addressing problems, not a formula for solving them. A problem-solving model can help a group stay on track and work efficiently. Without a model, the group might overlook many of its options and step into still other problems.

With a model, a group has a framework to help

- Air everyone's concerns and ideas
- Delve beyond symptoms to causes and root problems
- Explore the full range of solutions, selecting from that range a technically sound solution that is acceptable to all concerned
- Anticipate adverse impacts
- Follow through on steps needed to effect the solution
- Work together productively

People are the actual problem-solvers. But groups of people usually need an agreed-upon framework to keep them focused and on task.
Though problem-solving models can be highly sophisticated and technical, the model presented in this section has just six simple steps. Despite its simplicity, it is comprehensive enough to address all but the most technical problems. But because of its simplicity, groups adopting it are likely to remember and to use it.

The steps in the problem-solving model are:

1. Identify the problem
2. Diagnose the problem
3. Develop solutions
4. Select a solution
5. Implement the solution
6. Evaluate the outcome

The steps are arranged in a circle to emphasize the cyclic, continuous nature of the process. The basic concepts in the group-problem-solving model are outlined below

HANDOUT 1

A Group Problem-Solving Model

PROBLEM SOLVING: A SIX-STEP PROCESS

A problem-solving model helps to

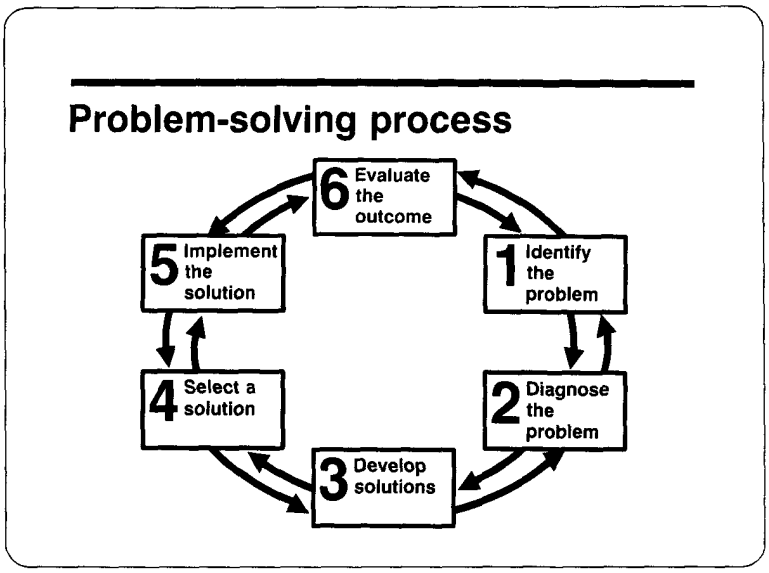
- **Air everyone's concerns**
- **Look beyond symptoms**
- **Explore all solutions**
- **Anticipate problems**
- **Follow through**
- **Work productively**

Introduction A problem-solving model is a **conceptual framework** for addressing problems, not a formula for solving them.

People are the actual problem solvers. But groups of people usually need an agreed-upon framework to keep them focused and on task. Without a model, groups may fail to

- air everyone's concerns and ideas
- delve beyond symptoms to causes and root problems
- explore the full range of solutions, selecting a technically sound solution acceptable to all concerned
- anticipate adverse impacts
- follow through on steps needed to effect the solution
- work together productively
- solve problems

Problem-solving models range from highly sophisticated technical models to relatively simple ones. The six-step problem-solving model presented here is easy to remember yet comprehensive enough to help a group address all but the most technical problems.



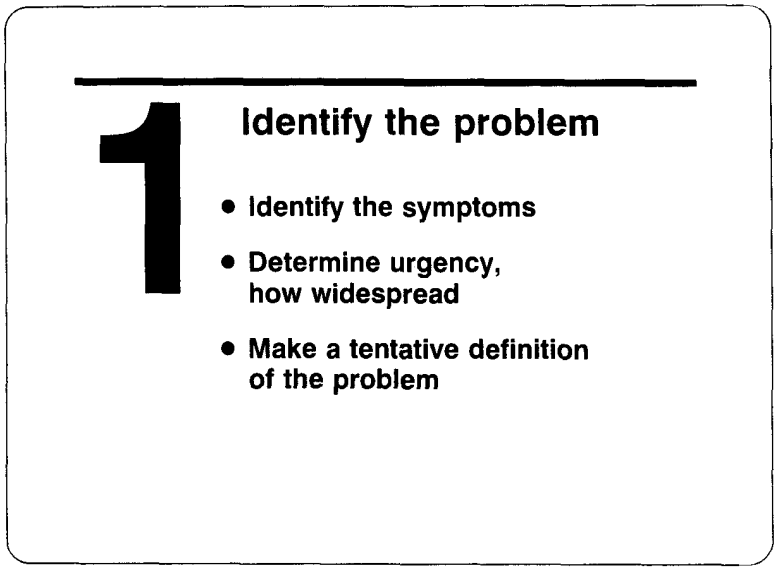
Overview

The sequence begins with "1. Identify the problem" and proceeds clockwise through six steps. The steps are arranged in a circle to emphasize the **cyclic, continuous nature** of the problem-solving process. The model has several important characteristics:

- There are no branches or choice points. All six steps are required in the order shown. When one step is completed, your group proceeds clockwise to the next step.
- The steps are repeatable. At any step, your group may decide to go back and repeat an earlier step. Diagnosing a problem, for instance, can lead back to redefining the problem.
- The process is continuous. Simply implementing a solution does not end the process. Evaluating that solution may identify new aspects of the problem or new problems that need to be addressed, leading the group to a new step 1.

Though the steps have discrete names, there is no clear demarcation between them. Identifying and diagnosing a problem frequently overlap. Selecting a solution may prompt the group to refine a solution or to develop additional ones. Evaluation mechanisms may suggest changes in the implementation plan.

Since the process is continuous, with some "recycling," a group can monitor the environment in which a solution is to be introduced; take into account other forces, mechanisms, and changes in the organization; and "roll in" any new information that affects the success of the proposed solution.



Step *1*

The first step, identifying the problem, is a broad review of the current situation—a fitting together of information, like pieces of a puzzle.

In this first stage, a group identifies and discusses the symptoms and scope of the problem. That is, it determines what "hurts," to what degree the symptoms are shared, and the urgency of relieving the symptoms.

You'll use **tools** such as brainstorming, interviewing, and questionnaires to gather this information.

As you go through this step, you'll find yourselves raising, reviewing, and discarding **statements of the problem** as you sort out what are merely symptoms and look behind those symptoms to make a tentative definition of the underlying problem.

2 Diagnose the problem

- Gather information
- Determine the causes
- Restate the problem

Step 2

Once you recognize the symptoms and have tentatively defined the problem, your group can begin to collect information about the nature of the problem. At this step, you may use tools such as cause and effect analysis or Pareto analysis to help you organize information and zero in on underlying causes.

This is the stage in which you determine the root causes of the problem. When you restate the problem, your definition will reflect the causes. Your efforts over the next two steps can thus be directed to finding solutions that address the roots of a documented problem, not merely its random symptoms.

3 Develop solutions

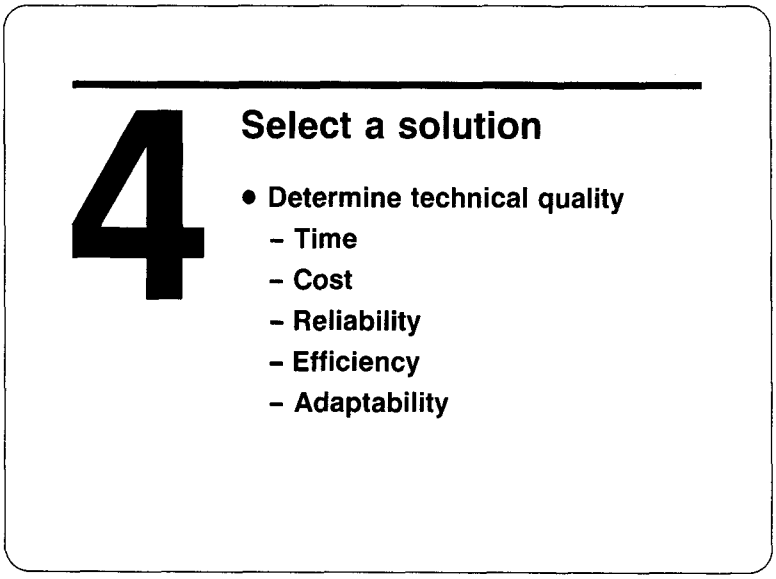
- **List all potential solutions**
- **Relate each to the causes of the problem**
- **Merge similar or related solutions**

Step 3

Once you've defined a problem, your "knee jerk" reaction may be to jump toward a particular solution. But creative problem solving requires you to **explore a full range** of viable solutions. To assemble a variety of solutions from which to choose, you must

- **generate** as many potential solutions as possible,
- **relate** each to the causes of the problem, and
- **merge** similar or related solutions.

At this stage, you're still not ready to select the best solution. You simply want to narrow the field, reduce redundancy, and eliminate any possibilities that don't address the causes you identified earlier. Force field analysis is a good **tool** for preliminary screening of this solution field.



Step *4*

In the fourth step, evaluate each potential solution for its strengths and weaknesses. Selecting a solution is a search for the most **effective** solution by applying two general criteria. An effective solution

- has sufficient **technical quality** to resolve the problem and
- is **acceptable** to those who will have to implement it.

Ask these questions when evaluating the **technical quality** of a proposed solution:

- ❑ Can it be implemented in a reasonable **time**?
- ❑ Can it be done within **cost** limits?
- ❑ Will it work **reliably**?
- ❑ Will it use staff and equipment **efficiently**?
- ❑ Is it flexible enough to **adapt** to changing conditions?

4 Select a solution

- Determine technical quality
- Determine acceptability
  - Perception of others
  - Manageable risks
  - Personal benefit
  - Organizational benefit

Step *4* (continued)

When evaluting a solution's acceptability, ask:

- ❑ Do the implementers support the solution, perceiving it to be worth their time and energy?
- ❑ Are the **risks** manageable?
- ❑ Will the solution benefit the **persons** affected by the problem?
- ❑ Will it benefit the **organization**?

Selecting a solution thus requires you to identify an effective solution—one that has sufficient technical quality to resolve the problem and is acceptable to those who will have to implement it.

5 Implement the solution

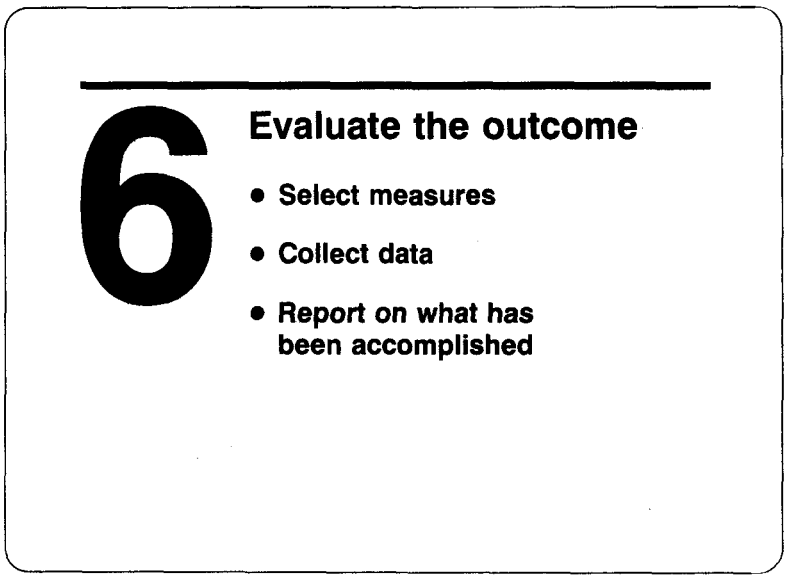
- **What action will be taken?**
- **Who will do it?**
- **When? For how long?**
- **Where? How? Why?**

Step 5

Choosing a solution doesn't immediately solve a problem. Putting a solution into action may prove as difficult as deciding on one.

The implementation stage requires **action planning**:

- **What** must be done?
- **Who** will do it?
- **When** will it be started? When will key milestones be completed?
- **Where** will the necessary actions take place?
- **How** will the necessary actions be carried out?
- **Why** are these actions a solution?



Step *6*

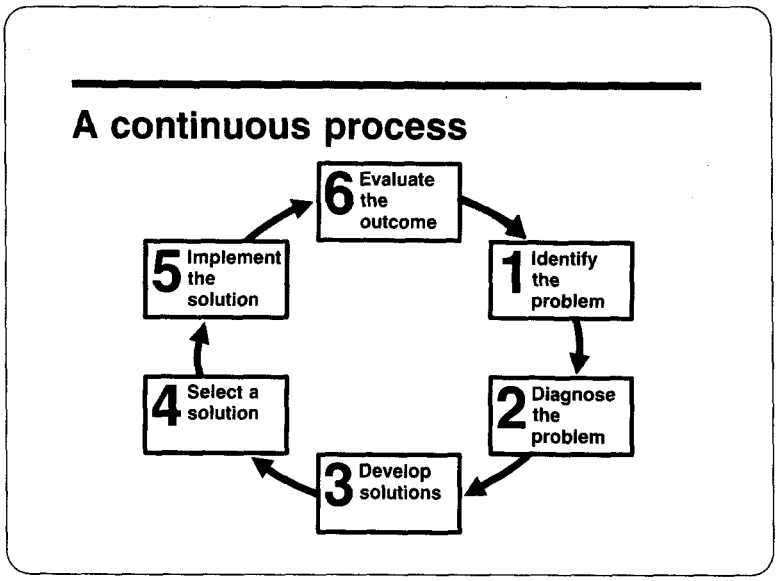
Most groups neglect or shortchange the evaluation step.

In simplest terms, evaluation is the **monitoring** that any project needs to ensure that milestones are met, costs contained, work completed.

But the more effective groups plan additional **feedback** mechanisms to detect the need for midcourse corrections and to ensure that the problem gets solved without creating new problems.

Collecting data and reporting on what has been accomplished keeps a group credible with its constituents.

Reflecting on its own processes and results keeps a group effective.



Review

Reflecting on its results helps a group identify its next step, bringing the problem-solving process full circle.

Remember these six steps:

1. Identify the problem.
2. Diagnose the problem.
3. Develop solutions.
4. Select a solution.
5. Implement the solution.
6. Evaluate the outcome.

Keep the six-step model in mind as you work to solve problems. It will prove invaluable in keeping group discussion on target. Any member can remind the group, "Aren't we trying to diagnose the problem at this stage? Why are we talking about solutions?"

The model is also a reminder that a group has not finished its work when it decides on the best solution. Without the framework of the model, it is all too easy to forget the followthrough—the implementation and evaluation planning—that makes the solution a reality.

3. 4 Using group problem-solving tools to tackle restructuring and competitiveness problems

What are the steps that a group would follow to actually use the problem solving model to real competitiveness problems in an enterprise? The following action module provides a set of the procedures, worksheets and instructions that can be used by a PI/CS team or other problem-solving group that has been organized to address competitiveness and other restructuring issues they may be facing.

However, it is recommended that before using this module, the IA Specialist should arrange for the target group to participate in the full training in group problem-solving that is set out in Module 3. This structured training will prepare them to successfully implement the action module within their own enterprise.

ACTION MODULE: Apply the six-step group problem-solving model and tools to a real problem

Note: The following materials (*Handout 1, Applying the Group Problem-solving Model and Tools to a Real Problem*) are also included in the Appendix at the end of the Guide, so they can be used as part of the full training program contained in Module 3..

HANDOUT 1

Applying the Problem-Solving Model and Tools to a Real Problem

PROBLEM-SOLVING WORKSHEET

Step 1 Identify the problem.

1a. Brainstorm—and record on flipchart paper—a list of "symptoms" or characteristics of your organization that indicate that a problem might exist.

1b. Sort through the symptoms that you have identified, lining through those that derive from other symptoms and restating the remaining ones as problems that need to be addressed.

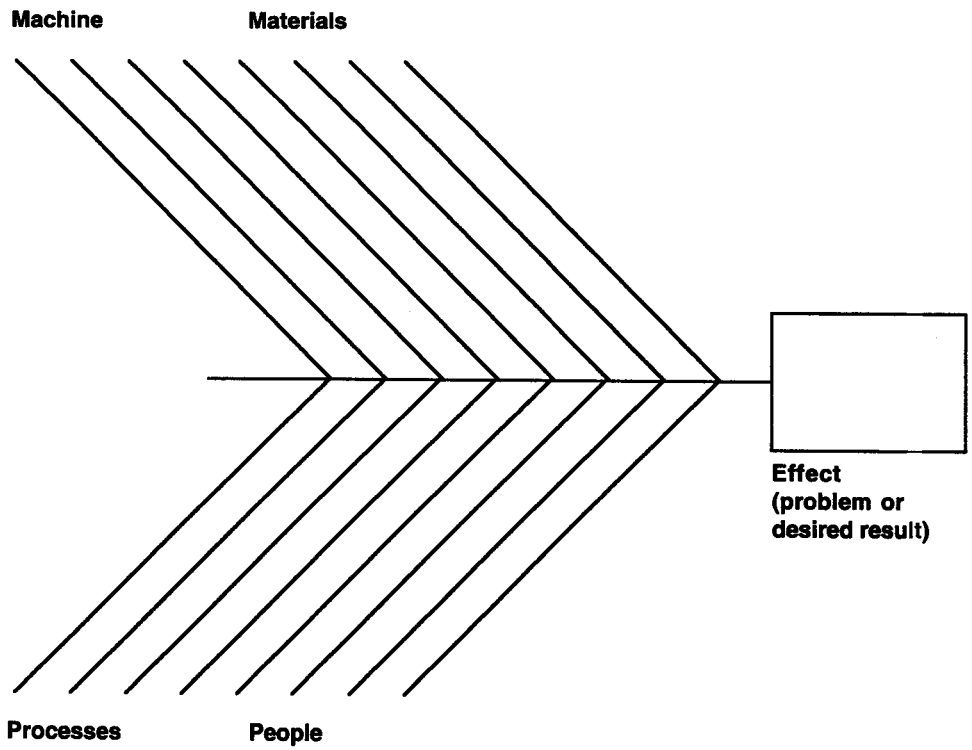
1c. Select one problem to work on, using the following criteria:

- You can do something about it.
- The problem has an impact on people and the organization.
- The problem is of sufficient importance to warrant your attention.

1d. Agree on an initial statement of the problem:

Step 2 Diagnose the problem.

2a. Draw a cause and effect (fishbone) diagram and brainstorm possible causes for the problem.



2b. From the cause and effect analysis, choose at least five "root" causes or factors contributing to the problem.

1.

2.

3.

4.

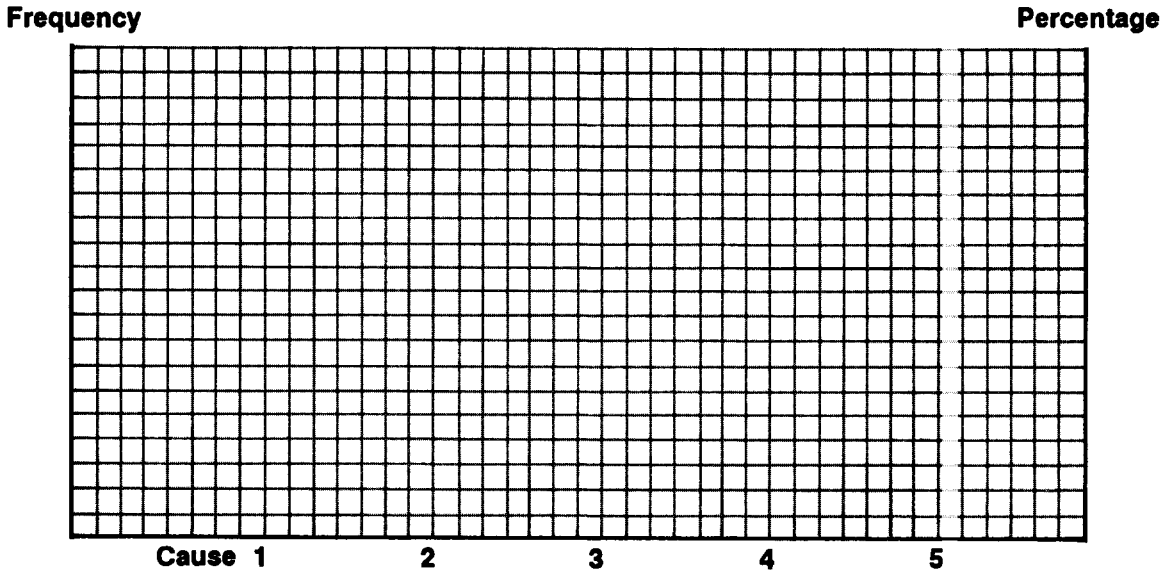
5.

2c. Choose a standard unit of measurement (e.g., frequency of occurrence, units not produced, dollars or personhours lost) that will allow you to compare root causes. Since you do not have time to gather real data, assign a "best guess" value for a given month to each of the causes.

Root cause	Frequency (or other measure)	Percentage of total occurrences	Cumulative percentage
1.			
2.			
3.			
4.			
5.			

2d. Renumber the root causes listed above from "1" (most) to "5" (least) to reflect the frequencies (or units, lost dollars, etc.) you assigned.

2e. Develop a Pareto diagram to display the relative importance of each of the selected causes.



2f. What is the real problem? Restate the problem in light of the causes you have explored and the data you have gathered:

Step 3 **Develop solutions.**

3a. **Brainstorm all the possible solutions to the problem.**

3b. **Integrate and combine similar solutions if possible.**

Step 4 **Select a solution.**

4a. Evaluate your potential solutions using the solution selection criteria of technical quality and acceptability. Check off each criterion that a potential solution meets.

	Technical quality				Acceptability				
	Timely	Cost-effective	Reliable	Efficient	Adaptable	Implementers support	Risk is manageable	Affected people benefit	Company benefits
Potential solution 1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									

4b. Place an asterisk (*) next to each of the five potential solutions that meet most of the criteria.

4c. List the five solutions marked with an asterisk and conduct a force field analysis on each of them.

Potential solution	Driving forces →	← Restraining forces
1.		
2.		
3.		
4.		
5.		

4d. Agree as a group on the solution that you believe will best solve the problem.

Step 5 **Plan to implement the solution.**

Describe the implementation plan for the solution you chose, using the following guidelines:

1. **What** actions must be taken?
2. **Who** will take them?
3. **When** will they be completed? Are there intermediate milestones?
4. **Where** will the actions be taken?
5. **How** will they be carried out?
6. **Why** is this series of actions a solution? (Does it solve the problem?)

Step 6 Plan to evaluate the process and outcome.

6a. Brainstorm some possible measures you can employ that will enable you to monitor and evaluate the success of your implementation plan.

6b. Brainstorm the kinds of information you will need for each measure and where and how you can find that information.

Annex 1

Additional Training Manuals and Resources

Committee Effectiveness Training (USDOL, 1989)
Shingo Prize for Excellence in Manufacturing: *Application Guidelines 2001-2002 (College of Business, Utah State University)*
Swanson, Richard A., *Analysis for Improving Performance: Tools for Diagnosing Organizations & Documenting Workplace Experience*, 1994.
The Baldridge Criteria for Performance Excellence. (NIST, 2002)

Chapter 4

Importance of enterprise restructuring to competitiveness and business success

4.1 Introduction

In transition economies, such as those in central and eastern Europe, many state-owned firms undergoing privatization need to restructure and possibly downsize to become more productive and competitive in the global economy. Typically, these actions have severe, adverse consequences on the workers and communities, especially when the recommendations for restructuring are made by financial experts with little regard for the effected workers and communities in which the enterprises are located.

What knowledge and information are needed by IA Specialists to encourage and assist enterprise managers and their workers to undertake enterprise restructuring that can not only help them to increase their competitiveness, but also help them preserve jobs and minimize layoffs?

This chapter and Chapter 5 discuss the importance of enterprise restructuring and competitiveness to business survival, define some of the terms and concepts needed to understand the restructuring process, and identify some innovative methods and techniques that employers in Western Europe and North America use to reduce operating costs and improve productivity and quality—in their efforts to achieve higher levels of competitiveness. This chapter is directed at the IA Specialist and enterprise managers, and Chapter 5 is directed at the enterprise managers facing the need or prospect of restructuring.

By understanding and promoting the use of "responsible" or "socially sensitive" restructuring approaches and techniques, IA Specialists can help employers improve their competitiveness *and* prevent or minimize the burdens and costs that layoffs and plant closings can have on the affected workers and their communities.

4.2 Restructuring to achieve and maintain competitiveness

One of the important military maxims is, "the best defense is a good offense." Sitting in a defensive position and waiting for the enemy to attack may not be the best way to win a battle or a war. Corresponding maxims in medicine are, "prevention is the best medicine" and "an ounce of prevention is worth a pound of cure." Doing nothing to prevent heart disease until after a person suffers a heart attack may be too late.

The above maxims apply to business situations that if ignored or left unattended can lead to loss of competitiveness and profits, downsizing and plant closures that displace substantial numbers of managers and workers. It is in everyone's best interests to encourage and help employers assess their business problems and take preventive or proactive actions *before* drastic restructuring measures such as mass layoffs, bankruptcy and closures become necessary. Displacements and closures can have severe long lasting negative consequences, not only on the workers and their families, but on the economic prospects of communities as well. .

Unfortunately, many business firms and organizations believe that enterprise restructuring measures leading to employee layoffs, including mass layoffs and plant closures, are a key to business success or a panacea for business problems. Too often the owners and managers of firms and business organizations fail to understand the negative consequences that mistaken belief can have on their workers, their communities and the long-term success of their enterprises.

Rather than restructuring willy-nilly, or by resorting to mass layoffs and plant closures as a first resort, employers should be encouraged to learn about, adopt and use preventive strategies and "socially responsible" restructuring techniques to keep their enterprises healthy and minimize the need for layoffs and mass worker displacement.

Employers should also be encouraged to be socially sensitive by actively helping their displaced workers adjust to their situation and find new jobs as quickly as possible—by participating in worker adjustment programs. They should also be encouraged to be good corporate citizens by helping their communities adjust to the loss of jobs and economic activity, and by actively participating in economic renewal activities through local economic development programs...

4.2.1 What is enterprise restructuring?

According to the authors of a study by the International Labor Organization (ILO) and European Bahai Business Foundation (EBBF), enterprise restructuring is: "the deliberate modification of formal relationships among organizational components. It involves redesigning work processes, delayering, eliminating structural elements through outsourcing, spinning off, selling off, and divesting units, activities or jobs. Restructuring is not a synonym for downsizing or reengineering but is a much broader and more inclusive concept."[1]

4.2.2 Why enterprises restructure

The ILO-EBBF study found that employers engage in restructuring for a variety of reasons. Their survey of European enterprises revealed a number of reasons and "trigger events" for undertaking enterprise restructuring. These include:[2]

[1] *Socially responsible enterprise restructuring*, A joint working paper of the ILO and EBBF, p. 12.
[2] Ibid., p. 15.

- **Survival.** Past profits may have turned into losses, foreign competition may have taken a major share of the market, or the cash flow, including lines of credit, may be inadequate to finance immediate requirements even though the company is profitable.

- **Competitiveness.** Deregulation or tariff reductions confront many companies that in the past benefited from various forms of protection. Dramatic changes may be required to remain viable under new rules of competition

- **Pressure from financial markets and shareholders**. Much has been written about how financial institutions, markets and analysts have persuaded managers to adopt a very short-term perspective in their decisions, even to the detriment of the long-term development and competitiveness of the enterprise.

- **Shrinking market demand or overcapacity.** This may be temporary or permanent and is often caused by financial and economic crises.

- **Poor management.** In a surprising number of cases, the need to restructure originates from management's short-term focus, poor strategic decisions and failure to anticipate.

- **Privatization**. Privatization stimulates restructuring of state-owned companies because they can no longer rely on subsidies and favored treatment. Restructuring may be a preparation for privatization or it may take place after privatization occurs.

Experience suggests that enterprise restructuring will continue to be a necessity for businesses to remain competitive and survive in an increasingly turbulent global economy. According to the authors of the ILO-EBBF study, "[c]ontinued turbulence and change in markets and increasing intensity of competition are among the few certitudes upon which business leaders can count."[3]

Because of these changes, businesses "operate increasingly in a highly interdependent ecosystem in which management must balance the interests of the various stakeholders"—shareholders, workers, managers and the communities where the enterprises are located. "This is particularly true in decisions on restructuring. All too frequently, employees are the first victims of restructuring when management decides to implement short-term cost reduction measures, often without really diagnosing the problems or studying the underlying reasons for the need to change and restructure."[4]

4.2.3 Definitions of "socially responsible" enterprises and "socially sensitive" restructuring

It is important that IA Specialists understand what the factors are that contribute to business success in today's world, what a "socially responsible enterprise" is and what socially

[3]Ibid. p. ix.
[4] Ibid.

responsible approaches can be used by managers to restructure their enterprises and maintain their business success.

What is a socially responsible enterprise? The ILO-EBBF study defines a socially responsible enterprise as one that:[5]

- Rewards shareholders with a reasonable return over time
- Is customer-focused
- Considers employees as its most important asset, provides meaningful work, fair wages and benefits, ensures their employability, and provides an enabling work environment
- Contributes to the prosperity and social cohesion of the communities where it operates
- Applies the golden rule ("do unto others as you would have them do unto you") to its business partners (suppliers, alliances, franchisees)
- Practices eco-efficiency and environmental sustainability

What is responsible restructuring? Responsible restructuring is a commitment by employers facing serious business problems to ask themselves "how can we change the way we do business so that we can continue to employ our employees effectively," instead of thinking "how many workers should we lay off so that we can continue to run our business without making any other changes."

What is socially responsible enterprise restructuring? The ILO-EBBF study defines socially responsible enterprise restructuring as: "using one or more approaches to consciously take into consideration the interests of all stakeholders—managers, owners (shareholders), workers, and the community." They also note that "in practice, the process is often as important as the substance of change to the success of restructuring. This means: respecting the values of the enterprise, seeking the involvement of those affected, practicing open communications and treating all employees with respect and dignity. The emphasis must be on overall 'stakeholder value' rather than short-term shareholder gains."[6]

Achieving success in today's turbulent global economy requires "socially responsible approaches" to business and restructuring. Such approaches are considered to be "in the best interests of shareholders as well as other major stakeholders in an enterprise,"[7] including workers and their communities.

What is employment security and how does it relate to socially responsible enterprise restructuring? Employment security is part of the business philosophy of socially responsible employers. It is a commitment by employers to protect their employees from losses of employment and earnings during periods of economic difficulty, including retaining their workers but not necessarily in the same job or work assignment. If layoffs cannot be averted, the employers actively help their employees to find suitable jobs with other employers, or facilitate the layoff process and impact on the workers and their families using socially sensitive approaches.

[5] Ibid.
[6] Ibid., 13.
[7] Ibid.

4.2.4 A rationale for using socially sensitive restructuring

There are six basic reasons why employers should adopt an employment security philosophy that includes socially responsible restructuring and positive enterprise adjustment measures.

Laying off workers is costly to an enterprise. The expenses associated with layoffs add up to a substantial financial burden that reduces the gains a company may make by cutting back the work force. These expenses include both direct and indirect costs: severance pay, higher unemployment insurance taxes, healthcare and other benefits after severance costs, administrative and legal costs, and the costs of rehiring and training workers in future expansions. Chart 4-1 outlines some of the direct and indirect costs of layoffs.

Chart 4-1

Costs of Layoffs

Direct Costs	Indirect Costs
♦ Severance pay, in lieu of notice	♦ Recruiting and employment cost of new hires
♦ Accrued vacation and sick pay	♦ Low Morale among remaining employees
♦ Supplemental unemployment benefits	♦ Increase in unemployment tax rate
♦ Outplacement	♦ Training and retraining
♦ Pension and benefit payments	♦ Potential charges of discrimination
♦ Administrative processing costs	♦ Heightened insecurity and reduced productivity

Layoffs have serious operational disadvantages. Frequent layoffs can cause a number of serious problems. Fear of losing their jobs lowers employees' morale. The process of bumping, usually based on seniority, can cause a painful realignment of workers and seriously disrupt business operations. Rapid turnover and low employee morale can decrease productivity and quality. Good workers may leave the firm for a more stable work environment. Workers may be encouraged to unionize to protect themselves. If already organized, they may become more militant and uncooperative in their relationship with the company. The reputation of a company can be blackened because of its treatment of its employees.

Layoffs have negative impacts on financial performance. The results of an exploratory study of the effects of extreme downsizing on the financial performance of 25 large firms in the U.S over

a seven-year period suggest that companies "do not realize cost efficiencies to the extent they may have expected prior to making dramatic reductions in levels of employees."[8] The researchers found that "there was virtually no link between the magnitude of the employment cuts by target companies and their subsequent earnings." The study concluded that the comparison companies (the companies that did not resort to severe cutbacks in their workforces) were more successful. "The apparent success of the comparison companies suggests that the sharp cuts in headcount did not yield positive results."

Employers often believe a number of myths about the advantages of downsizing to their business success and the lack of adverse impacts on their employees. Chart 4-2 compares a number of the myths with the facts about downsizing.[9]

Chart 4-2
Myths and Facts About Downsizing

Myth	Fact
♦ Downsizing boosts profits	♦ Profitability does not necessarily follow downsizing
♦ Downsizing boosts productivity	♦ Productivity results after downsizing are mixed
♦ Downsizing is a last resort	♦ Data indicate that downsizing is a first resort for many companies
♦ There are no adverse effects on work load, morale, or commitment to a company	♦ For most companies, downsizing has had adverse effects on work load, morale, and commitment
♦ Victims of downsizing do not suffer any long-term income loss as a result of structural shifts in the economy	♦ Downward mobility is the rule rather than the exception

Employment security creates a climate for change and growth. The principles of employment security and responsible restructuring produce a number of important advantages for employers: Employees protected by employment security willingly support changes to make their company more competitive and successful.. Employers are encouraged to invest in training and developing people, thus creating a more flexible and adaptable work force. Managers, supervisors, and workers are encouraged to concentrate on the enterprise's success. Employers are able to move rapidly to increase production and to service customers more quickly than the competition when a business slump ends

Employment security promotes productivity. One of the most important reasons for adopting a positive program of employment security is productivity. One American writer stated it this way: No amount of technological innovation, worker education and training, work force restructuring, or job redesign can realize its full productivity improvement potential without the cooperation of

[8] *Guide to Responsible Restructuring*, p. 3.

[9] *Ibid.*, pp. 7-9.

trusting employees, men and women who know that change in the workplace does not threaten their livelihood.[10]

W. Edwards Deming, often referred to as the father of total quality management, noted that employment security creates a bond between employee and employer and, ultimately, contributes to the success of quality programs. Today's high-performance work organizations find that Deming's words still ring true. When employees are assured of continued employment, they dedicate themselves to improving the organization and its products.[11]

Over the years, a number of research studies in the U.S. have demonstrated the positive correlation between employment security and increased productivity. One author found that offering job security to employees creates loyalty to the company and confidence and trust in management, greatly reduces resistance to technical change, lowers staff turnover, and improves employee relations – all competitive advantages that can contribute to higher productivity and profits.[12]

The author of a 1995 book published by the American Management Association questions the assumption that layoffs are "an acceptable tool for business success and growth."[13] In his work as a consultant, he has found that layoffs "are often short-term fixes followed by lackluster results, low morale, overwork and even sabotage by disgruntled survivors."

The demand for employment security is growing. Changes in the legal climate and demographics in many countries have increased the interest in and concern for employment security on the part of workers and governments.

4.3 Achieving competitiveness while minimizing layoffs

Is it possible for businesses to achieve competitiveness while minimizing layoffs? Experience over the past 20 years by employers in North America and Western Europe has demonstrated that it is possible—if employers are willing to adopt socially responsible approaches to employment security and enterprise restructuring, and governments are willing to provide guidance and assistance to help them carry out the restructuring process.

One approach used in North America is for national or provincial and state-level governments to teach employers the underlying philosophy and principles of employment security and to promote the adoption of socially responsible restructuring techniques.

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[10]James E. Bolt, "Job Security: Its Time Has Come." 61 *Harvard Business Review*. 116 (Nov.-Dec. 1983).
[11]*Guide to Responsible Restructuring*, p. 23.
12Fred Foulkes and Ann Whitman, *Full Employment: Product/Marketing Strategies* (Boston: Boston University Human Resources Policy Institute, 1983).
[13]Alan Downs, Corporate Executions. Cited in the *Wall Street Journal*, October 3, 1995.

Another North American approach is for state or provincial and local governments to actively help firms adopt and practice these principles by creating "early warning" systems, providing productivity improvement and cost saving technical assistance services, and establishing "rapid-response" and other support systems to help employers apply socially responsible restructuring techniques and socially sensitive approaches to provide adjustment assistance to displaced workers. The development of early warning systems will be discussed in Chapter 9.

ACTION MODULE: Steps enterprise managers can take to implement socially responsible restructuring

Although there are no blueprints enterprise managers can follow when developing a productivity-enhancing, employment-preserving restructuring program, there are some basic concepts and techniques they should consider before starting the process.

1. Know and use the factors that contribute to business success

The first step for employers is to identify, understand and use the factors that contribute to business success. According to the authors of the ILO-EBBF study on socially responsible restructuring, firing employees as the first resort is no longer desirable if employers wish to remain successful in today's highly competitive environment... The new factors for success include:[14]

- Building deeper and more strategic relationships with customers, employees, suppliers and other business partners
- Developing a reputation for integrity, trust, and environmental and social responsibility
- Being customer-oriented and a leader in quality, service and reliability
- Innovating and striving for continuous improvement and excellence
- Building an educated and motivated workforce

2. Adopt employment security and responsible restructuring policies

The second step is to adopt a basic employment security and responsible restructuring policies and communicate these commitments to the work force. The policies should include three basic guarantees:

- that no permanent employee will be laid off or downgraded as a result of internal productivity improvements;
- that the broadest commitment the company can afford with respect to employment security will be granted during business slumps and that this coverage will be increased as business success permits; and

[14] *Socially Responsible Enterprise Restructuring*, .pp. 3-4.

- that in the event that economic recessions, restructuring needs or other crises make layoffs unavoidable, the company will actively assist dismissed employees to find new jobs with other firms.[15]

3. Develop suitable restructuring guidelines

The third step is to develop and adopt some basic guidelines to follow when engaging in restructuring. Although there is no definitive or "right way" to restructure, the guidelines outlined in Chart 4-3 have yielded good results for U.S. companies and their work forces.[16]

Chart 4-3
Guidelines for responsible enterprise restructuring

1. Articulate a vision of what you want your organization to achieve.
2. Establish a corporate culture that views people as assets to be developed rather than as costs to be cut.
3. Be clear about your short- and long-range objectives; e.g., to cut costs (short-range) and to improve customer service and shareholder value through more effective use of assets (long-range).
4. Establish an alternative menu of options for reaching the short- and long-range objectives.
5. Involve the people who will have to live with the changes in making them; provide opportunities for input at all levels.
6. Communicate, communicate, and communicate! Share as much information as possible about prospective changes with those who will be affected by them.
7. Recognize that employees are unlikely to contribute creative, ingenious ways to cut costs if they think their own employment security will be jeopardized as a result.
8. If cutting costs by cutting people is inevitable, establish a set of priorities for doing so (e.g., outside contractors and temporaries are laid off first) and stick to it. Show by word and deed that full-time, value-adding employees will be the last to go.
9. If employees must be let go, provide as much advance notice as possible, treat them with dignity and respect, and provide a full range of assistance (financial, counseling, job search, etc.) to help them find new jobs. Use RR/WA programs and Reemployment Assistance Committees to facilitate the successful transition of displaced workers whenever possible.
10. Consider retraining and redeploying surplus workers to promote their employment security and self-reliance and to protect your human resources investment.
11. Give surviving employees a reason to stay. Explain what new opportunities will be available to them.
12. View restructuring as part of a process of continual improvement, with sub-goals and measurable check points over time, rather than as a one-time event.

[15] "An Institute Report: Keeping Workers on the Job," 9 *World of Work Report*. 2-3 (Oct. 1984).
[16] *Guide to Responsible Restructuring*, pp. 29-30.

For additional information about how IA Specialists can help employers organize, in a socially sensitive way, their efforts to assist workers who must be displaced as a result of enterprise restructuring, the reader should see the companion WSI guide *RRDWA Handbook for IA Specialists*, and a recent publication by the same author for the ILO, entitled *A Guide to worker displacement: Some tools for reducing the impact on workers, communities and enterprises*. (ILO, Geneva, 2001)

4. Follow the guidelines and implement needed restructuring responses

The fourth step an employer should take is to follow the restructuring guidelines and identify and implement the specific enterprise restructuring responses needed to maintain competitiveness within the enterprise and manage employment security for the workers.

There are a variety of strategies and tools available to restructuring employers. These strategies and the tools for implementing them are discussed in greater detail in the remaining chapters of Part II of this handbook.

Chapter 5

Use socially responsible restructuring to strengthen competitiveness and preserve jobs

[The material in this chapter has been adapted from Gary B. Hansen, "Module on enterprise restructuring and socially sensitive worker retention and displacement," ILO-ITC, Turin, Italy, September 2001]

5.1 Restructuring strategies available to employers

What restructuring strategies are available to employers? Employers and managers can use a number of approaches to facilitate the restructuring of their enterprises. One proactive job retention/layoff aversion strategy, based on the experiences of state dislocated worker units in the United States, suggests that employers consider the following restructuring actions:[1]

- **Operations and cost reviews.** Some firms having trouble can reduce increasing operations productivity and managing costs by resolving issues at a single choke point in the production line. But extreme situations may require re-engineering the entire manufacturing process.

- **Good management, labor-management cooperation.** Sometimes companies require new leadership to become more productive or entrepreneurial. Shop floor conflicts may require intervention to help labor and management groups talk and listen to each other and properly analyze problems or situations that are of current or strategic importance.

- **Financial restructuring.** Many at-risk manufacturing companies may experience a fiscal crisis that requires an immediate restructuring of the balance sheet to maintain the company's viability. Sometimes an unbalanced or inappropriate capital structure is the problem, but more often it is symptomatic of deeper underlying market or operational problems. Financial restructuring can involve but is not limited to refinancing or renegotiating existing debt, raising additional debt, renegotiating trade payables and other liabilities, raising additional equity capital and other financial engineering tools.

- **Modernization and upgrades.** If the equipment and machinery in a facility has

[1] "Layoff Aversion Strategies for Rapid Response," Steel Valley Authority, n.d.

deteriorated or the production system has not kept pace with the industry as a whole, a strategic or wholesale modernization or upgrade of the facility may be required.

- **Conversion to new products.** If a business is threatened with closure because its main product line has declined in markets, the company might be able to identify new products and markets.

- **Incumbent worker training.** Facility evaluation that leads to changes in the workplace should include input from the workforce and the retraining of workers affected by the changes. In general, ongoing incumbent worker training is a valuable investment that should impact the bottom line.

- **Succession.** Opportunities to save jobs and avoid hardships for workers and their communities occur when closely held businesses are sold and new owners plan to restructure them, causing job losses, and when a business owner retires and the absence of a successor precipitates a business closure.

- **Employee buyouts.** Pre-feasibility studies can be conducted to assess the viability of a company or group to purchase the plant and maintain operation. If the initiative to purchase the company comes from employees, unions representing employees, or management groups representing the larger workforce, the employee buyout process should involve a well-organized buyout committee. This is usually a complex and time-consuming task with many stumbling blocks along the way.

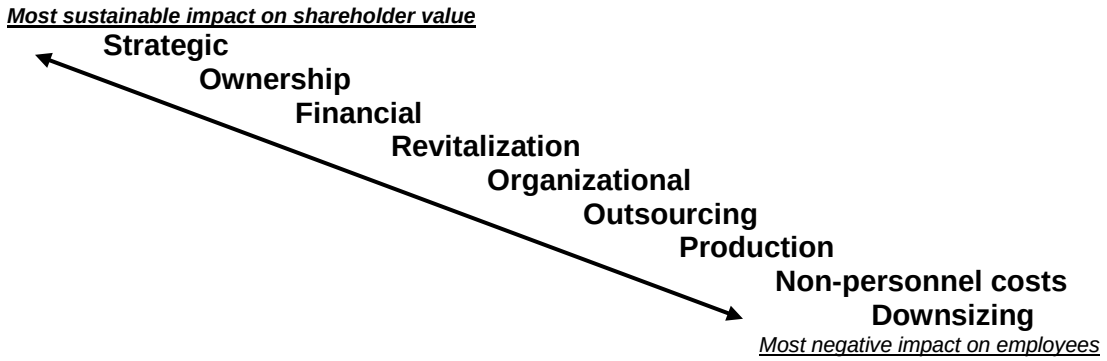
- **General buyouts.** Another last resort may be to work with the plant's management and employees to generate the initial due diligence material required to determine the feasibility of a general buyout. This process can be expedited by forming a buyout committee. Options include a leveraged acquisition or arranging for an outside third-party acquisition. "Strategic buyers" are often the best alternative.

5.2 The hierarchy of enterprise restructuring

Another enterprise restructuring approach classifies different types of enterprise restructuring actions into categories.[2] This approach was developed as part of the study on enterprise restructuring conducted by the International Labor Office and European Baha'i Business Forum (ILO-EBBF). The ILO-EBBF study classifies types of enterprise restructuring into nine overlapping categories in a descending hierarchy based on the sustainable impact on shareholder value and negative impact on employees. Chart 5-1 illustrates these nine categories:

[2] Ibid., 13.

Chart 5-1
The hierarchy of enterprise restructuring



The ILO-EBBF study defines each of these nine categories and lists questions employers should answer before embarking on restructuring within a category. The questions that can help employers understand each of the nine categories and determine whether they should undertake a particular category of enterprise restructuring are set out below as part of the **Action Module** in Section 5.4.

According to the ILO-EBBF study authors, it has been observed over time, "that the higher the category is in the hierarchy and the more strategic the approach, the greater the sustainable impact on shareholder value and the less the impact on employees and other stakeholders." For this reason, they believe that companies "should focus their attention initially on the 'upstream' approaches [to restructuring] and practice continuous 'rightsizing' rather than hurriedly initiating a major one-off downsizing programme."[3]

5.3 Approaches to diagnose an enterprise's health

Diagnosis of restructuring needs. According to the ILO-EBBF study, there are several different types of analysis and various approaches to diagnosing the health of an enterprise and determining the most appropriate category of restructuring:[4]

- **Industry analysis**: What are the characteristics, trends, key factors for success, opportunities and threats in the industry or industries in which the company competes? Industry means a cluster of companies manufacturing products or offering services that are close substitutes for each other.

- **Competitor analysis**: Who are the actual and potential competitors; what are their strengths and weaknesses, capabilities and limitations, strategies and probable future moves?

[3] Ibid., 13.
[4] Ibid., 16.

- **Societal analysis**: What important changes in government policy, consumer attitudes, employee expectations and political factors could offer new opportunities or become threats? Changes in government policy on regulation, trade liberalization, privatization, employment and monopolies can have a significant impact.

- **Company analysis**: What are the company's strengths and weaknesses relative to the key factors for success and to present and future competitors? How does company performance compare to cost, quality, delivery time, reliability and service with major competitors in present and potential markets? What are the market share trends? What are the trends relative to profitability by product, by country, by distribution channel and by customer category?

- **Share performance**: How does the share price compare with similar companies? Is the price/earnings ratio significantly different? Why?

- **Social and environmental performance**: Does the company set social and environmental goals and report on performance? Are relationships with each of the major stakeholders excellent, fair or poor?

- **Benchmarking to assess competitive performance and identify gaps and improvement opportunities**. Companies can establish realistic goals and strategies to improve by systematically evaluating the products, services, structures and work processes of other organizations, both internal and external, especially those recognized for their superior performance and best practices.

5.4 Questions employers should ask before restructuring[5]

How should an employer or enterprise manager determine whether to undertake restructuring? What restructuring category would be most appropriate to resolve the enterprise's problems or needs? What form of restructuring would have the least negative impact on the stakeholders? To help make an informed decision, an employer or enterprise manager should read the following list of restructuring categories and answer the questions about each one. An assessment of the positive and negative impacts of the various approaches can be plotted using the framework in Chart 5-1.

[5] This section summarizes material in *Socially responsible enterprise restructuring*, pp.17-32.

ACTION MODULE: Self-assessment questions for enterprise managers considering restructuring

This action module contains a number of self-assessment questions that enterprise managers should ask themselves before undertaking restructuring. The questions can help employers who are considering whether to undertake restructuring determine what category or type of restructuring they should undertake , and whether they are ready to undertake the process. The list of questions is not exhaustive, but is representative of the type of questions that should be asked in each category.

(1) Strategic restructuring

- ❑ Does the company need to redefine its basic business?
- ❑ Would a merger or acquisition considerably enhance the company competitiveness?
- ❑ Could joint ventures and alliances enhance competitiveness?
- ❑ Does the business portfolio need to be rebalanced?
- ❑ Should the company divest certain business units and activities?

(2) Restructuring ownership

- ❑ What types of ownership should be considered?
  - ➢ Spin-offs
  - ➢ An equity carve-out
  - ➢ Leveraged buy-outs
  - ➢ Management buy-outs
  - ➢ Employee ownership
  - ➢ Bankruptcy
- ❑ What are the advantages and disadvantages of each type of ownership?

(3) Financial Restructuring

- ❑ What types of financial restructuring should be considered?
  - ➢ Revising dividend policy
  - ➢ Repurchasing shares
  - ➢ Restructuring debt
  - ➢ Other specialized financial options
- ❑ What are the advantages and disadvantages of each type of financial restructuring?

(4) Revitalization

Revitalization is defined as mobilizing resources to achieve sustained profitable growth.

- ❑ Where do companies find revitalization opportunities?
- ❑ What are the strategies for growth?

- Superior responsiveness to the needs of key customers
- Creative management of channels, coming up with new channels for marketing and distributing products
- Effective sales force management to align efforts with potential and to align incentives with strategy
- Outstanding new product development and introduction
- Alliances. Joint ventures, alliances and other forms of partnership are ways to find new markets.

(5) Organizational restructuring

Trends: In today's world, successful businesses are:
using less and less vertical hierarchy;
using greater empowerment and individual responsibility;
using devolution of traditional head office functions to individual business units;
tearing down boundaries between functions to exploit cross-unit opportunities; and
inverting organization charts to put customers first and empower the employees who are in direct contact with customers.

- ❑ What approach to organizational change should be used?
  - Re-engineering
  - Delayering
  - Benchmarking
  - Participative management
  - High performance work systems
  - Cross-functional work teams
- ❑ What are the advantages and disadvantages of each approach?

(6) Restructuring of production

- ❑ What changes are needed to reduce lead times, increase marketing flexibility, reduce inventories, achieve more reliable delivery and improve competitiveness in costs?
  - Just-in-time manufacturing
  - Lean manufacturing,
  - Computer-aided design and manufacturing
  - Assembly-to-order rather than in stock
  - Global manufacturing
  - Outsourcing (see below)
- ❑ Can affected workers be empowered by change and involved in designing systems for humans as well as for machines?

(7) Outsourcing

Outsourcing involves contracting an outside organization to undertake activities previously carried out by the firm itself. It is form of restructuring because of fundamental changes in strategy, organization and staff.

- What is the purpose of outsourcing?
- What will be the impact of outsourcing on employees and former suppliers—and in some cases their communities?
- What type of outsourcing should be considered?
  - Traditional outsourcing
  - The customer retains ownership of the assets while staff and service responsibility are transferred to the supplier
  - Management contracting
  - The external service bureau
  - Various types of joint ventures
- What are the advantages and disadvantages of each type of outsourcing?

Before using outsourcing, review the best outsourcing practices in Chart 5-2.

Chart 5-2
Best outsourcing practices

- Do not outsource for just immediate cost reduction, outsourcing is about longer-term competitiveness.
- Adhere to the best practices and approaches to downsizing outlined in other chapters of this guide.
- Remember the human element -- inform and consult workers' representatives, keep workers informed about intentions to outsource. Maintain clear and open communication to lessen rumors;
- Differentiate carefully between core and non-core business and avoid outsourcing activities that may become core activities.
- Use outsourcing as a way to improve business focus.
- Plan the outsourcing process carefully to avoid losing core talent and expertise.
- Clarify the contract terms and expectations surrounding outsourcing and make sure all partners understand their role and commitments.
- Develop a partnership with the subcontractor, appoint an in-house contract manager to supervise the outsourcing strategy and monitor the relationship.
- Help the new firm get established and ensure that you are not the only customer of the outsourcing company.

(8) Reducing non-personnel costs

Most experienced groups in mergers and acquisitions tend to find greater synergies in non-personnel costs than in reducing the number of employees where duplication and overlap exist. One of the most important areas is in purchasing. Another important source of synergy is in information systems.

- What areas can be found in the non-personnel costs to achieve economies?
  - Purchasing. Chart 5-3 outlines some of the ways purchasing can be improved.
  - Information systems
  - Working capital reduction
  - Eco-efficiency through energy consumption and materials through product redesign, recycling, etc.

Chart 5-3
Achieving excellence in purchasing

- Reduce the number of vendors to improve quality, reduce costs and improve technology
- Build supplier partnerships and make them extensions of your own organization
- Search continually for new and better suppliers
- Establish clear bases for certifying suppliers
- Strive to build motivation and cooperation of suppliers
- Manage the inventory creatively (just-in-time manufacturing)
- Involve suppliers in quality management
- Build relationships with user departments
- Reduce transportation costs

(9) Downsizing

The ILO-EBBF study defines downsizing as "a reduction in the number of jobs. This may not require laying off employees or even reducing the number of employees because growth, attrition and other actions may absorb redundant workers."

- Does downsizing make good business sense?
- What are the hidden costs of downsizing?
  - Reduced productivity
  - Higher turnover
  - Decline in quality
  - Decreased creativity, entrepreneurship and risk taking.
  - Loss of key talent
  - Poor external image
  - Increased legal and administrative costs
  - High social costs
- What downsizing strategies are being considered?
  - Employee reduction
  - Site closure
  - Work redesign
  - Continuous improvement
- What are the best practices for downsizing?
  - A philosophy of employment security and responsible restructuring is adopted
  - A philosophy of continuous improvement is adopted
  - The downsizing decisions are well prepared
  - The downsizing process is planned very carefully
    --A reemployment assistance committee (RACs) will be used whenever possible
    --A worker assistance resource center (WARC) will be established
    --A peer counseling programs will be set up
  - The announcement, strategy and communications are well prepared
  - The implementation of downsizing is well managed
  - Local communities are supported
    --Partnerships with local government authorities are established to mitigate the impact
    --Collaboration with local authorities is carried out to build sustainable economic

development

- New external jobs are created or found for displaced workers
  --Large companies partner to support SMEs
  --A successful integrated approach for site regeneration
  --Support to employees in new start-ups
- The human resource function is managed effectively

If some downsizing will be necessary, a number of questions need to be answered before any announcements are made. These questions include:

- How can layoffs be minimized?
- What are the needs, concerns and likely impact of downsizing on each stakeholder?
- What is the business rationale for downsizing? What is the vision for the business in the future? How can they be articulated and communicated?
- What separation packages will be offered for voluntary early retirement and separation?
- What will the notification period be -- i.e., the date on which pay and benefits cease?
- Is a formal social plan necessary? What should be included? Will employee representatives be informed? Consulted?
- How can community and government agencies be involved?
- How should the company organize for implementation?

Chart 5-4 is a sample framework to assess the impact of restructuring on the various stakeholders. Socially responsible employers can use the framework to determine which of the restructuring categories will have the greatest positive or negative impact on each stakeholder.

Chart 5-4
Framework for assessing the impacts of restructuring on stakeholders

Impact (+/-) on stakeholders

Nature of restructuring	Shareholders	Customers	Employees	Communities	Business partners	Environment
Acquire unit						
Sell unit to workers						
Merge company						
New equity issue						
Increase exports						
Delayer structure						
Close plant						
Outsource production						
Downsize						

The next two sections of this chapter, section 5.5 and 5.6, describe some practical restructuring techniques and responses that can be used to improve productivity, reduce costs and implement human resource techniques to increase enterprise competitiveness and/or reduce the impacts of restructuring on workers.

Some of the restructuring actions discussed in Sections 5.5 and 5.6 may necessitate the displacement of existing workers. Responsible employers will attempt to minimize this outcome, and also take steps to assist the displaced workers to find replacement jobs.

The steps responsible employers can take to facilitate successful worker adjustment if restructuring results in worker displacement can be found in the companion *RRWA Handbook for IA Specialists*. (It should also be noted that another recent publication by the same author, ***A guide to worker displacement: Some tools for reducing the impact on workers, communities and enterprises*** **(ILO IFP/SKILLS, 2001),** addresses the actions and steps communities can take to organize and help employers engage in responsible restructuring, to help displaced workers impacted by restructuring make a successful adjustment, and to help the community achieve a successful economic renewal in the face of the restructuring.)

5.5 Practical tools employers can use to reduce non-human costs and improve enterprise competitiveness

The first component of responsible restructuring programs involves a wide range of practices to improve enterprise competitiveness and thereby minimize or prevent employee layoffs. To sustain competitive advantage, the enterprise needs to involve every employee.[6]

Twelve practices to improve enterprise competitiveness and retain jobs are::

1. Open book management
2. Direct cost cutting
3. Equity concessions
4. Competitiveness training
5. Productivity improvement and cost saving
6. Delayer without downsizing
7. Change the organization's culture
8. Step up export promotion
9. Enter into strategic alliances
10. Develop alternative products and encourage "intrapreneurship"
11. Locate a new plant in the area, and
12. Change the ownership of the facilities

[6] Adapted from Masaru Ishida, "Asian enterprise restructuring with a human face in the face of financial crisis," n.d., and Gary B. Hansen, *Preventing Layoffs*, pp. 6-11.

5.5.1 Open book Management

Enterprises can adopt open book management-to maintain or increase competitiveness by becoming a "least cost producer." Open book management is the practice of communicating with employees via "the numbers."

The open book management concept was developed and used by Jack Stack, a new CEO of Springfield Remanufacturing Company, for an employee buyout to save jobs. In 1983 the workers and managers purchased an engine-rebuilding plant from International Harvester Company that was being sold or closed because the parent company was in serious financial trouble. Using the open book methodology, Springfield Remanufacturing prospered and not only saved the workers' jobs but added new ones. Jack Stack said:[7]

> The more [workers] know about [their] company, the better that company will perform. This is an iron-clad rule. You will always be more successful in business by sharing information with the people you work with than by keeping them in the dark. Let your people know whatever you know about the company, the division, the department, and the particular task at hand. Information should not be a power tool—it should be a means of education. Don't use information to intimidate, control, or manipulate people. Use it to teach people how to work together to achieve common goals and thereby gain control over their lives. When you share the numbers [including financial numbers] and bring them alive, you turn them into tools people can use to help themselves as they go about their business every day. That's the key to open-book management.
>
> ***
>
> You don't become the least-cost producer by issuing edicts from an office, or by setting up elaborate systems and controls, or by giving pep talks. The best way to control costs is to enlist everyone in the effort. That means providing people with the tools that allow them to make the right decisions.
>
> Those tools are our magic numbers….[T]hey are the numbers that tell you whether or not your costs are lower than your competitors'….Your competitors; numbers provide you with your benchmarks. Open-book management is the means by which you share those benchmarks with the people in your company, the way you get everyone involved in the effort to become the least-cost producer...

Open-book management can be used as part of a cost-reduction process to increase an enterprise's competitiveness along with the following techniques.

5.5.2 Direct Cost Cutting

Employers can costs directly in four ways--reduce current and fixed asset costs, reduce non-human resource costs, reduce personnel costs, and use "givebacks."

[7] Jack Stack, *The Great Game of Business*, pp. 71-80

Reduce current and fixed asset costs. To lower inventories/payables, stop buying materials, parts, and supplies. Reduce production to lower products' stock. Stop investing in production/distribution facilities. Reduce paper, space. Dispose of slow moving finished products. Dispose of unused assets, memberships, shares, land, and excess buildings and office space. Consider leasing computers, equipment, and office space at cheaper rates. Repay commercial loans to reduce interest payments.

Reduce non-human operating costs. Reduce expenditures for hospitality, meetings, travel, advertising, and sales promotion. Reduce communication costs--fax, telephone, and computer networks. Reduce utilities--lighting, gas, heating, cooling, and water use. Limit unnecessary transport including company cars. Reduce purchases of furniture, machines, and tools.

Reduce personnel costs. Reduce personnel costs by reducing overtime, weekend work, bonuses, etc. Managers lead in sharing the pain. This approach is often overlooked, even during times of full-scale layoffs. If enterprises never require overtime, they may be overstaffed. It is important to weigh occasional overtime costs against overstaffing costs.

"Givebacks". Reduce wages and/or benefits. Employees facing layoffs are often willing to accept a "pay freeze" or a pay cut to protect their jobs. Pay cuts of 30 percent for top managers, 20 percent for middle managers, and 10 percent for line employees demonstrate equal sacrifices by everyone. Even unionized workers and their unions have accepted such measures to save jobs. Reducing fringe benefits and the number of paid vacation days and holidays can also eliminate monetary pressures for layoffs.

5.5.3 Equity Concessions

Equity concessions are a variation of the giveback approach to compensate for substantial enterprise losses. In the United States, the legal concepts embodied in employee stock ownership plans (ESOPs) have enabled a number of firms faced with serious financial difficulties and competitive pressures (e.g., United Airlines and Northwest Airlines) to negotiate agreements with representatives of their employees for substantial pay and benefit concessions to lower costs and become more competitive. The workers have accepted annual pay cuts over a two- to five-year period in exchange for stock in the company and restoration of wage cuts when the company returns to profitability. This topic will be explored more fully in Chapter 9.

5.5.4 Competitiveness Training

An important element of enterprise reform is the ability of managers and workers to adopt new ways of thinking and new techniques to effect changes in their enterprises. If countries are going to emerge from financial crises or economic downturns in more competitive positions, they need to adopt productivity enhancing restructuring programs. Even before the 1997 financial crisis hit, there were signs that competitiveness was declining in some Asian countries.

After the 1997 Asian Financial crisis, Thailand proposed that the nation undertake a major program of industrial restructuring to strengthen the industrial competitiveness of Thai industries and move toward the "production of high quality high value-added products for the middle-to-higher markets." However, the essential components of this industrial restructuring proposal and the mechanisms to implement them are based on the traditional industrial policy model.

While the objectives of the Thai government's proposal are commendable, there may be more effective and less costly methods to accomplish them. At present, the existing institutions, employer associations, trade unions, and productivity institutions are not equipped to provide the required range and number of services to carry out the competitiveness training. Therefore, the capacity of the appropriate institutions must be greatly expanded before they can provide the necessary training and technical assistance to help significant numbers of enterprises strengthen their competitiveness.

5.5.5 Productivity Improvement and Cost Saving

To obtain higher productivity and increase competitiveness, introduce or revitalize productivity improvement programs. In addition to raising workers' skill levels, all concerned parties need to join hands and make a concerted effort to improve productivity and achieve a better quality of life.

The success of productivity improvement in Japan, Europe and the United States highlights the importance of enterprise-level tripartite collaboration. In countries lacking such collaboration, enterprise reform efforts need activities to increase social partners' involvement in the process. As a result of the Asian Financial Crisis, employers groups such as ECONTHAI in Thailand have requested help to start such programs in their country.

As a part of enterprise restructuring, it may be appropriate to initiate productivity or quality drives or campaigns. For example, programs initiated in Korea and Thailand after the 1997 financial crisis encouraged consumers to purchase locally made goods. But if the products are not high quality, this may not be beneficial in the long run. National productivity and quality campaigns may be required to help the SMEs, co-operatives and larger enterprises improve their efforts.

Productivity bargaining. Productivity bargaining uses collective bargaining to change work rules and other terms of employment to achieve better matches between work force utilization and technological requirements. The result is a significant increase in productivity.

Cooperative labor-management relations. Introduce non-adversarial approaches to negotiations and conflict resolution procedures to improve labor-management (L-M) relations and strengthen L-M co-operation. Programs like the Interest Based Negotiations (IBN) and the Training for Partnership Workshop Series developed and promoted by the USDOL in the early 1990s can provide effective frameworks to help labor and management develop more co-operative relationships and effect productivity improvements. (See Chapter 6 for a more detailed

discussion and information about the tools that can be used to help reduce labor-management conflict and build L-M partnerships to strengthen competitiveness.)

Productivity improvement and cost saving (PI/CS) programs. During the past two decades, labor and management in many American and Japanese companies have developed various joint or cooperative approaches to improve productivity and quality. Among the more innovative approaches are: employee involvement programs, gainsharing plans, and labor-management (LM) PI/CS study teams (the last is also discussed in Chapter 6).

In addition to L-M PI/Cs study teams, employee involvement programs include quality circles, quality of work life programs, total quality management, and team-based management approaches such as the self-managed work teams at General Motors Corporation Saturn Division. Teams are most productive when workers have the necessary skills (especially statistical process control), management gives them maximum autonomy, and they handle the problems that occur within their enterprise.

Gainsharing plans (e.g., Scanlon, Rucker and Improshare) are formal supplemental compensation systems aimed at individual departments, plants, or companies to improve labor productivity or reduce costs. They offer financial bonuses to employees for improvements in productivity. Generally these plans include all non-management employees, but some plans cover a single department or group of employees. Suggestions usually focus on work processes, but they can encompass almost any issue within the enterprise.

The most widely used gainsharing plan in the United States, the Scanlon Plan, has two basic facets:

establishing a productivity norm and devising a bonus formula for improvements in productivity (the typical formula divides labor costs by the value of the goods produced), and

initiating the actual participation process.

The participation process involves setting up production committees and a screening committee. Production committees have both management and labor representatives and meet periodically to discuss ways and means to eliminate waste, improve jobs, increase productivity, etc. The screening committee meets occasionally to evaluate ideas scrutinized by the production committees. The management implements good ideas.

When gains in productivity occur, the savings are divided between the company and the employees. The division can be 50/50 or any agreed upon split. The payments to workers usually come in monthly cash bonuses. Individual bonuses are determined by the workers' monthly wages.

5.5.6 Delayer without Downsizing

During good times, several large multinational enterprises, such as the Ford Motor Company, have restructured their corporate organizations on a worldwide basis to enable them to remain competitive in their industries. In the case of Ford, their late 1990s restructuring was

accomplished with a minimal loss of employees and saved the company US$2 to $3 billion per year by the end of the decade. During the industry downturn in 2000, their positive approach enabled Ford to be in a better position than General Motors and Daimler Chrysler.

5.5.7 Change the Organization's Culture

To more effectively meet the needs of the enterprise, introduce management structures and human resource development techniques to create a flatter more dynamic "learning organization" that promotes higher levels of management-employee co-operation and participation and utilizes the workers' capabilities.

5.5.8 Step up Export Promotion

Step-up export promotion efforts at enterprise, regional and national levels by seeking out new opportunities to market goods or services in countries not usually considered. Provide training on export marketing, sales, finance, delivery and shipping arrangements.

5.5.9 Enter into Strategic Alliances

Explore new opportunities for strategic alliances, mergers and acquisitions, joint ventures, equity finance, and strategically integrated information systems.

5.5.10 Develop Alternative Products and Encourage Intrapreneurship

Improve enterprise competitiveness and protect jobs by changing management and marketing strategies. Aggressively seek new markets or expand market shares for the products or services being produced and develop alternative products for excess work force to produce or develop new enterprises to employ the workers. Committees of workers and managers evaluate enterprise assets (human and capital) to come up with new products that could be produced by the current work force and facilities. Consider starting an intrapreneurship program to encourage new product ideas.

Several factors facilitate the successful development of alternative products: management's desire to continue to employ its work force and to remain in the community; management's entrepreneurial spirit and willingness to search for new business and engage in new lines of work; and some type of available capital infusion from retained earnings or other sources to carry out the conversion.

5.5.11 Locate a New Plant in the Area

Locate a new plant in the facility itself or in the area of the facility to be closed instead of putting it in a "green fields" site or another community.

5.5.12 Change the Ownership of the Facilities

A change in ownership might be appropriate when either of the following two situations occur: (1) Absentee corporations no longer find a local plant compatible with their overall financial or product plans even though a plant or facility may be profitable, and (2) the owner of an enterprise is reaching retirement age without a logical successor to carry on the business In such cases:

1. actively seek a new owner to produce the existing products or to produce a new product or service; or
2. investigate the possibility of local management and/or workers acquiring the enterprise through an employee stock ownership plan (ESOP) or the formation of a worker-owned cooperative.

Often the turnaround of a company that was purchased by its managers and/or employees is attributable to subsequent changes in the organization's culture and the introduction of employee involvement and productivity improvement programs. Worker ownership as an alternative to layoffs has been especially attractive to workers in plants in small towns where job opportunities are scarce. Chapter 9 discusses how ownership changes can be implemented as part of enterprise restructuring.

The use of early warning networks and the other rapid response intervention techniques are briefly discussed in Chapter 9, and also more extensively in the publication, *A guide to worker displacement: Some tools for reducing the impact on workers, communities and enterprises* (ILO IFP/SKILLS, 2001). These tools can be used to facilitate the strengthening of enterprises and the transfer of ownership to preserve jobs and enterprises in a community.

Chart 5-5 provides an example of how Polaroid, a socially responsible employer in the United States, recently used this change of ownership process to save redundant jobs at one of its units being downsized—a printing plant in Massachusetts.

Chart 5.5
"Employees Stake Claim, Save Jobs:
Printing plant that once faced shutdown to be partly owned, run by workers."

When workers of Inner City, Inc., learned last year that corporate parent, Polaroid Corp. planned to sell or close the printing plant as part of a cost-cutting strategy, some of them panicked.

I felt kind of shaken," recalled Calvin Green, a 27 year old bindery assistant who cuts, folds and collates printed copies. "You get a little nervous thinking about the bills you have to pay and your future."

Today, the mood at Inner City's Roxbury office is decidedly upbeat as its 10 employees await the finalizing next month of an Employee Stock Ownership Plan, or ESOP, that will permit the plant's printing division to become an independent company, partly owned and wholly run by the workers.

Workers at Inner City credit an alliance between Polaroid and two non-profits with helping to create the ESOP, which will help them preserve jobs at the plant and give the workers an opportunity to run the business themselves. The alliance is important, they say, because of the real and perceived problems that prevent would-be entrepreneurs from launching businesses in urban neighborhoods.

According to the ESOP Association in the United States, there are 11,500 ESOPs nationwide, with 8.5 mission employees. When the ESOPs first became legal in the U.S. in 1974, there were 200. In the United States there are two types of ESOPs. According to the President of the ESOP Association, the most common is the closely held private firm where retiring shareholders and partners turn the business over to an ESOP on behalf of workers. This preserves the jobs and enterprise in the community. The second model, which represents about 20 percent of the 1,000 or so transactions done yearly, is the spin off model. This occurs when a big corporation spins of a subsidiary or a plant as part of a corporate restructuring process.

That is what happened at Inner City, Inc. Faced with a steep drop in sales due to reduced demand for instant film, Polaroid announced plans last year to reduce its overall work force by 11 percent, including 475 in Massachusetts. Inner City Inc. was part of the restructuring plan.

But the last thing Polaroid wanted to do was just leave. The company felt that they needed to do something to soften the blow. The answer, a partnership between the Dorchester Bay Economic Development Corp., a Local Economic Development Agency, Polaroid, and ICA, a nongovernmental organization (NGO) that specializes in helping workers set up employee-owned enterprises. Together, the three partners fashioned an exist strategy that launched the newly created Inner City Printing., as an employee-owned business—saving the jobs of the 10 workers..

The Dorchester LEDA conducted a feasibility study to determine the best way to save the printing division—which was making a modest profit for Polaroid. They concluded that the best solution was to help the workers set up their own business. They contacted ICA, and paid this group $15,000 to prepare a formal business plan for the Inner City's printing division. Polaroid agreed to provide a minimum of $1.5 million in business to Inner City over the next two years, enough to give the spin off time to remake itself as an independent entity. Additionally, they agreed to allow the new company to use $250,000 worth of Polaroid printing equipment. ICA then raised $595,000 in loans and equity to help finance the project.

The Inner City's ESOP works as follows: Employees will receive common stock, the kind with the greatest amount of rights, and will become owners right away. However, the stock will be held in an account by the ESOP trust. As the loans that were used to buy company stock for the workers are paid off, stock will be released from the trust account into the workers' accounts. Workers who leave or retire will be allowed to cash their stock and take the proceeds. Additionally, Dorchester Bay and ICA will receive a limited number of shares.

Source: Adapted from an article by Diane E. Lewis, that was published in the *Boston Globe* and reprinted in *ICA News and Events*, Spring/Summer 2001.

5.6 Human resource measures employers can use to minimize or mitigate the impact of layoffs

Some preventive measures need to be built in [human resource] HR strategies to be socially efficient in crisis management so that human sacrifice can sensibly be avoided in overcoming the crisis. Even for profitable companies the social cost of down sizing can be significant. For unprofitable companies it can be a disaster for both management and labor. Any downsizing normally triggers strong anger and resistance among trade union members. It is resisted even by managers. It may break down the whole cooperation, team spirit and commitment of people in the organization, and turn out a catastrophe in management. Once the social climate of the organization and labor management relations have been broken down it may take more time and efforts to recover from a crisis and restore core competency and competitiveness after the crisis is over. Such ill impact of down sizing can be alleviated or minimized by wise and sensible HR strategies in pre-, mid- and post crisis management. (Masaru Ishida)

The second internal restructuring technique emphasizes the workers' importance to the enterprise. Workers are among the firm's most important assets, and should be treated accordingly. Socially responsible employers apply the best human resource management techniques to provide continuity of employment to its workers, achieve the advantages of change and restructuring, and minimize the need for and impacts of layoffs on workers.

The human resource measures responsible firms use to prevent layoffs or ameliorate their impact can be grouped into five basic categories:[8]

1. Training as a method of internal adjustment
2. Socially sensitive ways to reduce the number of workers
3. Balance operations with buffers
4. Adopt worksharing
5. Redeploy work or workers

5.6.1 Training as a method of internal adjustment

How can training be used as a method of internal adjustment? It is not meant to include regular training activities of companies for their workers that take place as part of the ongoing production process. What is meant here is to discuss training that is expressly linked to periods of diminished production that would normally lead to workforce redundancies. This kind of training is triggered when a slowdown and redundancies loom. This type of training might be financed by the enterprise, but it could also involve some kind of public/private financing mix.

[8] Adapted from Masaru Ishida, "Asian enterprise restructuring with human face in the face of financial crisis," n.d.; Gary B. Hansen, *Preventing Layoffs*, pp. 12-22; and Peter Auer, "Socially responsible workforce adjustment: Options available to companies," Unpublished draft 20 August 2000.

Training is used as "active functional equivalent"[9] to "passive measures" such as temporary lay-offs or short-time work.

The general idea is that you invest in the skill of your workforce, when they are idle and thus have not to be taken out of productive work. Once things return to normal, the skills of the workforce are enhanced, broadened or updated and the workforce has become more productive. In OECD countries, public programs for supporting such redundancy avoiding training exist for example in Sweden, Germany or Denmark. The scarce evaluation of programs indicate that this kind of training has been beneficial for the workforce, but results are affected by the degree of uncertainty surrounding even business cycle downturns.

5.6.2 Socially sensitive ways to reduce the number of workers

5.6.2.1 Use Attrition and Hiring Freezes.

Attrition, sometimes called restrictive hiring, reduces the number of employees by not replacing workers who leave. With careful planning, attrition can prevent some layoffs. Because enterprises typically lose employees through turnover, they can reduce their labor forces by only hiring replacements that are absolutely essential. If internal transfers are used to fill vacant positions, employees receive some training.

The advantages of this approach are that it contributes to workforce morale and generates confidence in management's ability to handle challenges. The disadvantages involve the loss of "new blood," and the fact that shortages can develop in high turnover occupations, placing pressure on workers to work overtime and generating fatigue. Hiring freezes can also be extended to freezes on promotions.

5.6.2.2 Voluntary (Temporary) Leave.

During periods of economic difficulty, some companies encourage employees to voluntarily take temporary unpaid leaves. In most cases, companies continue the employees' benefits during their time off.

5.6.2.3 Early Retirement.

Depending on the demography of the work force, it may be possible to reduce the number of personnel through early retirement. This approach becomes feasible if the company is top heavy with long-service workers.

[9] When the functions of two or more policies fulfill the same goal, than they are functionally equivalent. In this example, both short time work and training fulfill the same goal of preventing dismissals. However, training is an "active" equivalent, because besides fulfilling its preventative goal it also enhances the skills of the individual, while short-time work (see point b) is only passively providing income replacement for the hours not worked. Not working is actually a condition for individuals (and firms) to draw short-time working benefits (see also section e).

Typically, a company offers employees age 55 - 60 or older an opportunity to receive full normal retirement age benefits without waiting. A cash bonus, based on salary and years worked and supplemental payments until public (social security) pension benefits begin, may be added. This approach eliminates payroll costs for senior workers and provides advancement opportunities for younger workers who otherwise might be lost to competitors.

A recent example of the use of early retirement to reduce the impacts of layoffs is the January 29, 2001 announcement by financially troubled Daimler Chrysler that they would downsize the Chrysler automobile operations by eliminating 20 percent of their global workforce. About 75 percent of the 26,000 jobs to be cut in Canada, United States, Mexico and South America this year will come through early retirement and attrition.[10]

One of the disadvantages of early retirement is that the best people may leave. This is particularly true of a voluntary program because the company cannot control who accepts the proposal. In addition, the incentives to attract sufficient recruits for early retirement may pose a heavy financial burden. Also, the laying off of senior workers can lead to costly legal battles, employee protests, and decreased morale.

5.6.2.4 Voluntary Resignation Inducements.

In a few instances, companies provide financial and other inducements to encourage employees who normally do not qualify for early retirement to quit voluntarily and permanently. Resignation inducements called “window plans” offer fixed periods of time when employees can choose to leave in exchange for proffered benefits. These plans are sometimes targeted at a specific group of employees. However, the same disadvantages that apply to early retirement (high costs and possible loss of the best employees) also apply to voluntary resignations.

5.6.2.5 Conversion Training

Training redundant workers for reentry into the labor market is an important approach. Such training for the external labor market has gained some importance in France, where they are part of minimum social plan requirements. Publicly financed or employer-financed programs for retraining exist in most North American and European countries as well and are part of the policy instruments used by `employment companies in Germany or Austria. (see below: intermediary organizations). The rationale of the conversion training measures is to provide training for redundant workers in order to enable them to take up jobs elsewhere in the economy. Such training can consist in shorter up date training or in longer term adaptation to new professions. Evaluation results have shown that their effectiveness depends on the business cycle and is decreasing when the number of redundancies increase, But the overall results of such measures are positive.

[10] James Hyde, “Chrysler to Slash 20 Percent of Workforce,” *Reuters*, January 29, 2001

5.6.3 Balance Operations with Buffers.

The assumptions regarding manpower and production buffers are that layoffs and rehires create instability in enterprises, damage employee morale, are expensive to administer, and can result in the loss of valuable employees. Consequently, employers should strive to maintain lean work forces by adopting comprehensive manpower planning systems to accurately project employment and devise ways to regulate employment as carefully as possible.

During serious business downturns some of these approaches can be temporarily reversed to provide work for employees, including:

- ***Developing a more flexible work force through careful selection and training*** supplemented by contract provisions (where applicable) that permit transfers among jobs. As noted in 5.1 above, using slow periods and downtimes to provide worker training and retraining as alternatives to layoffs can provide substantial benefits to employers. Such investments can help achieve employment stability and maintain a competent work force that stays abreast of technological changes.

- ***Using manpower buffers to handle fluctuations in workload***. Buffers include part-time and temporary employees, retirees, and subcontractors as well as overtime to handle workloads that exceed the full-time work forces' capacity. If a plant operates seven days a week, consider separate weekend crews rather than excessive overtime by the regular work force.

- ***Producing additional products or taking on service lines*** with sales cycles *that complement the demand for the regular product*.

- ***Warehousing goods during slack demand and offering incentives to customers to stockpile during slow periods***.

- ***Contracting short-term work or work that requires fluctuating numbers of employees****; e.g.*, maintenance and construction work.

None of the buffering alternatives is ideal. If temporary personnel agencies charge high rates, direct hiring is less costly. Long periods of overtime reduce output per hour, require expensive premium payments, and may cause resentment if overtime is discontinued. Employees may resent outside contractors. Internal transfers can be disruptive to receiving units. However, when employees know the programs are part of overall job security strategies to protect their jobs, they are more receptive to the balancing concepts and buffer techniques.

5.6.4 Worksharing

Worksharing or spreading out the work is a third line of defense to prevent layoffs. If the necessary employee cutbacks are too large to be met by attrition, early retirement, or other voluntary means, the only recourse may be shorter workweeks for everyone or laying off some employees, usually the newer ones.

The several versions of worksharing depend on where the firm is located, the nature of the industry, whether a labor agreement exists, and the contract provisions in force.

5.6.4.1 Reduced Hours.

If the labor surplus appears to be short-term, many organizations prefer to reduce their employees' work hours and keep all of them. Instead of a forty-hour workweek, management may decide to cut all employees' wages and hours by a fixed percentage.

5.6.4.2 Jobsharing.

Jobsharing is a specialized form of worksharing that divides a full-time position into two part-time positions. Two employees share the duties, responsibilities and accountability of the job equally, as well as the pay and benefits. Normally this is not an alternative to layoffs.

The benefits of jobsharing are: higher productivity; increased flexibility in scheduling work assignments for better coverage during peak periods; reduced absenteeism and turnover; improved job training; better employment options for people who cannot work full time; plus the unique individual skills two workers can bring to a single job by working half day or rotating work assignments—one week on, one off.

The disadvantages of jobsharing include administrative difficulties in splitting benefits and increased supervision, paperwork, and communication problems.

5.6.4.3 Layoff Rotation

In this version of worksharing, the affected workers work a specified percentage or period of time (e.g., four weeks) and are laid off for a specified percentage or period of time (e.g., one week) throughout the cutback period. While on layoff, workers draw supplemental unemployment benefits (SUB) and unemployment insurance (UI) benefits. This is a useful alternative for employers in states or countries that do not have short-time compensation UI programs such as those discussed below. One benefit of the layoff rotation plan is the retention of an experienced and loyal work force to start production when a recession or problem ends.

5.6.4.4 Short-time Compensation: Worksharing UI Plans

This form of worksharing (or short-time compensation as it is sometimes called) has been used in Western Europe since the 1920s and in North America, Canada and California since the late 1970s as an alternative to layoffs. Because of the success of the California experiment, a number of U.S. states have implemented short-time UI compensation. Employees receive partial unemployment insurance benefits for wages lost during work reductions.

Under the California Worksharing UI program, instead of laying off 20 percent of the work force when a firm reduces its work week and pay level by 20 percent, the employees work four days instead of five and receive one day's worth of weekly unemployment insurance

benefits. For example, workers who are eligible to receive $100 in weekly benefits on full layoff can receive $20 for each workday lost.

Participation in the program is strictly voluntary, but union consent is required when employees are covered by a collective bargaining agreement. To encourage employers to use the program, California has kept the administration simple and the paper work minimal. Few restrictions are placed on employers. Participating firms are not required to document that a reduction in hours is necessary before their employees can receive benefits, and there are no restrictions on the availability of fringe benefits, hiring, firing, or transferring employees.

Restrictions on employees are minimal. Only employees working for firms that indicate that their workload reduction is permanent are required to look for other work. Studies of California's worksharing program found that it benefited both employers and workers by diffusing the impact of business downturns, fostering job attachment, keeping skills fresh, and allowing workers to retain fringe benefits.

5.6.5 Redeployment: Moving Work or Workers

The last line of defense to prevent layoffs involves moving work to locations where company workers are available, or moving workers to work available inside or outside the company and retaining them on the company's payroll when they are seconded elsewhere.

5.6.5.1 Mobility grants

For awhile mobility grants have been used quite substantially for allowing reallocation of displaced workers. They have been part of the traditional Swedish labor market policy that, in general, was designed for structural change. The rationale for mobility grants is to allow workers to move geographically from areas of redundancy to areas with greater labor demand. The grants compensate for higher costs due to relocation.

5.6.5.2 Repatriation aids

Repatriation aids are a specific kind of mobility grant to provide displaced foreign workers with the means to move to their country of origin and either set up on their own or start salaried work. Such grants usually consist in a lump sum payment, travel expenses and the possibility to recoup pension fund monies earlier than statutory provisions would foresee. However, Take up seldom reaches expectations, and almost no information is available about the numbers of foreign workers who find alternatives to jobs lost in their home countries. Take up is also a function of the generosity of the repatriation grants.

Chapter 6

Reduce labor-management conflict and build partnerships to strengthen competitiveness

[Much of the material in this chapter has been adapted from Gary B. Hansen, "Module on Worker-Management Cooperation," ILO-ITC, Turin, Italy, June 2001, and supplemented with material adapted from several Interest-based training manuals prepared by the USDOL in the early 1990s]

Enterprises seeking to cut costs and increase productivity as part of their competitiveness strategy tend to create uncertainty, anxiety and insecurity among their workforces. When these actions are taken unilaterally without any consultation or input from the workers who will be affected, the results are usually less than optimal, and can be disastrous. Restructuring to cut costs or improve competitiveness can lead to low morale, labor unrest and even strikes and violence with long-lasting negative consequences to the enterprise if not handled properly.

As a result of painful experience over a lengthy period of time, a number of employers and trade unions in North America and Western Europe have developed more cooperative and less adversarial approaches to guide their labor-management relationships. Many of these approaches have been forged as a result of financial problems, global challenges, and serious restructuring needs.

Most importantly, the shift from a less conflictual to a more cooperative relationship between labor and management has had a very positive impact on the participating enterprises and their workers, leading to stronger, healthier and more productive enterprises and more satisfied, stable and motivated workers.

For these and other reasons, it is important that employers and workers in enterprises and economies that are restructuring be provided with some basic tools and training to help them reduce conflict and build more cooperative relationships. This chapter provides a framework for analyzing and understanding labor-management relationships in an enterprise, and outlines some tools that can be used to help the parties make improvements in their relationships if they want to do so.

6.1 Cooperation or Conflict in Labor-Management Relations[1]

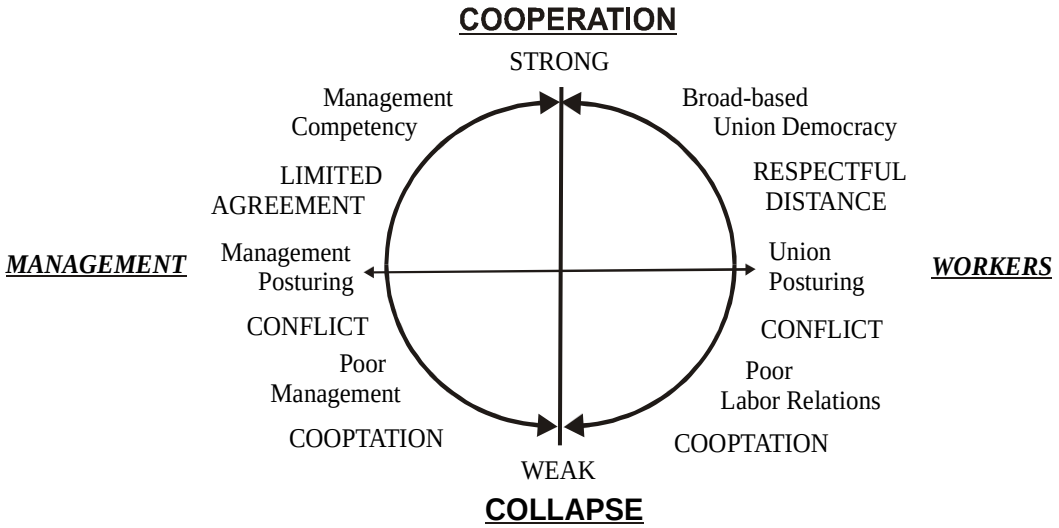
What are the basic features of worker-management relations in a market economy? It is not two gunfighters shooting it out at the OK corral, even though the media often portrays it that way by focusing on strikes and conflict. It is equally unrealistic to expect an absence of conflict in worker-management relations.

There are a number of ways of looking at collective bargaining and worker management relations. Three of these can help employers and workers understand the nature and complexities of this process, and to better understand the differences between conflict and cooperation when applied to worker-management relations.

6.1.1 Basic Positions of Workers and Management

One way to look at worker management relations is to view their basic positions. Chart 6-1, developed by Ed Cohen-Rosenthal and Cynthia Burton, puts worker-management relations on an axis.

Chart 6-1
Basic Positions of Union-Management Relations



The vertical axis represents the strength of the parties and the horizontal axis the polar interests of management and workers. The goal of cooperation is to have the two parties come together at the top of the diagram. At this point there is a strong, competent management and a strong and democratic union representing the interests of workers. As stated by these authors,

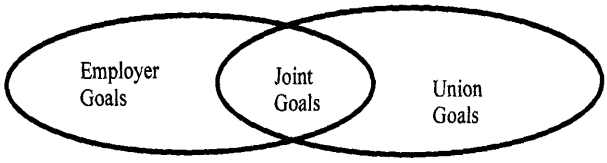
[1] This section has been adapted from Edward Cohen-Rosenthal and Cynthia E. Burton, Mutual Gains: A Guide to Union Management Cooperation, Praeger, 1987, ILR Press, 1993

There is no comfort in a union in having a weak management that is unable to perform well. A weak and divided union is more trouble to management than strong representation. Posturing by either party leads to serious problems. Management's relying on its rights clauses rather than being competent and correct, leads to conflict and mismanagement. Union leadership's not responding to the merits of particular situations leads go gridlock and poor membership representation. When both occur at once, the result is terrible conflict. When there are serious power imbalances between the parties, there is a danger of co-optation by the stronger party. Worse yet, weak management and a weak union lead to little energy or capability for problem solving.[2]

6.1.2 Separate and Overlapping Goals of Workers and Management

Another way to view worker-management relations is as circles indicating separate and overlapping goals. Chart 6-2 illustrates this situation.

Chart 6-2
Overlapping goals of Employers and Unions



Traditional trade unionists' view: Some unionists focus solely on the differences between workers and their bosses, asserting that they have nothing in common and their goals never intersect. They view management as selfish and manipulative and think it best to keep union interests as separate as possible to avoid any misunderstanding as to which side they are on. They see no overlap in the circles.

Organizational theorists' view: Some organizational theorists see only the overlap. They envision a blissful identity of interests between the parties: that good managers are totally aligned with their employees' concerns, and that they're going in the same direction and share a common culture. Differences of interests or hierarchy are discounted. They see the two circles as overlapping.

Both views are naive. Workers and management interests are never identical. Both commonality and differences occur in all situations. At a fundamental level, employers want more for providing executive compensation, dividends, and investments while workers want higher wages, benefits, and the best working conditions.

[2] Edward Cohen-Rosenthal and Cynthia E. Burton, Mutual Gains: A Guide to Union Management Cooperation, ILR Press, 1993, pp. 7-8.

Too often, workers and managements refuse to work together because they are afraid that the other party will gain at their expense. However, management and unions should focus on attaining their own goals with integrity, including ways that require or can be enhanced by mutual cooperation. The amount of overlap determines the degree of cooperation.

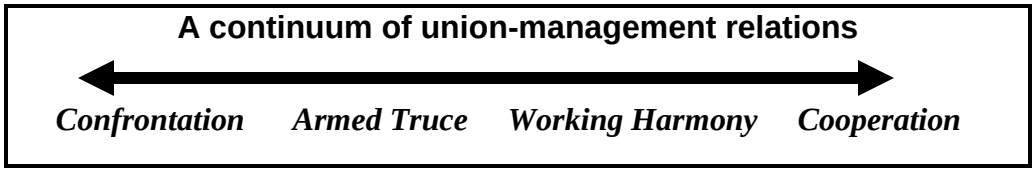
6.1.3 Continuum of Worker-Management Relations

A third way of looking at worker-management relations is to place them on a continuum. Some years ago two scholars who had studied industrial relations in the United States, Frederick Harbison and John Coleman, concluded that there were four different kinds of worker-management relations that can occur in a collective bargaining relationship.

1. Confrontation
2. Armed Truce
3. Working Harmony
4. Union-Management Cooperation

Based on their research, the scholars also believed that these kinds of relationships could be placed on a continuum, as illustrated in Chart 6-3.

Chart 6-3



1. Confrontation

Confrontation is akin to warfare. It occurs when an employer seeks to eliminate a union as a representative of its workforce and to operate in a union-free environment. The employer's activities and actions, legal and illegal, are designed to undermine the union, resulting in continuous conflict, frequent violations of labor laws, bitter strikes and labor strife, and a high rate of grievances.

2. Armed Truce

Armed Truce is defined as:

1) Management believing that, at best, unions and collective bargaining are necessary evils in modern industrial society.
2) Labor leaders believing that their main job is to challenge and protest managerial actions.
3) Both parties disagreeing about the appropriate scope of collective bargaining and the issues that should be subject to joint determination.
4) Management and union competing for the workers' loyalty.

5) Management and unions agreeing that major differences in collective bargaining are settled on the basis of the relative power of the company vis-à-vis the union.
6) A mutual desire to contain conflict and negotiate differences under the terms of a collective bargaining contract.

3. Working Harmony

Working harmony is defined as:

1) Management's acceptance of collective bargaining based on its conviction that the union is an asset as well as a liability in running the business.
2) Union's conviction that the attainment of its objectives depends in large measure upon the continued prosperity and well-being of the company with which it bargains.
3) Both parties' aware that although their objectives conflict in important areas, compromises can be negotiated that allow each side to feel that it is advancing its interests.
4) Management retaining the sole responsibility for core functions in running the business while the union polices the managerial actions and removes obstructions which lie in the path of efficient production.
5) A broadening of the scope of issues subject to joint discussion and negotiation.
6) Each party's recognition of the complexities of the other's internal problems coupled with a willingness to help solve some of the thorny issues.

Working harmony is characterized by the use of labor-management committees, quality circles or action teams, joint study teams, and other parallel and limited cooperative autonomy.

4. Worker-Management Cooperation

Worker-management cooperation is the most difficult to achieve and occurs in the fewest organizations. It is described by the following characteristics:

1) The management's conviction that the union is both willing and able to organize cooperative activity among the employees to achieve lower costs and increased efficiency.
2) The company's willingness to share some vital managerial functions with the worker representatives.
3) The union's eagerness to be a production-boosting partner in return for tangible and intangible benefits for the union and its members.
4) Both parties assuming joint responsibility for solving production problems and eliminating obstacles interfering with greater efficiency.
5) Mutual trust and respect coupled with expressed confidence that union-management partnership “pays off” for both parties involved.

Originally, in the United States, this highest kind of labor management cooperation described the union-management relationship developed in 1939 between the American Velvet Corporation in Stonington, CT, and the Clothing Workers Union. That ongoing relationship includes the union

in production planning and results in gainsharing payouts to the workers. It demonstrates that cooperation can be maintained over a long period of time when both parties are committed to the process and are willing to do what is necessary to make it work.

Examples of union-management cooperation are the GM and the UAW in their Saturn project in America and the Shell-Sarnia plant and Chemical Workers Union of Canada. More recently, 3M and Vertex Data Sciences are good examples of how labor management cooperation has been achieved by two enterprises in Great Britain.

6.1.4 Trends motivating worker-management cooperation

What are the trends that are motivating unions and managements to embrace cooperation? There are a number of contributing factors to managements and unions that lead to their increased desire for cooperation. A few of these are:

- **Responding to global and domestic competition**. The greater the competition to an enterprise, the more incentive there is to cooperate for mutual survival. Conflict becomes a destructive luxury.
- **Economic restructuring in transition countries**. In countries undergoing economic restructuring and privatization, old worker-management relations have been destroyed. New ways must be found to work together in a market economy—especially if the enterprises are to be competitive in the face of global competition and the workers and managers are to have any prospect of saving their enterprises or retaining their jobs.
- **Coping with a changing workforce**. When workplace demographics change, employers and unions must adapt to the new realities.
- **The dynamics of new technology**. Modern technology requires new modes of organization and production. New technology can have enormous impacts on safety, skill requirements, and job security for workers.
- **Flexibility as a new management imperative**. The realities of today's world require that organizations change or die. The pace of change has increased dramatically in the past two decades, and organizations must respond or suffer the consequences.
- **The demand for employment security**. Workers and their unions have responded to the impact of rapid change and the need for flexibility by employers with an increased sense of insecurity. The need for job security can outweigh the demands for pay and benefit increases. There is no quality of work life if there is no work. In order to preserve jobs in the future requires unions to become more involved with management in improving present operations and shape the future to include continued employment.

The remaining sections of this chapter are focused on two areas: (1) how the two parties to a labor-management relationship, managements and union leaders, can achieve greater cooperation in their worker-management relations; and (2) what are some of the tools that can be used to help them achieve this objective.

6.2 Conditions for successful labor-management cooperation

Studies conducted in the U.S. over the years have concluded that nine conditions are necessary for successful labor-management cooperation:

1) The ***management fully accepts the collective bargaining process and unionism***. The company considers a strong union as an asset to management.
2) The ***union fully accepts private ownership and operation of the business***. It realizes that the welfare of its members depends upon the success of the business.
3) The ***union is strong, responsible and democratic***.
4) The ***company stays out of the union's internal affairs***. It does not try to alienate the workers' allegiance to their union.
5) ***Mutual trust and confidence exist*** between management and the union. There are no serious ideological incompatibilities.
6) ***Neither party to bargaining adopts a legalistic approach*** to the solution of problems in the relationship.
7) ***Negotiations are problem-centered***--more time is spent on day-to-day problems than on defining abstract principles.
8) ***There is widespread union-management consultation*** and highly developed information sharing.
9) ***Plant grievances are settled promptly***, with flexibility and informality, whenever possible.

6.3 Maintaining successful worker-management cooperation

Too many employers and unions overlook the following three key factors that affect the continued success of labor-management cooperation programs:

Labor-Management cooperation programs are not permanent. Successful L-M cooperation programs require continual hard work and constant renewal, including a formal structure and adaptation to the changing environment. Structured programs last far longer than informal programs based on the personal relationship between the union and management leaders.

Macroeconomic forces affect the longevity and incidence of successful L-M cooperation programs. These programs appear to thrive during periods of crisis, national emergency and strong competitive pressures on the economy. Outside forces encourage unions and management to cooperate. Without outide pressure, management often mistakes good fortune for good management. Unions are more cooperative when employers accept their legitimate role and unemployment and competition from external forces and nonunion shops squeeze them.

Historically, there has been competition between joint union-management programs and management-initiated avenues for worker participation. Because many employers are constantly trying to make unions unnecessary, unions often fear company-initiated programs.

History suggests that unilateral management programs usually fail. They either fold due to a lack of sustained interest or inadvertently fuel unionization by showing that collective action is necessary for lasting improvements in working conditions. (In the *Electromation* labor law case in the U.S., the National Labor Relations Board and courts found that the employer dominated the program and used it to subvert the process of collective bargaining—the management selected the employees who discussed wages, etc.)

Cooperation alone cannot solve all the economic and social problems that employers and unions face, but it can definitely improve working relationships.

In traditional adversarial labor relations, the union is usually inflexible and opposed to any change. In a cooperative environment, the union and management work together to achieve improvements that are mutually beneficial.

6.4 Benefits of worker-management cooperation

Both unions and managements benefit from cooperative approaches to labor-management relations.

6.4.1. Benefits to workers and unions

The Benefits to workers and unions include:

- ☑ Increased access to information and prenotification of changes in work arrangements and technology
- ☑ Additional input to help management avoid errors or decisions that would hurt union membership
- ☑ Fewer grievances; worker concerns are resolved more quickly and more fully
- ☑ More interest and activity in the union
- ☑ Increased work satisfaction
- ☑ Increased union ability to address a broader range of workers' concerns
- ☑ Increased membership education and skill levels
- ☑ Reduction in stress caused by poor supervision
- ☑ Improved communication with co-workers.
- ☑ Increased union visibility that projects a better image
- ☑ Customers impressed by the cooperative spirit
- ☑ Improved bottom line company performance that may provide more money for wages and benefits, for modernization and expansion, or for health and safety improvements
- ☑ Improved efficiency and productivity that may ensure that jobs are not lost and may facilitate expansion and more jobs

6.4.2 Possible risks for workers and their unions

There are, of course, some potential pitfalls or risks when workers and their unions enter into greater cooperation with management.

- ❑ The union may become an apologist for management and lose its credibility with the workers
- ❑ Cooperation in joint activity could be a preamble to softness in negotiations over traditional matters such as wages and benefits
- ❑ Direct communication from management to workers without acknowledging the union's role may weaken the workers' allegiance to the union
- ❑ Efforts should not contradict uniform rules or lead to unequal treatment of employees
- ❑ Other dangers could be political splits, contract violations, job loss resulting from increased productivity or speedups, downgrading of jobs, etc.

How can unions avoid co-optation?

- ⇒ A union should keep its own interests in mind during the development and maintenance of a joint effort. A union should get involved because the program helps it meet its own important objectives.
- ⇒ The program should be truly equal and joint.
- ⇒ The union must be knowledgeable about cooperative programs and the proper ways to design them.
- ⇒ The union must participate in the evaluation of the program to understand whether the union has been co-opted.

6.4.3 Possible benefits to management

Why should management cooperate with workers and their union?

- ❖ Management is concerned with obtaining the best possible return on assets. The union should be considered as an asset. Given the cold realities in the business world, cooperation makes sound business sense.
- ❖ Union-management cooperation in its participatory forms is an extension of the management principle of delegating responsibility. Delegating more responsibility to the workers leaves management free to deal with other issues.
- ❖ By taking the initiative in seeking union-management cooperation, management affirms its overall responsibility for leadership. Cooperation is not giving in, but rather a way for management to further its goals and objectives, resulting in more effective, stronger management.
- ❖ Flexibility is a central management imperative. L-M cooperation increases flexibility and reduces rigidities of hierarchical management structures.

What benefits can worker-management cooperation provide to management?

- ☑ A forum to review budget considerations, complaints and other management concerns. The forum enables employees to better understand management's concerns and positions on issues.
- ☑ An opportunity for advanced discussions of operational problems, planning and scheduling and other matters that impact on employee work schedules, overtime schedules, layoff, recalls, temporary transfers or new job opportunities. Because

employees frequently resist new proposals that are unilaterally initiated by management without employee input, labor-management committees provide a forum for resolving such resistance before it arises.

- ☑ An open channel of communication to establish rapport with the union. To avoid getting bogged down in small issues, day-to-day labor relations problems, such as grievances, are not discussed.
- ☑ An opportunity to respond to employees' ideas, suggestions and complaints. This demonstrates to the union and employees that management is sincerely interested in improving the workplace.
- ☑ A means of communicating with employees through their elected leaders.

Other reasons for management's participation:

- ❑ It motivates employees to do their jobs well. It enables management to work with employees in new ways.
- ❑ Involvement in cooperative activities has a positive impact on labor negotiations and contract administration. It helps both managements and unions to improve their problem solving, communications, planning, and group processes skills. In turn, management and unions apply these skills during contract negotiations. As a result of cooperation in other areas, day-to-day contract administration becomes more problem-solving and problem-preventing oriented. Resources traditionally used for contract negotiations and administration can be redirected into cooperative problem solving and problem prevention, making the managers' jobs easier.

6.4.4 The bottom line: Payoffs to management and workers

- ☑ **Higher profitability**
- ☑ **Improved management effectiveness**
- ☑ **Increased organizational flexibility**
- ☑ **Improved working environment**
- ☑ **Enhanced productivity**
- ☑ **Stronger market profile**
- ☑ **Greater employment security**

6.5 Moving from conflict to cooperation

Many labor-management relationships are adversarial and based on confrontation and conflict. In the U.S., academicians, consultants, and the U. S. Department of Labor have developed several approaches or processes to help labor and management make the difficult transition from adversarial to more cooperative relationships. Most of these methods use or modify the collective bargaining and dispute resolution processes as the basis for reducing conflict and increasing cooperation. They start with the existing bargaining relationship and introduce a set of carefully designed techniques or procedures into the negotiating process to help the parties diagnose overall problems in the workplace and assess the nature of their relationship. Working

together, they identify and solve problems and initiate other confidence building and cooperative activities. Eventually, the self-defeating adversarial bargaining is replaced by mutually beneficial integrative bargaining.

Five examples of techniques that can be used to help unions and managements to accomplish the transition from conflict to cooperation in collective bargaining relationships are:

1. Federal Mediation and Conciliation Service (FMCS) -- Relations by Objectives
2. Blake-Moulten/ECR & Associates -- Conflict Resolution Model
3. USDOL -- Interest-based Negotiations
4. USDOL – Interest-based Grievance Handling
5. USDOL -- Partnership for Change

6.5.1 FMCS -- Relations by Objectives

The ***Relations by Objectives (RBO)*** process, developed by the U.S. Federal Mediation and Conciliation Service (FMCS) in the 1970s, uses the existing collective bargaining relationship as a springboard for the formation of joint labor-management committees and other cooperative activities. RBO is proposed by the FMCS mediators to de-escalate hostility and conflict when unions and management have been involved in a history of conflict and mediator intervention. It works best when the top leadership acknowledges the problem and is committed to rescuing it.

RBO consists of an intensive six-step conflict resolution process that guides the participating union and management group through an analysis of their present hostile relationship, the setting of mutually acceptable objectives to improve that relationship and the planning of action steps and a timetable to meet their objectives.

The RBO process is taught in an intensive four-day workshop with labor and management representatives—after a planning meeting is held by a facilitator to brief the parties and obtain their commitment to participate in the workshop. Six steps are carried out during the workshop:

1. During the first step both the union and management separately analyze their relationship. Each party then lists what it can do to improve joint cooperation. Most of the discussions center on operational issues in the organization.
2. The second step consists of a joint meeting where the two lists are shared, clarified, and discussed. Those lists usually contains some overlapping goals.
3. In the third step the parties agree on a single list of goals for improvement.
4. During the fourth step the group breaks down into smaller union-management teams to discuss action steps on the goals identified.
5. During the fifth step the teams report back to their union and management groups what they have discussed and the proposals they wish to put forward.
6. During the sixth and final step they come together to review the action items and agree on a course of action.

Joint initiatives that emerge from the RBO process are maintained in an on going way through an action plan and a joint committee. Sometimes the FMCS mediator assists with follow-up or may even serve as chair of the joint committee.

ACTION MODULE: Steps to implement the Relations by Objectives Process

Starting a Relations By Objectives (RBO) program. As discussed above, the mediator-directed RBO process developed by the FMCS is designed to improve the relationships between labor and management bargaining groups that are experiencing considerable hostility in their current relationship, and their leaders want to improve the situation. The process is designed to start with the existing relationship and through a series of structured steps seeks to reduce conflict and move the parties toward the acceptance and implementation of mutually agreed objectives that will improve their relationship.

Step 1: Hold separate planning meetings with the facilitator

Separate planning meetings are held between Federal Mediators, company and union officials at appropriate levels to review the RBO program and obtain a commitment to participate.

Program participants include top management officials, production managers industrial relations and other company personnel. Union personnel include the grievance committee and local union officers.

The RBO program is conducted in a retreat setting involving three or four days of intensive 10-14 hours a day. The size of the groups range from 20-40 persons

Step 2: Divide up into mixed L-M teams and a facilitator

Upon arrival at the retreat site the group is divided into teams comprised of labor and management members and a facilitator. Through a series of group exercises followed by audio-visual presentations and discussions, the teams carry out four exercises. answering such questions as: What do you expect to gain from this program?

Step 3: Convene into labor and management conferences to address specific questions

The parties are then split into labor and management conferences with a facilitator in each conference group to address two questions:

1. What should the other party be doing to improve labor-management relations?
2. What should you be doing?

Each conference group prepares a list of answers for each of the two questions.

Step 4: A joint meeting is held to share lists, clarify and narrow the list of objectives

After consolidating the lists, the facilitators bring the labor and management groups back together to review the lists and narrow the selection of mutually agreeable objectives on each list.

The entire group is asked to consolidate the four lists into a single list of mutual objectives. The goals usually fall under one of several headings:

- Labor-management communications
- Management attitudes and practices
- Forman-steward relations
- Training needs

Step 5: The four subject area lists are given to mixed L-M teams to develop action steps

The general subject areas are then divided between the original "mixed" labor-management teams. Their assignment, with the facilitators help, is to develop specific action steps to accomplish the goals agreed to in the previous step.

Step 6: The management and labor conferences review the action steps proposed

Management and union groups meet again in separate conferences to review the mixed team action steps developed to achieve the objectives on which the two sides have already agreed.

Step 7: Entire group reassembles to review goals, action steps and agree on next steps

The entire group reassembles to hammer out any differences.

A review is made of the goals, action steps, and assignments of responsibility, and a timetable for resolution of the problems is adopted. This concludes the formal RBO training program.

Results achieved by RBO programs:

- ☑ A general reduction of friction in labor-management relationships
- ☑ Fewer strikes
- ☑ Reduction in the number of grievances
- ☑ Organization of formalized joint labor-management committees to continue the program

6.5.2 Blake-Moulton/ECR & Associates -- Conflict Resolution Model

Where there is intense labor-management conflict, a ***Conflict Resolution Model (CRM)*** based on behavioral science theory about inter-group relations could be used. One such model is the Blake and Moulton conflict resolution model. This approach helps the parties recognize union and management disputes as symptoms of a pathology in the problem-solving area, diagnose the causes that produce the symptoms, and directly deal with the causes rather than just treat the symptoms.

In the CRM model, the union and management parties focus on understanding the character and nature of their relationship, not on directly resolving concrete issues. The participants in CRM training develop self-images and images of the other party, share and discuss these perceptions and their implications, diagnose their current relationship, consolidate understanding on key issues and points of friction, and end with plans for the next steps in the resolution of commonly perceived problems.

A variation of this model, promoted by the ECR & Associates consulting group in Virginia, begins with the parties separately identifying their ideal relationship. Five questions guide them in the process:

1) What kind of labor-management relationship would help you meet your own responsibilities?
2) In the normal course of labor relations, how can you work together?
3) How can the labor-management relationship contribute to the best operation of the organization now and in the future?
4) How should people involved in this relationship treat one another?
5) What can the other party reasonably expect of you?

This conflict reduction process encourages an open but private exploration of thoughts, feelings and options by management and the union. First, union and management participants expand their notions of what is possible in the relationship. Then, they join together to develop a common list based on the overlap between their separate lists, including items on each party's list that the other party finds acceptable. The common list include items on which there is broad consensus. There are always items that are not agreed on, ensuring the integrity of the process.

A "what-then" feedback format provides insight into the current situation while avoiding personality conflicts. Participants learn how to give constructive feedback to get important feelings and issues into the open. Each group separately examines questions such as: What situations cause you the most difficulty in doing your job? What situations make you angry or upset with the other party? What behaviors do you find counterproductive or wasteful? What situations make you most pleased, or what behaviors do you find most welcome? Each group comes to understand its current relationship.

After brainstorming the barriers between the real and ideal in mixed union-management groups, the parties know what the current situation is, where they want to go, and what is blocking their

progress. The labor and management participants separately identify their institutional interest in moving forward and unilateral actions that would help the relationship progress. Making unconditional commitments to improve their relationship helps both parties demonstrate trustworthy behaviors that are also in their own interest.

Together the parties develop joint-effort strategies.

6.5.3 "Interest-based" Negotiations

The most recent and widely adopted approach to improve collective bargaining and develop more cooperative labor-management relations in the United States is ***Interest-based Negotiations (IBN).*** (Sometimes it is called P.A.S.T., "win-win," or mutual gains bargaining.) IBN was developed by the U.S. Department of Labor and others using the integrative bargaining concepts first identified by academics Richard Walton and Robert McKersie in the 1960s. The concepts were subsequently refined and elaborated by the Harvard Negotiation Project in the 1980s.

IBN is based on problem-solving principles and the belief that, fundamentally, collective bargaining is a problem-solving exercise. The IBN process assumes that each party to labor-management negotiations comes to the table with a set of problems it wants to resolve. For example, management may be concerned with overall compensation costs, flexibility in operation, absenteeism, and a host of other issues. The union may be concerned about rising living costs, job security, career mobility, and fair treatment in the workplace.
In traditional bargaining, sometimes called distributional or positional bargaining, concerns take the form of proposals and counterproposals or demands. A fair compromise is attempted, but both parties seek to distribute the benefits as closely as possible to their own bottom lines.

Integrative bargaining focuses on the problem at hand, not simply the specific proposals. The IBN approach to integrative bargaining consists of a six-step problem-solving process based on four fundamental principles that work well in labor-management relations because the parties, whether they like it or not, are so reciprocally dependent.

The IBN approach also can be used in a wide range of fields, from community relations, labor-management relations to international conflict and commercial negotiations.

<u>Six-step IBN problem-solving cycle</u>

The six-step problem-solving cycle is the core of the IBN negotiations process. The essential steps are:

I. Select an issue

Jointly select an issue
State the issue clearly

II. Develop and discuss all interests behind the issue

Flipchart interests
Post and review the flipcharted lists of interests
Discuss and clarify each interest. Inspect the list for position statements.
Convert each to an interest by exploring the concern, need, or problem the position is trying to resolve.
Identify mutual interests
Recognize the legitimacy of the interests and the full scope of the issue--mutual as well as separate interests.
Restate the issue as appropriate.

III. Generate options

Use brainstorming. Generate as many options as you can to meet the expressed interests and use the flipchart to record every idea. (Remember the brainstorming rules -- no judging, aim at quantity not quality, piggyback on the ideas of others, and work through a pause.)
Generate options that
satisfy one or more interests
satisfy others' interests

Clarify and ready options for evaluation. Eliminate duplicates; combine pieces of options to form complete options.

IV. Establish standards or objective criteria

Propose possible standards--qualities of a solution
Clarify the meaning of each proposed standard
Reach consensus on standards

Examples of standards: simple, fair, affordable, legal, workable, industry practice, cost, efficient, equitable, flexible, ethical, practical, ratifiable

V. Evaluate each option against the standards

Discuss each option
Various evaluation techniques are available to assist the parties in reaching consensus on the best option or solution, e.g., mutually developed criteria or multi-voting.
Amend, combine, or develop new options
Eliminate options which meet few or none of the standards

VI. Develop the solution and capture it in writing

Combine options, or elements of options, that meet the standards. Strive

to create the solution that meets as many interests as possible.
Reach consensus on the solution
Draft the solution or appoint a committee to draft it.
Check for consensus on the written solution.

The negotiating teams apply these steps to each issue on the list of issues and interests compiled by each party prior to the starting of negotiations. Every step in the problem-solving cycle is conducted jointly with full participation of each member of the negotiating teams.

IBN negotiators use a variety of techniques to help develop consensus solutions, including brainstorming, consensus decision-making, listening and clarifying, process checking, converting positions to interests, and recording decisions using a matrix.

Four basic IBN principles

The four basic principles underlying the IBN process are:

1. *"Separate the people from the problem*." Be hard on the problems and soft on the people. Pay attention to maintaining long-term, positive relationships by separating the specific issues of disagreement from personal antagonism. Key behaviors that help support the relationship during negotiations include: imagining oneself in the other party's shoes, not blaming the other side for one's problems, discussing each other's perceptions, and phrasing proposals so they are consistent with their counterpart's values. Active participation by both parties in the exploratory process to develop greater commitment to arriving at workable solutions. Good communication skills are essential.

2. "Focus on interests, not positions." Each side comes to the bargaining table with legitimate interests, usually multiple interests without equal weight. The parties openly acknowledge each other's interests. By so doing they may uncover areas of common interest. Some interests may be different but complementary, such as increased productivity and increased wages. This helps build the framework for agreement.

By becoming sensitive to each other's interests, both of the parties can address their own interests while working to bring about mutually rewarding results.

3. "Invent options for mutual gain." Four areas inhibit the generation of options: "(1) premature judgment; (2) searching for the single answer; (3) the assumption of a fixed pie: and (4) thinking that solving [the other party's] problem is their problem." The parties need to be creative to generate a variety of solutions for difficult problems. They need to ask "what if?" and explore each option. Rarely is there a simple, single, either/or choice.
Reframing the issue can put it into a new perspective. Breaking the problem up into its constituent causes or parts and trying to solve each cause or part is also helpful.

4. "Insist on using objective criteria." Problem-solving often breaks down because of pressure exerted by the union and management. Consequently, before agreeing to specific proposals, labor and managements must agree on the common criteria for acceptance. The

criteria may include standards of cost, fairness, reciprocity, professional standards, prevailing rates and conditions, scientific measurements, precedents, equity, legality, effectiveness, verifiability, and/or other mutually agreeable measuring rods. Merit and common criteria provide a common framework for the parties to jointly discuss and evaluate proposals. They help ensure that the outcomes advance the interests of both parties.

The parties should "(1) frame each issue as a joint search for objective criteria; (2) reason and be open to reason as to which standards are most appropriate and how they should be applied, and (3) never yield to pressure, only principle."

Interest-based negotiations enhance the long-term relationship while opening up options for the resolution of both side's pressing issues. They give both the union and management the right to assert their interests and to withhold agreement until they feel they are sufficiently met.

The results achieved by hundreds of organizations using IBN have almost always been an improvement over their past bargaining practices.

Consensus Decision Making:

The parties reach consensus when all members agree upon a single alternative, and each group member can honestly say:

I believe that you understand my point of view and that I understand yours.
Whether or not I prefer this solution, I support it because--
--it was reached fairly and openly, and
--it is the best solution for us at this time.

Guidelines on Reaching Consensus:

- Listen: Pay attention to others
- Encourage participation
- Share information
- Don't agree too quickly
- Don't bargaining or trade support
- Don't vote
- Treat differences as a strength
- Avoid arguing blindly for you own views
- Create a solution that can be supported

Definitions

Issue: a subject under discussion; the what, the problem to be solved.
Interest: one party's concern, need, or desire, behind an issue; why the issue is being raised.
Mutual interest: an interest both parties hold in common.
Separate interest: an interest only one party holds, but not necessarily one that interferes with or precludes an interest of the other party.
Position: one party's proposed solution to an issue; the how.
Option: a potential, often partial, solution that can meet one or more interests.

Solution: an agreement reached by the parties using consensus, after the evaluation of options.
Techniques: skills required for interest-based problem-solving.

⇒ ***Brainstorming:*** a process used by the parties to create as many ideas as possible in a short period of time; a process to generate innovative and creative ideas.

⇒ ***Listening and clarifying:*** Listening is the capacity to hear effectively, understanding the words as well as the emotions and body language of the speaker. Clarifying is asking questions to verify or expand upon the information received.

⇒ ***Consensus decision making:*** A consensus decision is one about which each group member can honestly say: "*I believe that you understand my point of view and that I understand yours. Whether or not I prefer this decision I support it because…It was reached fairly and openly, and it is the best solution for us at this time.*"

⇒ ***Process checking:*** Process checking is a technique for monitoring adherence to the interest-based process and the interactions of team members.

⇒ ***Converting positions to interests:*** If a demand, solution, proposal, or position appears on your interest list, convert it to an interest by asking what problem it is trying to solve or what concern it is intended to address. An issue is a subject under discussion or negotiation; the *what*, the problem to be solved. A position is one party's proposed solution to an issue; the *how*.

⇒ ***Recording:*** Recording is the writing of spoken ideas on a flipchart for all team members to see. Recording is used to capture: ground rules, issues, interests, options, standards, and solutions.

⇒ ***Use of matrix:*** Some teams create a matrix to record the group's consensus on the degree to which the option satisfies each standard or criteria.

Action Module: Steps to implement Interest-based negotiations

There are four steps or stages in the interest-based negotiations (IBN) process. These steps correspond generally to the major stages in traditional negotiations, but the process and techniques used are quite different.

Step 1: Prepare for Interest-based negotiations

- ❑ Educate constituents about the IBN process.
- ❑ Inform constituents of why you have chosen this process and seek their support for embarking on a new process.

  Educate constituents on the supporting principles, problem-solving steps and expected outcomes.

- ❑ Seek Information from constituents.
- ❑ Use surveys, interviews, information meetings, or informal discussions to help surface

constituent interests around the issues.
⇒ clarify the diversity of constituent issues and interests
⇒ get “buy in"-participation-in the process so that the negotiating team can work in a supportive environment, and
⇒ help establish the relative importance of various issues and interests.

- ❑ Compile a list of Issues and Interests.
  Using the information gathered from constituents, compile a list of issues and interests. Inspect the list for position statements. Convert each to an interest by exploring the concern, need, or problem the position is trying to resolve.

.

- ❑ Write an opening statement
  This statement reaffirms your commitment to the interest-based process and expectations and objectives for the negotiations. It will be shared with the other party at the opening of negotiations.

- ❑ Convene a pre-negotiations meeting
  ⇒ Share the issues lists with the other party before negotiations so that they have time to prepare interests on all issues.
  ⇒ Share your proposed ground rules and work to reach consensus on a final set of ground rules. . You may wish to post your ground rules for reference during negotiations

Step 2: Open Negotiations

These two steps are accomplished jointly.

- ❑ Share opening statements.
  . Discuss your opening statements affirming the joint commitment to the interest-based process.

- ❑ Discuss the lists of issues.
  Clarify and understand the scope of the issues.

Step 3: Negotiate using the six step interest-based problem-solving cycle

The following six-step problem-solving cycle is repeated for each issue the parties are negotiating. All steps are accomplished jointly.

1. **Select an issue**.(What)

   Jointly select an issue.

State the issue clearly. Clarify the issue as needed to insure that the group has a mutual understanding of the meaning.

2. **Discuss all interests behind the issue**.(Why)

The understanding of interests is key to the interest-based process.

Interests are brainstormed first, and then clarified as needed.

Post and review your flipcharted lists of interests around the issue.

Discuss and clarify each interest. Convert any remaining position statements to interest statements.

Identify mutual interests: circle the interests appearing on both lists.

Recognize the legitimacy of the interests and the full scope of the issue-mutual as well as separate interests.

Restate the issue if appropriate.

3. **Generate options**.

Use brainstorming to develop as many options as you can to meet the expressed interests and use a flipchart to record every idea. (Remember the brainstorming rules-no judging, aim for quantity not quality. try to break set, piggyback on the ideas of others, and work through a pause.)

Generate options that
⇒ satisfy one or more interests
⇒ satisfy interests other than your own

Remember that options are not commitments.

Clar1fy and ready the options for evaluation. Eliminate duplicates; comb:f'e pieces of options to form complete options.

4. **Propose qualities of a solution**.

Select objective criteria to evaluate the options.

Clarify the meaning of each criterion or standard proposed. Eliminate redundancies; combine overlapping criteria or standards.

Reach consensus on criteria or standards to narrow the options.

Examples of *standards*

simple	efficient
fair	equitable

affordable	flexible
legal	ethical
workable	practical
industry practice	ratifiable
cost	common area practice

5. **Evaluate each option against the criteria selected**.

   Discuss each option. At this point the parties discuss the various options using the criteria to develop a solution.

   Negotiators may amend options, combine them, or think of new ones as the evaluation proceeds. Add revised or new options to the end of the list to be evaluated in turn.

   By consensus, eliminate options that meet few or none of the criteria or standards.

6. **Develop the solution and capture it in writing**.

   Combine options, or elements of options, that both
   ⇒ meet the criteria and
   ⇒ .meet as many interests as possible.

   Reach consensus on the solution. This is not just a settlement but a consensus decision to accept the solution. Use consensus guidelines:
   ⇒ Free discussion is encouraged
   ⇒ Issues are discussed, people are not attacked
   ⇒ Listen to other ideas
   ⇒ Discuss differences openly, but avoid competing or arguing
   ⇒ Strive to reach a durable solution, not just a settlement
   ⇒ If a person disagrees with the group consensus has not been reached
   ⇒ Person who disagrees must offer an option to meet his needs.

   Draft the solution, or appoint a committee to draft it.

   Check for consensus on the written solution

- ❑ As noted at the beginning of Step 3, *the interest-based problem-solving process is repeated for each issue the parties are negotiating*. When all issues identified in Step 2 have been resolved to the satisfaction of the parties, the negotiations are completed.

Step 4: Communicate the Results to Constituents

- ❑ Prepare a joint statement about the process and its results.

- Using the prepared statement, inform the constituents (bargaining unit members and management group) of the results

In addition to the interest-based negotiations process that has been described above in this section, the USDOL also developed and field-tested interest-based methodologies and training materials that can be used in grievance handling and other forms of conflict resolution and problem-solving in the workplace. These materials are included in the next section, and referenced in Annex 1 at the end of the Chapter.

6.5.4 Using Interest-based grievance handling to settle rights (or other) disputes

In market economies like those in North America and Western Europe, labor-management relations systems are typically based on collective bargaining. These systems usually have some formally structured procedure to adjudicate worker grievances arising out of the application of the collective bargaining agreement at the enterprise level. There may be (1) a publicly established labor court system to adjudicate disputes and grievances arising out of the administration of the agreement, or (2) a grievance system contractually established by the parties for the handling of rights disputes arising out of the collective bargaining agreement. The steps in this second system allow an aggrieved worker to have an issue discussed at several levels: first by a supervisor and shop steward; and then at higher management-union levels If the grievance is not resolved satisfactorily at these levels, the issue is normally taken to arbitration, where it is resolved by a outside arbitrator selected by the parties.

Because of the success of this contractually established grievance systems in the United States, most public and private sector collective bargaining agreements have embraced this approach.

The large number and variety of cooperative labor-management programs developed during the 1970s and 1980s focused primarily on the non-contractual aspects of the L-M relationship. They deliberately avoided infringement on the rights established in the collective bargaining agreement and the system for adjudication of those rights, the grievance system.

However, with the introduction of interest-based approaches to negotiations described in this chapter, in the late 1980s and early 1990s, it was inevitable that these innovative and more cooperative interest-based processes would be used within a rights-based framework to resolve grievances and problems of contract application and interpretation within enterprises as well. Consequently, the United States Department of Labor's Bureau of Labor-Management Relations and Cooperative Programs began exploring the use of interest-based grievance handling for rights disputes. As a result of the early successes achieved, an interest-based grievance handling process was actively promoted by the bureau, and training materials prepared and circulated to facilitate its adoption and use. It is now seen as a natural complement to those enterprises that have adopted interest-based negotiations and who are seeking to become "high performance" workplaces.

6.5.4.1 Grievance handling dispute resolution systems

It is useful to consider the interest-based grievance handling process within the context of the other dispute resolution tools or systems available to those employers and unions seeking to build more cooperative labor-management relations and high performance workplaces.

Because of the nature of labor-management conflict in the workplace, sometimes the parties cannot solve a problem in the workplace, even with the help of a union representative and a labor relations advisor using the interest-based techniques and processes. Sometimes the issue, problem, or grievance will be moved to the third step of the grievance process—grievance arbitration or a labor court. In situations where labor and management are seeking to use a more cooperative approach in their relationship—in addition to interest-based negotiations—there are several possible models for this next step. Some of these are:

1. Grievance mediation

Grievance mediation is where a mutually agreed upon third party is designated to use mediation skills to help the parties resolve the conflict.

Advantages:

- Used to avoid arbitration or the labor courts
- Like a pre-trail session
- Sometimes a respected outsider can help uncover underlying problems that have not yet surfaced.
- It is a fluid procedure with few rules (unlike arbitration)
- A mediator whose focus is on uncovering interests and provides the parties with substantial voice in the process and settlement can be quite effective

Disadvantages as perceived by the parties:

- Outcome is unpredictable because arbitration hearing rules do not apply (advantage or disadvantage?)
- Emphasis on compromise may be seen negatively by those organization and union representatives with a highly developed sense of right and wrong. Compromise is not always satisfying to people involved in a dispute.

2. Internal or External, Ombudsman

An ombudsman is when a neutral party, internal or external, is designated to help the parties resolve the issue. It is often used to help resolve non-contractual issues. This person may also be used to resolve contractual issues.

Advantages

- ❖ Advantages are the same as using a mediator: informal, uncovers interests, parties are active participants in the process.
- ❖ An internal ombudsman may have the extra advantage of familiarity with the organization; the organizational culture and the people who work there.

Disadvantages

- ❖ Disadvantages may be the same as using a mediator; unpredictable outcome; compromise is something dissatisfying
- ❖ If an internal ombudsman, there may be some question as to impartiality "who's payroll" s/he is on.

3. Arbitration

The intent of arbitration is to avoid taking unresolved grievances to court. Abitration is the final step in most contractually established grievance procedures. It is a process by which the parties to a dispute submit their differences to the judgment of an impartial person selected by mutual consent. The parties jointly pay for the cost of arbitration. The parties have agreed to accept the decision of the arbitrator as final and binding. Originally, arbitration was intended to settle conflict, and avoid strikes that disrupted work. Although less formal than a court procedure, over the years a whole body of arbitration rules, procedures, and precedents have been established.

Advantages

- ❖ Provides an alternative to taking matters to court.
- ❖ Takes away the responsibility for conflict resolution. The "loser" can blame the defeat on "that arbitrator."

Disadvantages

- ❖ The parties are constrained from dealing with real interests.
- ❖ Someone else decides.
- ❖ It is more costly than settling prior to arbitration.
- ❖ The results in an arbitration may not produce a solution to the problem.

It should be noted that even where interest-based grievance handling procedures or other alternatives have been adopted, *arbitration should be used by the parties for certain types of disputes:*

- ⇒ Discharge cases where the union may have a significant risk of a "duty of fair representation" charge.
- ⇒ In significant cases that may set a precedent.

4. Joint Issue Resolution Team

A joint issue resolution team (JIRT) is a labor-management team, designated by union and management leaders, to solve rights conflicts in a public or private enterprises. The team uses the interest-based problem solving process to develop acceptable solutions to rights disputes. A JIRT can be a standing committee established by the contract, or may be formed as needed. The JIRT is comprised of impartial people—not involved in the conflict.

A number of businesses and other organizations (e.g., schools, utilities, manufacturing business, etc.) in the United States have included the concept of JIRTs as part of their grievance process. Each organization has determined the authority of the team.

A JIRT is usually activated after the parties have tried and failed to resolve a grievance through the first or second steps of their grievance procedure.

What are the advantages and disadvantages of using a JIRT to resolve rights disputes?

Advantages

- A JIRT strives to achieve procedural, substantive, and psychological satisfaction, resulting in a durable solution to a problem rather than just a settlement.
- The parties are part of the process, helping to achieve a resolution to their problem.
- It is less costly and quicker than using a mediator or artibrator.
- There is open information sharing for uncovering interests.

Disadvantagess

- There may be a reluctance to submit to “peer” review.
- The grievant cannot blame a neutral outsider for “defeat.”

6.5.4.2 Essential features of the Interest-based JIRT process

The JIRT discussed above uses the interest-based problem-solving process to resolve any rights grievance or problem situation referred to it by the management and labor union. The core steps in the interest-based grievance handling process are:

1. Gather all relevant information

   - Identify what happened
   - Ask questions

2. Define the issue

   - State the problem (What)

3. Explore the interests behind the issue

- ❑ Uncover hidden issues and problems
- ❑ What are the underlying concerns, cares, and fears behind the issue? (Whys)
- ❑ Clarify the parties' interests

4. Brainstorm options for solution/agreement

- ❑ All participants will brainstorm options
- ❑ What are potential solutions to the problems?
- ❑ How can the parties' interests be satisfied?
- ❑ Use brainstorming guidelines

5. Agree on objective criteria to evaluate the options

- ❑ Fair
- ❑ Equitable
- ❑ Workable
- ❑ Legal
- ❑ Affordable
- ❑ Others

6. Discuss the options based on the criteria

- ❑ Use open and free discussion
- ❑ Combine options to formulate best solution

7. Use consensus to reach a solution to the issue

- ❑ Use consensus to reach problem solution, not just settlement

8. Reduce the outcome to writing

- ❑ Check that the resolution is satisfying to the parties
- ❑ Is the outcome durable, or will the problem recur?

Note: If the resolution is not acceptable, the grievant using a JIRT has not waived the right to take the matter to arbitration.

6.5.4.3 Definitions of a grievance

If only contract violations are grievable, many problems may go unresolved or be ignored by management and the union. The broader the definition of a grievance the more problems that can be dealt with by management and the union. If the goal is to improve the quality of work life and to improve the organization, the more problems that can be dealt with the better.

Typically the contract defines what is a grievance. This varies among enterprises from a violation of the contract to anything that impacts on an employee's work performance

Some examples of grievance definitions used in high performance work organizations include:

Northwest Gas Co.

"…to resolve all issues which arise daily within the workplace."

Rohr Industries

"openness is the key to a harmonious and productive work environment. Individuals should feel free and secure enough to approach one another about mutual problems and concerns.
…to resolve problems with their Work Team using problem solving methods."

Dayton Power and Light

"Unlimited Referral. There is no limit on the nature of issues which may be referred to this process by employees, the Union, or the Company. The process will be used to advance positive ideas as well as to examing perceived wrongs."

Casper, Wyoming School District

"Grievance shall mean a claim by one or more employees of an alleged violation, misapplication, or misinterpretation of the professional negotiations agreement."

6.5.4.4 Steps to implement an interest-based grievance handling process.

ACTION MODULE: Steps to implement interest-based grievance handling

The management and labor groups that intend to use the interest-based grievance process should establish and train a JIRT to function in their organization. They must also establish, as part of their collective bargaining agreement, the framework, procedures and authority granted to the JIRT. The JIRT would then apply the core steps of the interest-based problem solving process in the following manner to address an issue or grievance referred to it for resolution by the party who filed the grievance.

Step 1: Preparatory activities of the JIRT members

Prior to conducting a joint interest resolution meeting, the management and labor members of the JIRT must separately accomplish three preparatory activities. Completing these steps are critical to the effective and expeditious handling of a grievance or issue by the JIRT.

1. **Gather all relevant information**

Identify what happened. Interview all parties involved in the incident (the employee and supervisor involved in the conflict, witnesses, others). Gather all paper records and relevant contract clauses.

2. **Define the issue**

Each party should discuss what happened and develop a brief statement of the problem or conflict

3. **Explore the interests**

Each party must explore the interests behind the issue.

These three activities must be completed by both parties in preparation for a joint meeting with the other party. Both management and labor members of the JIRT must be prepared with the information in order to continue the process in a joint meeting.

Step 2: Hold a formal JIRT meeting

The JIRT convenes a meeting to resolve the grievance, issue or problem to be considered. At the meeting the JIRT members carry out each step of the interest-based process as they work to come up with a solution for the grievance or issue presented.

The parties should use flipcharting to share the Step one information prepared and work through the remaining steps of the interest-based problem solving process. They should also remember that these steps are guided by the interest-based *principles* and *assumptions*.

The interest-based principles are codes of conduct or behaviors that guide the process::

- Attack the issue, not the person
- Focus on interest, not positions
- Focus on opportunities and possibilities
- Help satisfy the other parties interests as well as your own

The assumptions are a set of beliefs about using an interest-based process, which describe the positive results parties can hope to achieve:

- The interest-based process can result in both parties being satisfied with the outcome
- It can produce creative solutions to the conflict
- It can produce solutions that the parties are motivated to uphold
- It can improve the overall labor-management relationship

The JIRT proceeds to systematically complete each of the following interest-based grievance steps:

4: Jointly agree on the issue

The labor and management parties on the JIRT need to compare their individual statements of the problem or issue, and come up with a joint statement of the issue that all the members can agree on.

5: Explore and clarify the interests behind the issue

In Step 1 each party explored their interests behind the issue. At the joint meeting (Step 2) interests of each party should be shared with the other party. The other party listens and asks questions to clarify, but it is not a time for debate.

Note: In order to understand this step it is important that the parties understand the definition and use of the word "interest." Interests are defined as needs, desires, fears behind a conflict/issue. What one cares about or wants. The "why" behind an issue.

6. Brainstorm options for a solution/agreement

Options are potential solutions that can satisfy the parties' interests. The parties must ask what needs to happen to resolve the issue. The options should be generated based on the parties' interests. Brainstorming is a group process to generate ideas, and is used to identify options in a joint meeting. The guidelines for brainstorming are:

- ⇒ All ideas are recorded where all can see them (flip chart)
- ⇒ Members contribute ideas in rotation, all participate
- ⇒ Members contribute one idea per turn
- ⇒ Welcome creativity, avoid criticism or evaluation of ideas
- ⇒ Build on others' ideas
- ⇒ Don't critique or evaluate ideas at this time
- ⇒ Aim for quantity
- ⇒ Any member may pass; no comment
- ⇒ When all ideas have been given and recorded, a general discussion begins

5. Agree on objective criteria to evaluate the options

Criteria are objective standards to compare and judge the options. Examples are: :fair, equitable, legal, workable, and affordable. Criteria allow the parties to evaluate the options objectively.

6. Discuss options based on the criteria

At this point the JIRT discusses the various options using the criteria to choose a solution. Options can be combined to formulate the best solution. This should be an open and free discussion.

7. Use consensus to reach a solution to the issue

This is not just a settlement but a consensus decision to accept the solution. Remember the principles and assumptions of the process:

- ⇒ Free discussion is encouraged
- ⇒ Issues are discussed, people are not attacked
- ⇒ Listen to other ideas
- ⇒ Discuss differences openly, but avoid competing or arguing
- ⇒ Strive to produce a durable solution to the problem, not just a settlement
- ⇒ Consensus is reached when group members can say
  "I believe that you understand my point of view.
  I believe that I can understand your point of view.
  Whether or not I prefer this decision, I will support it because it was arrived at in a fair and open manner"
- ⇒ If a person disagrees with the group, consensus has not taken place

8. Reduce the outcome to writing

The solution should be in writing so that everyone has the same understanding as to the outcome.

- ⇒ Check that the resolution is satisfying to the parties.
- ⇒ Is the outcome durable, or will the problem recur.

Step 3: Communicate the results to the affected parties

When the JIRT has concluded its work, the results (solution) should be communicated to the grievant and other appropriate parties. The JIRT's work on this issue or problem is now complete. It stands adjourned until the next conflict is assigned to it for resolution.

6.5.5 Creating a "Partnership for Change"

When the dramatic changes created by globalization, the end of the cold war, reduced trade barriers and growing competitiveness, economic restructuring, and governmental downsizing converged on America in the early 1990s, labor and management were caught in the middle and have been struggling to adjust to the consequences of these changes. In a number of industries there has been a recognition on the part of both workers and management that if they and their organizations are to survive and prosper in the years to come they must fundamentally change the way they relate to one another, and that as part of the change process they must

fashion new and more cooperative relationships. Elected officials and labor leaders at the federal and state levels have also recognized the need to develop more cooperative relationships in an era where taxpayers are calling for smaller and more efficient governments.

To facilitate the achievement of these objectives, the U.S. Department of Labor has developed a series of training materials and workshops variously called "Training for Partnership," and "Partners in Change."

The Training for Partnership series consists of five integrated workshops that provide an effective learning environment to help public or private employers and their union-represented workers establish a dynamic labor-management partnership. The five components of the Training for Partnership Series are:

Training for Partnership Workshop Series

1. Preparing for Change
2. Crafting the Council
3. Promoting Partnership
4. Partners in Change - Working Together
5. Putting Partnership to Work

Modules in the five Training for Partnership workshops

1. Preparing for Change

A one day workshop in which labor and management discover and describe why they should participate in partnership activity. By the end of the workshop, participants will understand the benefits to be gained for employees, management, the union, their organization, and the enterprise or agency.

Modules:
- Introduction and objectives
- The new partnership environment
- Philosophies and practices of joint initiatives
- Brainstorming
- Benefits to be gained
- What can each party contribute
- Knowledge and skills needed
- Resources
- Wrap-up

2. Crafting the Council

A one day workshop in which labor and management design their road map to a partnership: establishing the agreement, membership, groundrules, and other logistics to get the partnership council started.

Modules: Introductions and objectives
The power of vision
Establishing the partnership council
Behavioral ground rules
Writing the agreement
Wrap-up

3. Promoting Partnership

A one day workshop in which labor and management conduct their first partnership meeting to review the newly created partnership agreement, discuss and plan the constituent review and ratification process, and use interest-based problem solving to design a structure for full employee involvement.

Modules: Review the agreement
Review and ratification process
Interest-based processes
Knowledge and skills needed
Resources
Wrap up

4. Partners in Change

A two day workshop in which labor and management representatives analyze their organizational culture, and political and technical systems, initiating a joint change process. Participants identify their separate and joint perceptions of their organization and create a joint vision of the future.

Modules: Introductions and objectives
Philosophies and Practices of Joint initiatives
Understanding organizations
Organizational culture
Organizational change
Brainstorming
Decision-making
Present state
Future state
Next steps
Wrap-up

5. Putting Partnership to Work

A one day workshop in which participants will identify priority issues to be addressed by the partnership council, learn and apply "interest-based" problem solving processes, and design action plans and strategies for achieving goals and objectives.

Modules: Introductions and objectives
Interest-based processes
Prioritizing goals
Develop an action plans
Strategies for success
Wrap-up

6.6 Building worker-management cooperation in the workplace

IBN or one of the other conflict-reducing approaches to bargaining can serve as the foundation on which to build labor-management cooperation. It can lead to additional joint cooperative activities, including using interest-based procedures for handling grievances and establishing labor-management committees and partnership councils to deal with issues such as health and safety, training, quality improvement, employee assistance and wellness, productivity improvement and cost saving, and energy conservation. This section will first discuss the characteristics and functions of labor-management committees (LMCs) and then discuss two specific uses of the L-M approach at the enterprise level that have been successfully used in North America to address the issues of restructuring and enterprise competitiveness.

6.6.1 Characteristics and functions of labor-management committees***

In a healthy, cooperative environment, the most common forum for union-management cooperation is the labor-management committee (LMC). In general, LMCs are appendages to existing structures used for communication and problem-solving. They serve as a bridge between collective bargaining and joint problem solving in the workplace. When well run, they have a positive impact on organizational performance and industrial relations.

LMCs are composed of management and worker representatives who meet to deal with mutually agreed upon topics. They may be general committees at the company level whose purpose is to maintain open communications between the union and management, such as the Mutual Growth Forum created by the United Auto Workers Union and the Ford Motor

*** Taken from National Center for Productivity and Quality of Working Life, Starting a Labor-Management Committee in Your Organization: Some Pointers for Action, Spring 1978.

Company, or they may be located at the plant level and oriented toward specific topics such as training health or safety.

Labor-management committees come into existence in several ways. Sometimes the collective bargaining contract calls for these committees and sometimes it does not. Often, they arise out of the collective bargaining arena because an issue is clearly of common interest and of an ongoing nature. For example, ***health and safety committees are the most common and most important specific labor-management committee***. (A nationwide study in the U.S. indicated that workers believe they should have a lot of say about health and safety.) Health and safety committees are relevant in almost all industries and work environments, manufacturing, transportation, building and construction, and offices. Where health and safety LMCs have been used, there has been a 40 percent reduction in injuries and a 20 percent increase in productivity in construction firms.

The second most important and common LMC is involved in joint training. Most apprenticeship training, and especially that occurring in the construction industry, is directed by joint training committees. These committees ensure that apprentices receive the training they need to be successful as journeypersons and also inventory workers' skills, assess recent changes, and determine future needs so as to establish effective continuing education programs.

In the U.S., the International Union of Operating Engineers and the Sheet Metal Workers' International Association and their contractors have connected apprentices and journeypersons to apprenticeship programs for college credit, leading in some cases to degree and certificate programs. In the telecommunications and auto industries, joint LMCs have been instrumental in organizing upgrade training for current employees and retraining for redundant workers with resources obtained through the use of "nickel funds"--financial contributions based on 5 or 10 cents for each hour worked--which help pay for the training and retraining courses.

In other instances ***LMCs may be created to deal with specific concerns, such as productivity improvement and cost saving***. The LMC at the New York City Sanitation Department has been very successful over the past decade in effecting cost savings in this department. Productivity Improvement and Cost Saving LMCs are becoming more widely used due to the impact of globalization on American businesses and the need for competitiveness.

In addition to operating at plant and company-levels, LMCs also operate at the area or industry levels. Area labor-management committees composed of representatives of many employers and unions in a community or region have been formed in many parts of the United States, forging partnerships for economic development in cities, counties, and states. The Jamestown Area Labor-Management Committee provides leadership to the economic revitalization of the region in western New York where it is located. Other LMCs operate at the industry level, such as in the hotel and clothing industries. In the telecommunication industry, an LMC organized by AT&T and the Communications Workers and Electrical Workers Unions examines options and makes recommendations for containing health-care costs while retaining premium services.

The effectiveness of LMCs vary depending on the caliber and level of the people involved, the resources and training available to the committee, and the commitment the organization involved has to the topic being addressed.

The following list summarizes the fundamental characteristics of LMCs. Labor-Management Committees:

- Are an addition to existing structures used for communications and problem-solving
- Are not a substitute for, nor an alternative to, free collective bargaining
- Are advisory without mandatory powers
- Can be created to deal with general issues or specific concerns
- May or may not be called for in the collective bargaining agreement
- Can be organized at the company or plant level, area or industry level
- May consider any matters related to improving an organization's performance which are not usually taken up in collective bargaining
- May help employees develop themselves and improve their working lives
- Foster sharing information about the state of the organization,
- Foster sharing of ideas to improve operations and the conditions of employment
- Foster sharing of gains, either according to preestablished formula or through collective bargaining, once they have become evident
- May be created when both parties: (a) have a desire to improve their relationship through greater cooperation; or (b) perceive a threat to their mutual security, e.g., through restructuring or privatization, loss of markets, declining profitability, poor L-M relations, work force dissatisfaction leading to high turnover, absenteeism, etc.

6.6.2. Ten points for effective labor-management committees

The U.S. Department of Labor provides the following "Ten Summary Points for an Effective Labor-Management Committee": These are presented below in Chart 6-4.

Chart 6-4

"Ten Summary Points for an Effective Labor-Management Committee"

1. Both parties share mutual interests in the long-term survival and success of the enterprise and the community, even though they may have conflicting goals in other matters.

2. Both sides want to make the L-M committee work and have realistic expectations of what it can accomplish. Participation in regular sessions symbolizes this commitment, which is known throughout the organization.

3. Labor members of the joint committee are believed and trusted by the rank and file; management members have sufficient status and authority.

4. Maximum voluntary participation is encouraged; employees, including supervisors, are kept informed and involved in matters considered by the labor-management committee and have opportunities to express their views on its recommendations.

5. The joint committees do not take up matters that infringe on the rights of either party as established under the collective bargaining agreement or the grievance procedure.

6. Job security is recognized as a basic to the program's success.

7. The parties have a mature, open relationship. Each is willing to listen to the other side. Both agree to concentrate on finding answers to problems at hand and discovering opportunities for collaborating.

8. The joint committees are promptly informed about the status of their recommendations. If they are not, the committees lose interest and stop operating.

9. Numbers of channels of communication are encouraged and an atmosphere of mutual respect prevails. However, communications must be accompanied by substantive recommendations.

10. New ideas are encouraged and their value weighed objectively. Concrete problems of interest to both management and labor must be pursued by the committee if it is to function productively.

6.7 Using in-plant LMCs and PI/CS study teams to cut costs, improve productivity and save jobs

Formal in-plant LMC-directed programs to reduce costs, streamline operations, and improve productivity are among the most successful of the various techniques to improve the economic viability and competitiveness of enterprises. Though these techniques have various names and forms, this guide uses the terms "productivity improvement" and "cost saving" (PI/CS) to describe these LMC activities.

In North America, PI/CS study teams and LMCs may have different objectives and methods, but most of their approaches include similar steps to preserve jobs and increase competitiveness.

Experience in the United States suggests that it may take a serious competitive threat or a financial crisis to force the parties (labor and management) in a threatened enterprise to overcome the practical and economic risks inherent in close cooperation and cause them to consider initiating an in-plant LMC-directed PI/CS process.

Outside consultants or neutral third parties can help the workers and managers initiate the PI/CS process and serve as facilitators or informal mediators when misunderstandings arise.

Prior co-operative experience contributes a common language and experience that can facilitate setting up a productivity improvement or cost saving process before a crisis occurs. Hence, all businesses should be encouraged to undertake labor-management cooperation efforts because they help them organize PI/CS efforts as needed. The co-operative LM process can be facilitated by participating in the Training for Partnership and the other training programs outlined in this chapter.

The following two examples of successful LMC-directed PI/CS approaches, one from the United States and one from Canada, illustrate their innovative but slightly different job and enterprise-strengthening techniques. The American approach typically is initiated at the local level by the parties themselves with the assistance of a state government Dislocated Worker Unit rapid response IA specialist or a private consultant. The Canadian approach is usually introduced and facilitated by a professional staff member from the Canadian Industrial Adjustment Service, a government-funded adjustment program.

6.7.1 USA: Using in-plant LMCs and PI/CS techniques to cut costs and save jobs

In the United States, PI and CS approaches have been promoted and implemented in a number of settings to save jobs and enterprises:

- by company and plant union and management leaders faced with layoffs or closure because of lagging productivity, high costs and declining competitiveness;

- by employers and unions working together or with the help of external consultants or university productivity centers; and

- by state and local government labor market adjustment services provided under the 1988 U.S. Economic Dislocation and Worker Adjustment Assistance Act (EDWAA) and its successor legislation.

The key point to remember when considering the use of PI/CS approaches to prevent layoffs or plant closings is that time is a critical factor. Joint LMC PI/CS techniques must be initiated before decisions are made to outsource work or close an enterprise.

ACTION MODULE: Steps to start a labor-management PI/CS study team to preserve jobs and improve enterprise competitiveness

The LMC-directed PI/CS approach has eight basic steps that were developed specifically to help firms save jobs and increase their competitiveness. Although this eight-step process cannot guarantee success in every instance, it has worked in many North American business settings.

Step 1: Identify the problem(s)

At the first indication (the sooner the better) that a firm or any of its units (department, division, etc.) faces a threat that could result in possible job losses or closure, labor or management should approach the other party about starting a joint LMC-directed PI/CS process. They should focus on developing answers to the following questions:

Step 2: Form a joint L-M steering Committee to oversee the PI/CS process

To succeed, the PI/CS process must have the total support of both top management and the union (if one is present). Therefore, it is important to form a group or steering committee comprised of toplevel managers and union officials (or representatives of the workers) to sanction, guide, and monitor the PI/CS process. This group should meet regularly to provide ongoing leadership to PI/CS activities and to handle any problems that arise.

The PI/CS Labor-Management steering committee:

⇒ helps select and train PI/CS study team members;
⇒ develops a plan and target for the PI/CS team;
⇒ supports the team throughout the study; and
⇒ helps implement the team's recommendations

Step 3: Develop a plan and target for the PI/CS study team

Before organizing a PI/CS team, L-M steering committee members should decide on the:
team size;

- ⇒ team member selection criteria;
- ⇒ training for the team;
- ⇒ space and materials for the team;
- ⇒ scope and guidelines for team activity;
- ⇒ time frame for work completion; and
- ⇒ resource people to help the team.

The PI/CS team's mission and the urgency of its task determines some of the above issues.

At the outset, the PI/CS team should be given a specific dollar target and told what will happen if they succeed or fail. They should also be told who will be responsible for evaluating the final recommendations.

Step 4: Form and train the PI/CS study team

The PI/CS team's composition is vital to its success. Include both employee (union members if the firm is organized) and management members on the team.

Team members should be trained in the guidelines and boundaries of their work, the financial background of the operation, and the target or benchmark and how it was determined. They should also receive training in problem-solving techniques, etc.

Step 5: Study the problem(s) and develop solutions

The PI/CS team should examine all aspects of the threatened operations, especially major cost elements, inefficiencies and causes of low productivity, and collect ideas for improvement and fashion them into specific proposals.

Team members should have access to all the people and information necessary to conduct an effective study of the threatened operations.

Team members should have adequate time to complete their mission, including time away from the job.

Step 6: Submit and evaluate the findings and recommendations

The PI/CS team should submit a report of its findings and recommendations to a group of top managers and union leaders for their review and evaluation.

The report should include:

- ⇒ an explanation of all cost-saving or productivity improvement ideas;
- ⇒ a calculation of the dollars that can be saved if the proposal is implemented;
- ⇒ material from the team's investigation which documents the proposals; and
- ⇒ a plan for implementation.

The management and union (if the firm is unionized) have to decide whether to accept the PI/CS team's recommendations and to notify the employees of their decision and its implications.

Step 7: Implement the recommendations

Top managers and union leaders (if a union is present) should develop an implementation strategy that includes:

- ⇒ a step-by-step action plan;
- ⇒ an implementation timetable;
- ⇒ clear assignment of responsibilities; and
- ⇒ plans for providing needed resources.

Step 8: Evaluate and follow up on the implemented changes

This final step in the PI/CS process is to evaluate the effectiveness of the implemented changes.

- □ Did the change lead to anticipated improvements and cost savings?
- □ Were there any unintended side effects?
- □ Did improvements occur as planned?
- □ What was learned that will help in the future?

Chart 6-5 summarizes the elements considered essential to maximizing the success of a productivity improvement or cost savings program based on the cooperative in-plant LMC model: Chart 6.6 provides an example of how the PI/CS study team approach has been used to reduce costs and save jobs in the United States.

Chart 6-5
Essential elements contributing to successful LMC-directed PI/CS projects

- ❖ Initiate the PI/CS study before making decisions to outsource work, reduce the workforce or close an operation.
- ❖ Form a group of top-level managers and union officials (or workers if no union is present) to sanction, guide, and monitor the PI/CS process. This group, usually called a steering committee, should meet regularly to provide ongoing leadership to PI/CS activities.
- ❖ Include both workers and union leaders (if applicable) and management employees on the PI/CS study team.
- ❖ Give team members access to the people and information they need to conduct an effective study of the operation in question.
- ❖ Give the PI/CS team a specific target at the outset.
- ❖ Agree upon a procedure to evaluate the team's recommendations before they begin their work.

Chart 6.6
Xerox and the ACTWU: Saving jobs and reducing costs*

Increased competition in the copier and duplicator business in the late 1970s caused the Xerox Corporation's market share to drop from a high of 93% in the early 1970s to 42% in 1981. That year, the management at a Xerox plant in Webster, New York, completed a study of operations. Based on its findings, the management decided that millions of dollars could be saved by subcontracting several commodities and subassemblies being produced in the plant's wire harness department to outside vendors. That action would eliminate all the jobs in that department.

The Amalgamated Clothing and Textile Workers Union (ACTWU), Local 14A, representing the hourly workers at Xerox, reacted to the management's announcement with a counterproposal: It asked that a joint union-management study team (going beyond the existing employee involvement activity) be set up to find ways to restructure the department and reduce costs. The company and union began collaborating on a high-stakes project with important implications for both sides. With the help of an outside consultant, the joint team negotiated ground rules and set up structures and processes to provide them with the support they needed.

A joint union-management steering committee was formed to help get the necessary information and assess the feasibility of ideas. The aim was to construct a study team of open-minded members who represented the wire harness department's skills and expertise and could work independently or as team players. Eight team members were selected from volunteers. They were taken off their regular jobs to concentrate full time on the problem for six months.

The study team began their work after two weeks of training on problem-solving and other areas needed for their work and participating in information sessions. They were also given a cost-saving target or "benchmark." The figure represented the difference between the costs of producing the harnesses internally and subcontracting them to outside vendors. At the end of the six months, the wire harness study team had identified twelve ways to save $3.7 million (the goal was $3.2 million). The team's recommendations were made to a high level L-M policy committee which accepted most of them for implementation. The study team succeeded in saving 180 jobs.

Because of the success of the PI/CS process, five other study teams have been formed in the plant—turnings, extrusions, and castings in the fabrication department and a second wire harness team. These teams have identified savings of 24 to 40 percent

. The PI/CS process continues to provide successful cost savings and productivity improvements and is now part of an ongoing cooperative relationship between the ACTWU and Xerox. The union is substantially involved in operational decisions, and management has increased flexibility in the production process

*Adapted from Sally Kliegel and Ann Martin, eds., *Fighting Chance: New Strategies to Save Jobs and Reduce Costs*. ILR Press, 1988, pp. 13-32.

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6.7.2 Canada: Organizing in-plant PI/CS committees to cut costs and save jobs

In Canada, the objective of productivity improvement and cost savings (PI/CS) committees is to strengthen the economic viability of enterprises and preserve jobs. To do so, the Industrial Adjustment Service (IAS), a small government-funded organization with local offices in each Province, promotes the use of techniques like those described above and provides technical and financial assistance to employers and workers willing to use this approach as part of their industrial adjustment process.

The Canadian version of labor-management PI/CS committees, like its American counterpart, is directed at preserving workers' jobs by improving the health and competitiveness of enterprises. Chart 6-7 illustrates how the Canadian PI/CS process works in an enterprise.

How the Canadian IAS promotes the LMC-directed PI/CS process

In Canada, the IAS officers educate employers, workers, and unions in each Province about the availability of adjustment services, including PI/CS assistance for enterprises facing or having difficulties, through marketing and publicity efforts. Workers, unions, employers, other economic development agencies, or community employment services bring information about specific difficulties to the IAS.

Upon learning of problems that can be resolved by using the LMC-directed PI/CS process, IAS officers contact the employers to inform them and the union (if applicable) about the LMC PI/CS approach. They help the parties identify the project objectives, organize the committees, find suitable neutral chairs to guide committee activities, identify specialized consultants if needed, and monitor the projects.

The Canadian IAS reports that, except during recessions, 50% 70% of their Adjustment Officer's time is devoted to organizing joint LM committee-directed PI/CS projects. It also reports that even in the few situations where the LMC-directed PI/CS process cannot solve productivity or other problems and firms eventually lay off workers or close, the established labor-management cooperation framework makes it easier to set up and operate successful plant-closing or layoff adjustment committees.

Establishing criteria for using the LMC-directed PI/CS process

The establishment of criteria for funding joint LMC-directed PI/CS committees is left up to each IAS Officer in the field. However, the basic criteria is based on the impact the joint PI/CS effort can have on preserving workers' jobs (or increasing the number of jobs available) and maintaining a healthy enterprise in the community.

The Canadian IAS funds joint L-M committees for a wide variety of adjustment situations:

- ⇒ to cut costs and improve productivity;
- ⇒ to improve product quality because of customer loss due to poor quality;

- ⇒ to evaluate the need for new technology to maintain competitiveness;
- ⇒ to come up with new products to replace maturing products;
- ⇒ to develop training plans for new employees to expand companies' operations;
- ⇒ to help employers and workers improve employee/employer relations to overcome distrust, poor attitudes, low morale and a lack of motivation on the part of both supervisors and workers; and
- ⇒ to suggest cost saving proposals to reduce costs and relieve firms from subcontracting work and laying off workers to remain competitive.

The joint LM committee to address PI/CS concerns is established by a formal agreement with the employer, union (where applicable) and the IAS officer. Generally, the employer and the government share the committee costs. The Canadian IAS normally funds one-half of the expenses of projects costing up to CAN$25,000.

Identifying firms that can benefit from LMC-directed PI/CS projects

The IAS officers develop information-gathering channels to learn about enterprises facing or having difficulties that could lead to mass layoffs or closings and that could benefit from the creation of IAS-sponsored PI/CS committees.

The Canadian IAS stresses flexibility for each IAS Officer. They believe "this helps make the whole system work better, and does not tie the Adjustment Officer down to a set of pre-established rules."

ACTION MODULE: Steps to start an in-plant PI/CS project to strengthen an enterprise and prevent layoffs and closures

Starting Joint LMC-directed PI/CS Projects. The LMC-directed PI/CS job preservation process works in both unionized and nonunion firms. If there is no union, the IA Specialist can ask management to select the workers to serve on the PI/CS committee or he can ask to get the workers together and have them elect representatives to serve on the committee.

Usually, a IA Specialist uses the following five steps to organize a labor-management PI/CS Committee in a threatened business enterprise.

Step 1: Contact the employer and union (if one exists)

First, an IA Specialist contacts the employer and union (if their is one) to explain how the LMC process works, determine if the problem can be resolved through this approach, and outline the role the IAS can play in starting a PI/CS project.

Step 2: Draw up an agreement

If the employer agrees to accept the proposal for a project, the IA Specialist draws up an agreement that is signed by the employer, the union (if applicable) and the country Project Office. This agreement provides: (1) the mission and objectives of the LMC in carrying out the PI/CS project in the company, including the general area of research and study; and (2) the method the firm and the Project Office will use to share the operating costs of the committee.

Typically, the company and the Project Office divide the PI/CS committee costs on a 50/50 basis; but other arrangements are possible. Committee expenses include the chairperson's fees and expenses, the wages of workers while attending committee meetings, administrative support costs, and compensation for persons or organizations carrying out goals established by the committee (such as special consultant's fees and expenses if one is needed) subject to Project Office and IA Specialist approval.

The contract establishing a PI/CS committee normally runs for one year. However, under special circumstances, it can be extended if the Project Office feels it is in the interests of the project and the workers to do so.

Step 3: Find a suitable chairperson

If necessary, the IA Specialist assists the committee to find a suitable PI/CS committee chairperson. Normally, IA Specialists are prepared to suggest the names of several people (people with PI/CS expertise or other skills that the committee needs to carry out its work) who could serve as a neutral chairperson. The committee should interview the candidates and select the chairperson.

The neutral chairperson functions more as a "project manager" a chair, facilitator, mediator or consultant as appropriate. The chairperson chairs all the meetings of the full committee and provides assistance, when requested, to any subcommittees or task groups that may be set up to study particular problem areas.

Once the PI/CS committee is operational and a neutral chairperson has been hired, the IA Specialist attends the meetings of the committee, but takes a less active role.

Step 4: Arrange for LMC training

The IA Specialist helps arrange for problem-solving skills training (e.g., Interest-based Problem Solving) and Committee Effectiveness Training (CET) for the PI/CS committee as needed. Experience gained during the 1980s USDOL/NGA Canadian-American Demonstration Project in the United States showed that PI/CS committee members, particularly those serving on a work-related committee for the first time, benefit from training. Also, experience in the U.S. demonstrated that PI/CS committees benefit from training in:

- ⇒ problem solving
- ⇒ cost-of-quality analysis
- ⇒ brainstorming

- ⇒ interpreting charts and graphs
- ⇒ project management
- ⇒ conducting interviews
- ⇒ time management
- ⇒ making presentations
- ⇒ basic cost accounting
- ⇒ using calculators
- ⇒ cause-and-effect analysis

Technical experts in such areas as engineering and finance in the firm can also provide training and subsequent consulting assistance to PI/CS team members as appropriate.

Step 5: Monitor the progress of the PI/CS committee

The PI/CS team is given whatever time they need to determine the best alternatives for achieving productivity improvements or cost savings. Also, they are given whatever information they need to complete their study and make their recommendations and the assistance of internal or external technical experts as needed.

When the PI/CS committee completes its work, it prepares a report for the company management. The decision of whether or not to implement the committee's recommendations rests with the employer (as noted earlier).

The employer pays all expenses incurred in implementing the committee's recommendations, but, typically, the expenses of operating the committee are shared with the Project Office. In some cases, training or other activities may qualify under other government programs. Requests for funding of these activities is normally handled by the procedures established by each program or agency.

Chart 6.7
Burrell Bedding Ltd.: Creating a competitive enterprise with more jobs

Burrell Bedding Ltd., founded in 1904, enjoyed a strong and financially successful operation for many years. However, in the early 1980s the company was allowed to run down. In 1986, new owners tried to restore the firm to profitablity. By 1987, sales and marketing were under control, but serious morale and discipline problems persisted in the production and operations side of the business.

In late 1987, Burrell's management asked the Canadian Industrial Adjustment Service for help. The company, union and the IAS signed an "Assessment Incentive Agreement" that provided for 40% funding from the Canadian Employment and Immigration Department (parent of the IAS), and 60% from the company. The four-member joint planning committee, two from management and two representing the employees, studied new technologies and productivity improvement measures and the effects they would have on the workforce. A non-affiliated chairperson chaired the committee, and an IAS officer provided assistance and guidance.

A completely new plant layout with improved equipment was necessary. The committee, with the assistance of a management consultant, planned the move from Scarborough to a nearby location in Richmond Hill. A Human Resources Agreement was signed, followed by the working out of a Human Resource Plan. Where necessary, employees were moved to more appropriate duties, and new workers were hired. Cross-training was introduced so that every employee was capable of performing at least two functions. Once trained, the workers were encouraged by a measured work incentive plan, incorporating quality elements.

The Burrell Bedding planning committee met all its objectives. The improvements have led to new and bigger customers and a large increase in monthly invoicing. All participants consider the project to have been an great success.

Box-spring making is an example of the increased productivity. Historically, two men had produced 40 box springs per day. After the PI/CS projects were completed, one worker was able to produce 50–60 units per day; an average increase in productivity of 175%. Similar improvements in productivity occurred throughout the plant.

Under the leadership of the IAS officer, the Burrell PI/CS committee achieved:

- A stable, contented workforce three times the original size;
- Better manufacturing controls;
- Tighter cost and inventory controls;
- Greatly reduced labour costs;
- Improved employee training; and
- Improved quality

6.8. Conclusions about worker-management cooperation

Worker-management cooperation, built on a foundation such as interest-based negotiations and grievance handling, group problem-solving, partnership councils, and labor-management committees—especially PI/CS Study Teams--institutionalizes the common aspirations of both parties to achieve a better future and the best possible relationship. Although, conflict reducing techniques and more cooperative approaches to collective bargaining and industrial relations cannot guarantee industrial peace or trouble-free workplaces, worker-

management cooperation fosters respect between the two parties and provides a basis for working together to achieve important and tangible improvements for everyone. In a cooperative environment, the union and management work together to achieve positive change--and to find answers to the questions of how jointly to achieve success.

6.8.1 How IA specialists can help employers and their workers move from conflict to cooperation

Where are enterprise managers and worker representatives now and where do they want to be on the L-M relations continuum? How can they be helped to move their relationship from conflict to cooperation?

As was pointed out at the beginning of this chapter, there are at least four approaches to worker-management relations: Confrontation, Armed Truce, Working Harmony, and Labor-Management Cooperation. It is useful to consider which of these approaches enterprise managers and their trade union counterparts in your community or region are currently using in their worker-management relationships. If they are using working harmony or labor-management cooperation, you, as an IA specialist, should consider how and what tools in this chapter should be used to introduce them to the joint L-M processes for reducing costs and strengthening the competitiveness of their enterprises.

If the employers and workers in your community are using a more confrontational or armed truce approach in their relationships, then you should consider ways to introduce them to the less adversarial processes of interest-based negotiations and the range of practical tools that can be used to help them build a more cooperative relationship. You should show them how these tools can be used as a basis for achieving a more successful restructuring of the enterprise and also increasing the possibility of saving jobs as well..

The choice of which approach to use, confrontation or cooperation, is theirs. Once that decision is made, and if the decision is to move toward a more cooperative relationship, it is up to you, the IA Specialist, drawing on the tools in this handbook and the resources of the WSI Integrated WCE Adjustment Project, to provide or obtain the technical assistance and training to help them make the changes they want and need to achieve their mutual objectives of a healthy, competitive enterprise that provides good jobs for its managers and workers..

6.8.2 Additional Resources

Annex 1 contains a list of additional training resources that IA Specialists can use to help employers and unions reduce conflict and develop more cooperative labor-management relationships. Training and technical assistance to use these tools can be provided by the Integrated WCE Adjustment Program through the WSI Country Director.

Annex 1

Additional L-M Relations Training Manuals and Resources

Training Manuals

Committee Effectiveness Training (USDOL, 1989)
Interest-based Grievance Handling. (USDOL, BLMRCP, 1993)
Interest-based Negotiations: Trainers Guide (USDOL, BLMRCP, 1992)
Interest-based Negotiations: Participants Guide (USDOL, BLMRCP, 1992)
Interest-based Problem Solving: Trainers Guide & Participant Workbook (USDOL Academy, 1993)
Leading the Saturn Way (Saturn and Tennessee Dept. of Econ. & Community Dev., 1993)
Partners in Change. Trainers Manual, (USDOL, BLMRCP, 1993)
Training for Partnership Workshop Series: Trainer's Manuasl (USDOL, Office of the American Workplace, 1994)

Training Videos

Interest-based Bargaining
Mediation: Is This For You
Principled Negotiations
The Labor Arbitration Process
Working Together: Saturn and the UAW

Other Published Resources

Bargaining by Objectives (1988)
Creating Labor-Management Partnerships. (1995)
Designing Conflict Management Systems. (1996)
Getting Past No (1993)
Getting to Yes. (1983*)*
Getting Together (1989)
Mutual Gains: A Guide to Union-Management Cooperation (1987)
P.A.S.T. is the Future. (4th edition, 1995
The Mediation Process (2nd edition, 1996)

Annex 2

Continuum of Labor-Management Relations

	Management	Employees	Union
	Directive Command		
	At times the manager informs people why a decision was made. Maintains strict control over organizational systems.	Employees listen to rationale behind certain management decisions. They have no direct input	Union representative is occasionally informed of decisions along with rest of work group. Reactive role.
Category I: **Confrontation**	**Autocratic Authoritarian Management**		
	Manager directs, controls and maintains rigid chain of command. Highly bureaucratic structure. Lots of specialization. Multi-leveled organization	Employees respond to decisions. No input and/or ideas for improvement allowed.	Union leadership takes care of own goals. Waits for manager to error. Adversarial -- even hostile -- relationship with many grievances.

Continuum of Labor-Management Relations

Employee Input

Manager allows input on certain preselected issues. Tries for consensus. Maintains control over work flow and processes.

Employees have limited direct input on certain issues. Those issues tend to be superficial.

Union position occasionally sought and offered on minor issues.

Category II:

Armed Truce

Selective Information Sharing

Manager "sells" ideas. This involves telling group what to do and asking them to support. Communications generally one way -- down.

Employees receive information about certain issues and are expected to support. They have no direct input.

Union representative at times told of decision before implementation. Reactive role maintained.

Management ***Employees*** ***Union***

Continuum of Labor-Management Relations

Category III:

Working Harmony

Task Forces

Management	*Employees*	*Union*
Managers and sometimes the union are involved in setting boundaries around key issues, and then involving union and employees on multi-disciplined task forces to address them. Recommendations from the task forces, if consistent with management and union boundaries, are implemented.	Employees are directly involved in day-to-day decisions that impact them. They work in teams and make contributions to their group and the business as a whole.	With formal role in process, union is cooperative and supportive as long as their goals and values are recognized and differences respected.

Problem Solving Groups

Management	*Employees*	*Union*
Manager and union form problem-solving groups. Typical example is labor-management committee. Most improvement ideas must be approved by management. Union has role. Some skepticism exists for all.	Employees give direct input on a wide array of problem issues. Input is sometimes acted upon and sometimes not.	Union has designated representative in all problem solving groups. Collective bargaining items are out of bounds. Union has clear role.

Continuum of Labor-Management Relations

Category IV:

Union-Management Cooperation

Work Design and Goal Setting

The work group (managers, union, employees) is involved in work design, exploring innovative ideas for improved service, product design, work flow, quality and productivity The group is also involved in setting its own goals and how to best meet them..

Distinction between managers and employees has lessened. A strong interdependent relationship exists. More management and union time is spent on strategic issues and the work group handles the day-to-day issues of the business. Very flat organization.

Union goals and values are incorporated. Partnership occurs on the job with union leaders closer to their members. Diversity is valued and encouraged.

Participative Decision Making

Managers involve work groups directly in decisions that affect them. Communications are very open and free flowing with employees and union. Consensus format used in decisions. Boundaries are explored and agreed to.

Employees address "real" issues, getting regular information about the company's performance. They have a sense of responsibility and responsiveness to the direction of enterprise. Mutual goals are emphasized.

Union is proactive on key issues of shared concern. Union positions are incorporated into decisions.

Management ***Employees*** ***Union***

Case Study

Ostrowiec Steelworks
FSO

Chapter 7

Use Quick Start training to improve enterprise competitiveness and save jobs

7.1 Training workers for reemployment and competitiveness

A critical element of successful enterprise restructuring and economic renewal is obtaining and retaining workers with the skills and expertise necessary to make privatized enterprises competitive globally and attract new enterprises to a region or local community.

But how are workers going to get the necessary skills to make a community's businesses competitive? Furthermore, how are the workers unemployed by mass layoffs and plant closings going to get the skills required by new emp

Countries in Western Europe and North America have developed a variety of programs to meet the skill training needs of workers and businesses. The most successful programs link the concerns, needs, and resources of the workplace with the training and educational capabilities of the technical and vocational training systems.

A large number of U.S. state and local governments include training partnerships between technical training institutions and industry in local economic renewal strategies. Recently, countries in central and eastern Europe began using training partnerships to provide specific skills and upgrade training to unemployed workers to help them get jobs in privatized enterprises and start up enterprises and to give them and their supervisors the specialized skills to increase the international competitiveness of their firms.

Recent studies evaluating the effectiveness of Active Labor Market policies and programs being used in Poland and Hungary were carried out for the World Bank, U.S. Department of Labor and Ministries of Labor in these two countries. The study of Poland concluded that "short-term [modular] skill focused training was most effective and there was some evidence that retraining provided by private firms was more effective".[1]

[1]Christopher J. O'Leary, *Evaluating the Effectiveness of Active Labor programs in Poland*, W.E. Upjohn Institute for Employment Research, April 1998, p.xv, p. 57.

Two successful examples of the newer types of short-term modular training programs for economic renewal; and competitiveness used in the United States, and recently introduced into Central and Eastern Europe by the U. S. Department of Labor, are the "Quick Start" and "Custom Fit" training programs.

7.2 Quick Start and Custom Fit training programs

Quick Start and Custom Fit are short-term training or retraining programs that are specifically designed for a new, expanding or restructuring company that must retrain its work force because of changing products, technology or production processes. The Quick Start methodology introduced in Central and Eastern Europe was derived from the successful Custom-Fit type training programs developed in the United States.

Quick Start and Custom Fit training programs:

- result in job creation
- attract new companies to a community or region
- keep companies from moving from a community or region
- increase productivity for an existing or restructured company

Quick Start and Custom Fit training programs respond to specific industry needs. They must be custom-tailored to fit the needs of the client company.

Successful training programs require such key elements as:

- clear communication among industry personnel, the local labor office and the training provider
- excellent, flexible instruction
- administrative support
- careful and thorough planning of each cooperative effort

The training provider must acquire specific information about the client company's operations, products, and customers. The provider must also know the legal, social, economic, technological and demographic conditions relating to the company and the region.

The training must be short, focused and intensive. Short training schedules mean that an enterprise receives a quicker return for its investment, as do employees and the agency providing the financial resources.

Quick Start and Custom Fit training programs for new, expanding and restructuring enterprises are usually supported fully or in part by government funds. In many cases, costs are shared by more than one government agency and also by the company involved. Elected officials are more apt to provide funding under one of the following two circumstances:

1. The potential cut back or closure of an employer of a large number of the workers in a region.
2. The potential for a substantial increase in employment of the region's workers by a foreign company or a domestic enterprise that is considering relocation.

Funding for Quick Start and Custom Fit training programs is an investment that improves the quality of life and can be recovered in the form of increased wages, an improved economy, and additional taxes from both an enterprise and its employees.

In Central and Eastern Europe Quick Start training programs are usually started when a partnership is created between the country's Ministry of Labor/National Employment Service, one or more vocational training institutions and a USDOL/WSI Industrial Adjustment Project. These partners come together to implement business retention and worker adjustment components as part of bilateral or multilateral technical assistance programs to facilitate economic restructuring.

7.3 Hungary: "Quick Start" training programs

Introduction of Quick Start training in Central Europe. According to business, labor and government leaders, the Hungarian economy must attract new companies and assist existing companies in their modernization efforts to remain or become competitive in world markets and to provide job opportunities. Unfortunately, in the mid-1990s the Hungarian vocational training system lacked the capability to directly provide assistance to companies (business and industry) in training workers for specific jobs and to develop positive attitudes and skills for quality and productivity.

For these reasons, in 1995 the Hungarian Ministry of Labor asked the U.S. Department of Labor (USDOL) to assist them to develop and implement a technical assistance program called "Quick Start" in their regional Vocational Training Centers and County Labor Offices. Quick Start was designed to give them the capability to assist companies to screen workers, to provide job specific skills training, and to develop the attitudes and knowledge necessary for high quality products and services.

During 1995 and 1996 the USDOL Quick Start advisors went to Hungary to assist the Hungarian Ministry of Labor to accomplish its objectives in three areas:

1. **Provide job specific training to meet the identified needs of a business or industry** that are required to establish new operations, expand existing operations, or modernze equipment or production methodology to help them remain or become competitive in the world market.
2. **Establish a close working relationship with industry**, business and the general public to increase the relevancy of vocational training in Hungary.
3. **Develop workers' attitudes and skills to improve the quality of the products and services** they produce or provide

USDOL-recruited training advisors, working cooperatively with the Hungarian Ministry of Labor staff, began teaching the staff of regional Vocational Training Centers the techniques of training needs analysis, job and task analysis, scheduling, instructional planning, and program implementation. The training centre staff then developed and provided specialized and skills training for displaced or unemployed workers requested by the local individual industries and businesses that are restructuring, privatizing, or entering new markets.

Objectives of Quick Start. The objectives of the "Quick Start" program are to:

- create an awareness in industry and business of the services that the training center can provide under the "Quick Start" program.
- provide the necessary training in the methodology of conducting job specific training for a usiness or industry to one or more persons designated in each of the locations.
- develop the knowledge and technical skills necessary to perform job and task analysis by one or more persons in each location.
- assist an industry or business to develop a training plan to meet specific training needs.
- To develop the ability to transform job and task analysis data into a training plan in one or more industries at each site.
- develop a systematic approach to setting up and conducting job specific training programs.
- train instructors to effectively conduct job specific training programs.
- assist a company to organize and implement job specific training program.
- conduct a pilot customized training programs in each of eight regional training center locations in Hungary.

How the Quick Start Program works. The Quick Start program is designed to prepare workers for immediate employment in new jobs if they are unemployed or for other jobs if their present job becomes obsolete. The regional Vocational Training Center, the County Labor Office, the company, the Hungarian Ministry of Labor, and the U.S. Department of Labor cooperate in providing the training program. The funding is provided by the U.S. Agency for International Development.

Before Quick Start training can be conducted in a region, an agreement must be reached on the nature and extent of the program by the USDOL/WSI project director, representatives of the Hungarian Ministry of Labor and County Labor Offices, and representatives of the participating companies or the local Business Council.

The County Labor Office is responsible for recruiting and screening applicants from among the unemployed. The company is responsible for selecting existing employees from within the company. The final selection of unemployed trainees is a cooperative effort by the County Labor Office and the company.

The Quick Start training program is designed by the USDOL-recruited advisor/consultant, a representative of the regional Vocational Training Center, and a company representative. The training is very specific for the company and for the job. It is based upon a precise analysis of each job for which training is to be done. First, a training needs analysis is carried out on each job on-site in the company by the USDOL advisor and Vocational Training Center representative, assisted by the company training officer and a foreman or supervisor. The analysis identifies each task a worker must do, how it is done, what the worker must know to do the job, and possible hazards and safety requirement for each task. Based on these findings, a manual is prepared containing the results of the training needs analysis and setting out the specific elements of the training to be provided for each job. The instructors are given a short training course so that they understand the objectives of the program and how to use the anlysis information.

Theoretical classroom training is done first. Orientation to the company is a part of this training. Practical work training is done in the company in an actual work setting. Company personnel teach this part of the training. The company agrees to employ all the trainees who complete the program and are suitable for employment.

The Vocational Training Center is responsible for the coordination and control of the project.

Using this Quick Start training methodology, three pilot projects were successfully completed at Kisvarda, Debrecen, and Mohacs in Hungary. The three pilot projects illustrate how the 'Quick Start" training program is facilitating market economy development, generating employment, and contributing to successful privatization and increased competitiveness of firms in Hungary.

Training unemployed workers to work in a poultry processing plant in Kisvarda. This project was a joint effort among the Regional Training Center at Nyiregyhaza, the County Labor Office, and the Hajou Bet Company, a food processing company that processes chickens, rabbits, and geese. The County Labor Office recruited and screened 230 people, and 75 were selected to begin the training program on March 27, 1995; 73 persons completed training programs and 61 persons were employed by the company. Of the remaining 12, two found other employment and nine were judged not suitable for employment because of excessive absences during the training period and other reasons, and one person was found to have a health problem which rendered him unsuitable for employment in the company.

Of those available for employment, 61 of the 70 (or 87 percent) were employed. These employees are paid the normal salary for their job.

The monitoring of the program and communications among the three partners has been excellent and continuous.

From March to September 1995, production at the company increased by 20 percent and the quality improved. The company stated that the project was very worthwhile to them. They were very pleased with the work of the regional Vocational Training Center and the County Labor Office and will continue a close working relationship with them. Twelve of the trainees have been selected for additional training and for higher-level jobs. All three partners are very complimentary of the assistance and training provided by the U.S.industrial training consultant.

Because of the well-designed training and improved quality, the processing plant is capable of exporting poultry to the markets of the European Union. The Kisvarda Quick Start Training Program has been judged a success and is a positive example to other businesses and workers in the region.

Training unemployed workers for employment at the duckling processing plant in Debrecen. As a result of the successful Quick Start project in Kisvarda, the Hadu Bet Company asked that a similar project be undertaken at their duckling processing plant in Debrecen. The

company had purchased the former state-owned enterprise that had shut down several years ago because of a loss of markets and wanted to restart operations in the summer of 1995.

Over 1,600 people were recruited and screened by the County Labor Center, and 540 were referred to the training. Of the 540 people trained, 510 (or 94 percent) have been employed and are continuing work. The rate of pay they are receiving is higher than for similar levels of semi-skilled work in the area. The positive effect of this project on the economy of Debrecen is clearly evident. The company is extremely satisfied with the training program and the quality of the workers' skills.

The Hadu Bet Company and the regional Vocational Training Center subsequently began working together to train forklift operators and the other company employees at Debrecen.

Management and worker training at the Synthetic Wood Fiber Plant in Mohacs. The Mohacs Quick Start project was a joint effort among the regional Vocational Training Center at Pecs, the County Labor Center and the Mofa Company, a privatized company that produces a variety of wood particle hardboard products. This former government-run synthetic wood fiber enterprise in southern Hungary was sold to a group of private investors. It was the first privatization project in that region. The Mohacs project included training for new workers and training for employed workers in new skills required for their jobs.

The Mohacs project started on June 12, 1995. The training needs analysis was completed and a training manual prepared that was used in the new worker training. The screening and selection of new workers was done by the County Labor Office and the Mofa Company. Twenty-five trainees were selected and received training. The company hired all who successfully completed the training. In addition, 58 Mofa employees received specialized training in marketing, free enterprise, and computer skills. This training was provided by trainers from the regional Vocational Training Center.

As a result of the close alliance created by this project between the regional Vocational Training Center and the Mofa Company, a project to implement total quality management (TQM) throughout the company was later implemented. The regional Vocational Training Center staff, after receiving training from the management faculty at the University at Pecs, provided TQM training for the company.

The Mohacs project is viewed as highly successful by all measures. Eighty-three persons were employed or continued employment as a result of the project. The training center and the company have continued to cooperate in training efforts. The company anticipates expansion as a result of demand for its products and the availability of training for new workers.

Future of Quick Start in Central and Eastern Europe. Based upon the successful results achieved in the three pilot projects carried out in 1995, the Quick Start labor market intervention program was expanded and institutionalized by the Hungarian Ministry of Labor. In 1996, this innovative training approach was systematically introduced into other regions and Vocational Training Centers throughout the country.

Quick Start programs were introduced by the USDOL in Bulgaria in 1997, and they were introduced in Poland as part of the coal restructuring project in Upper Silesia in 1998.

7.4 USA: Utah "Custom Fit" Training Program

How the Program Works. The successful Quick Start program introduced in Hungary and other CEE countries is based on experience gained by state governments when operating short term intensive skill training programs for business and industry in the United States during the past 20 years. An example of how the methodology incorporated in Quick Start has been successfully used in the United States is illustrated by the Custom Fit training program in Utah.

The mission of the Custom Fit Training Program, originally started in 1992 to meet the "emergency vocational needs" of Utah businesses, is "to provide training and assistance to company employees through applied technology centers (ATCs) and post-secondary institutions in order to stimulate economic development, facilitate the creation of new jobs, articulate with public schools, and provide businesses with trained workers."[2] Custom Fit training Programs are coordinated jointly by the business, ATC and Utah Office of Education.

The state of Utah has a population of over two million people and a growing economy. It is divided into seven regions. Each region has assigned an applied technology center (ATC), community college or other designated vocational education institution to administer the Custom Fit program. Each center is committed to design, develop and deliver job preparation and upgrade training to meet the needs of the businesses and industries in the region. ATC services deploy technology through technical and managerial training, hardware and software demonstrations, business partnerships, technical assistance, distance learning and computer-based training, small business development, service brokering, etc.

This state-funded program is an important part of the economic incentive package that state and local economic development officials offer to Utah firms seeking to expand their operations and to major firms thinking of locating in Utah. It is intended to provide training for three types of Utah businesses: (1) *new businesses*, (2) *expanding businesses*; and (3) *businesses needing to be restructured or revitalized to remain competitive*. Each of these categories is defined as follows:

"New businesses" include (a) for-profit businesses newly incorporated or licensed in Utah; (b) incorporated or licensed businesses in the state that have been purchased by other parties and are \subsequently restricted; (c) incorporated or licensed businesses that open additional facilities in another region of the state; or (d) incorporated or licensed businesses that close in one region and reopen in another region.

"Expanding businesses" include all for-profit businesses in Utah whose growth results in a net increase of new full time (35 hours per week) jobs when measured against their maximum employment during the previous twelve months.

[2]State of Utah. Mission, Authority, and Standards Utah State Custom Fit Training Program (R277–913) October 1994.

"Businesses needing to be revitalized" include Utah businesses that are in danger of losing their competitive edge because of outdated equipment, technology, or knowledge. To obtain the increased or improved training needed to upgrade their work force, the businesses must express in writing to the Utah Office of Education that they have had a reduction in net profits during the past two years or expect a reduction in net profits during the next two year.

Custom Fit Training funds are used for short-term customized training, not course work for post-secondary degrees. To qualify for Custom Fit Training, employees must receive wages of at least US$6.00 per hour and be permanently employed for a minimum of thirty-five hours per week. Training normally lasts for three to four months, six months is the maximum. Appropriate documentation of progress and completion is required.

The program can provide up to US$500 per trainee to pay for the training. These funds can be used to pay for instruction, books and supplies, curriculum development, and supervised on-the-job training by a supervisor appointed by the business participant. The maximum amount of Custom Fit funds that any individual company can receive is $100,000, or not more than 25 percent of the region's current year allocation).

The primary benefit of the program is its flexibility. Custom Fit takes into consideration the unique training needs of individual companies. This is particularly relevant for mid-size and small firms with limited training budgets or experience. Many of these companies would not have training of any kind without Custom Fit Training.

Funding priorities. The Utah Custom Fit program has three funding priorities:

1. *Business firms* based on the availability of CFT funds, company/ industry stability, employee wages, employee benefits, increased or improved potential industrial or commercial opportunities, employee turnover and longevity, and prior participation in CFT programs or acceptance of funding.
2. *Custom Fit Training staff* evaluate training proposals to assess their potential to initiate additional new net jobs, to upgrade employees to assure the business' competitive position and to enhance economic development in Utah; and
3. *Training for production, processing and assembly-type jobs.*

The Custom Fit Program is administered by the Utah State Board for Applied Technology Education (hereafter Board) aided by an advisory group appointed by the Utah State Board of Education consisting of representatives of the Office of Education, State Job Service, higher education, Office of Community and Economic Development, Office of Rehabilitation, ATCs, and business and industry from each region where funds are distributed and business representatives agree to participate.

Custom Fit funds are appropriated by the Utah Legislature to the Board to be expended through Utah's public schools, ATCs, and institutions of higher education providing Custom Fit Training programs. Currently, the state legislature is funding this economic development program with about US$2 million..

Results of "Custom Fit" training.[3] During the first two years of operation, 1992 to 1994, 295 businesses and 17,136 employees received training under the Utah Custom Fit Training Program. The average cost per trainee was $256.

One of the important contributions of Custom Fit Training programs is that they form an effective partnership between education and business. A survey of Utah employers participating in Custom Fit Training found that only 22 percent of the responding firms had, at their own expense, used training provided by educational institutions prior to using Custom Fit. After the Custom Fit program introduced them to the training resources of the educational institutions (including ATCs and community colleges), 45 percent continued to use such training at their own expense.

Characteristics of firms using Custom Fit Training:

- a manufacturing firm
- fewer than 500 employees
- a limited training budget (Custom Fit is critical to the firm's training program)
- trainees have "high school or less" education
- entry level training includes craft or technical skills
- low turnover rates
- training includes classroom instruction and curriculum development by an ATC or community college.

7.5 Steps to implement a Quick Start Training Program

ACTION MODULE: Seven steps to implement a Quick Start training program

The following seven steps for implementing Quick Start programs are based on the USDOL/WSI manual for developing Quick Start training projects in Bulgaria, and manuals and materials used to implem*ent* Quick Start projects in Hungary and Custom Fit programs in the United States.[4]

Step 1: Establish labor office/business/vocational training center linkages

The Preparatory Phase of a Quick Start program includes: establishing a partnership among the providers and customers, determining the eligibility criteria for participation, developing a marketing plan, and marketing the training concept among employers.

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[3]"A study of the custom fit training program," Salt Lake City: University of Utah Bureau of Economic and Business Research, March 1995.

[4]*A manual for developing Quick Start projects in Bulgaria, 1997*. (Developed by USDOL in cooperation with USAID and the National Employment Service, Ministry of Labor and Social Welfare, Sofia, Bulgaria); Gary B. Hansen, "USDOL Quick Start training for enterprise competitiveness;" USDOL,"Manual: Developing a Quick Start Project;" USDOL, Quick Start Training Programs for Hungary."

Determine criteria for selecting target companies and trainees. Quick Start partners determine the eligibility criteria used to select companies to receive training assistance. Four types of companies might be considered eligible for Quick Start training:

⇒ A restructured company that needs to upgrade its workers' skills to remain competitive.
⇒ A restructured company that is expanding its operation.
⇒ A restructured company that is introducing a new product or process.
⇒ A new company that needs assistance in training new workers.

Quick Start training can be provided to companies willing to hire unemployed workers, or to companies whose workers need to be retrained to maintain or improve their competitiveness.

Develop a marketing plan. Once the decision is made about what types of companies or industries and workers can be helped, the enterprises must be made aware of the availability of Quick Start training and how it can help them be more successful. The company also must be convinced that an ample supply of potential workers exists in the area who possess the basic qualifications to be trained, and that the training program will train them for specific jobs in the company.

Using available media, information from the Local Labor Offices, vocational training centers, Chambers of Commerce and other sources, contacts should be initiated with potential client companies to explain the Quick Start program and invite their participation. Background information must be gathered about a specific target company--its operations, its customers, its products and services, and its competition. Possible sources of such information include annual reports, credit reports, and company officer biographies.

Set up an initial visitation with the target employer. The initial contact may include a telephone call, an office meeting, or a meeting at the company. The purpose of this contact is to provide the employer with a thorough understanding of the Quick Start Program including how it will operate, what government agencies will provide and do, what the company must provide and do, the expected outcome and its value to the company.

Explain Quick Start methodology and process. The objectives of the Quick Start programme should be explained to the employer. Quick Start uses a structured training development process to identify a firm's training needs, and designs and delivers customized skill training for existing or unemployed workers who will be hired upon completion of training. Quick Start training improves the skills of workers and competitiveness of their enterprises. This Preliminary Phase should also involve learning about the client's needs and problems by allowing the company representative to describe the company's problems and determining what the company wants to accomplish through training.

Establish procedures and sign training agreement form. After explaining the Quick Start objectives and process, the employer should be invited to participate and asked to sign a written training agreement. The agreement spells out what each partner will be expected to do. It stipulates clearly the roles and responsibilities for everyone involved, eliminating any surprises

later on. It is the responsibility of the designated individuals representing the three partner organizations (local labor office, vocational training centers and businesses) to ensure that the services are provided within the time frames specified in the training plan to be developed. The agreement should specify:

- ⇒ the objectives to be met
- ⇒ who will be trained
- ⇒ the number of trainees
- ⇒ the dates and times the training will occur
- ⇒ who will conduct the program
- ⇒ the number of instructors
- ⇒ the instructors' qualifications
- ⇒ the company's responsibilities
- ⇒ the training Center's responsibilities
- ⇒ the local labor office's responsibilities
- ⇒ the costs involved, payment method and responsibility

The signing of a training agreement completes the Preliminary Phase of the Quick Start program.

Step 2: Implement a systematic training development process

The Developmental Phase starts with job and task analyses conducted by Quick Start training specialists from the USDOL/WSI Industrial Adjustment Project and the partner vocational training center, assisted by the company training officer and a foreman or supervisor. Their job is to:

- ⇒ *Determine the jobs for which training will be provided.* A job is a collection of tasks performed to produce a product or service.
- ⇒ *Conduct a job analysis* of each job for which training will be provided using such techniques as observing, interviewing, holding supervisory conferences, and administering questionnaires and checklists. The purpose of the job analysis is to assure that the training program addresses skills, behaviors, and knowledge requirements essential for successful job performance.
- ⇒ *Develop task and duty statements.* After data has been collected, the tasks are analyzed and developed into task statements. These are grouped and sequenced into logical units of work. Duty statements describe a cluster of related tasks, making it easier to develop training plans.
- ⇒ *Select tasks for inclusion in training*. Each task should be examined to determine which ones to include in the training program. .
- ⇒ *Develop performance standards for each task.* The performance standard should be based on the level required for acceptable performance.
- ⇒ *Develop performance steps.* Performance steps are a series of steps required to complete the task. They are developed for each task to determine the knowledges, conditions, materials, tools, equipment, and safety considerations for the task.

- ⇒ *Identify tools, materials, equipment and work aids.* A list of the tools, equipment, materials, and work aids required to carry out each task is developed.
- ⇒ *Identify knowledges, skills, abilities, and attitudes.* Each task statement and performance step must be analyzed for the minimum knowledges, skills, abilities, and attitudes a trainee must have to successfully complete the task.
- ⇒ *Identify safety hazards and conditions.* The conditions, circumstances or situations under which the worker performs tasks must be described and analyzed to determine if they might cause injury to the worker or others, result in damage to tools, equipment and materials, and prevent successful task performance by the worker.

Step 3: Develop training curriculum and materials

Develop a curriculum and training plan, and assemble training materials. This step includes reviewing job and task analyses and statements, performance steps and knowledge requirements. A format for the training plan is selected based on need. It must include the instructional activities, resources and methods.

When developing instructional activities, consideration must be given to the trainees' ability levels, education levels, varied learning styles, individual interests, and emotional needs. All instructional activities should be designed to provide trainees with experience in successful task performance. Use of modern teaching technologies and instructional activities is also encouraged. Successful job instruction depends on the efficient use of these tools.

The training delivery plan must consider such factors as:

- ⇒ location of training--such as on-site, vocational training center, etc. and facilities requirement
- ⇒ type of training--formal classroom, on-the-job training, etc.
- ⇒ location and availability of qualified instructors
- ⇒ development and use of customized training materials
- ⇒ instructional methods and techniques to be used
- ⇒ audio-visual requirements
- ⇒ programme length, number of hours, training period length
- ⇒ pre- and post-tests
- ⇒ basis for documenting trainees' progress
- ⇒ methods of evaluation

The plan should also include a training timetable that takes into account:

- ⇒ the urgency of the training as determined by the original training need
- ⇒ number of trainees involved
- ⇒ time required to train staff to develop the training program
- ⇒ time required to develop learning packages sufficient to start the course and to allow enough lead time for developing the remaining learning packages
- ⇒ time required to prepare learning stations
- ⇒ times when the required production equipment will be available

⇒ times when instructors will be available
⇒ time required to implement the training for each modular unit
⇒ time required to implement the entire training course

Step 4: Select and train instructors

A key element of the developmental phase is the careful selection of instructors. They should:

⇒ be knowledgeable about the subject
⇒ understand how to work with adult learners
⇒ have practical work experience.

Most Quick Start training programs use company personnel as instructors, especially for the practical skill part of the program. Company personnel make good instructors because they:

⇒ know the process and have a good understanding of what is being taught
⇒ do not require training to learn the technology
⇒ can keep the trainees' attention during training, especially if they are supervisors

Full-time vocational training center faculty may be well suited to teaching the theoretical component of the training program.

It is essential to train those who provide expertise in planning, developing, and conducting Quick Start training to companies. They should be given a Train-the-Trainer course convering the selection and efficient use of the various instructional tools and techniques and understanding the learning process. This includes:

⇒ understanding job and task analysis, the sequencing of job tasks, and using this information in teaching
⇒ developing course agenda and lesson plans that can be used to guide the instructional process
⇒ learning to use teaching aids (such as audiovisual materials and equipment appropriately
⇒ learning how to plan classroom teaching that is directly related to the skills and knowledge of the job
⇒ learning how to present new material to adult learners

Step 5: Recruit, screen and select trainees

The first element of the Implementation Phase is identifying potential trainees. The Local Labor Office is primarily responsible for recruiting potential trainees from unemployed workers and for the initial screening of the applicants. Employers identify trainees from existing workforce. In most cases, the final selection of trainees is a joint effort of the labor office and the company. The Labor Office can recruit potential trainees by:

⇒ reviewing files of unemployed persons registered in the labor office

- ⇒ newspaper articles and want ads
- ⇒ radio and television announcements
- ⇒ placing posters in places frequented by local people

Using the job analysis, the company and the labor office should agree upon the basic educational requirements, physical abilities, aptitudes, interests, and attitudes required for the job. The labor office may use the following screening techniques:

- ⇒ testing
- ⇒ interviews
- ⇒ previous worker experience

The company should assist in the final interview and selection of the trainees.

Step 6: Conduct the skill training program

The second element in the Implementation Phase consists of scheduling, organizing and delivering skill training to selected trainees. Company trainers usually provide practical skill training, and the vocational training center staff provide the theoretical training.

Step 7: Evaluate the results

Following the delivery of the skill-training program, the results are evaluated. This is the final element in the Implementation Phase. Quick Start training should be continually evaluated and revised, particularly when new equipment and technology changes occur. Evaluation should occur on two levels: course evaluation and program evaluation.

Course evaluation includes an evaluation of the course by the trainees to determine how well the training content is received. Course evaluation also includes an assessment of the trainees and the instructors by the program provider.

Evaluation of the trainees' skills and knowledge acquired from the course is one of the most critical steps in the training process. Tests should be constructed to address three domains of trainee learning--manipulative skills, knowledge, and attitude--related to task performance standards.

The course may teach the desired competencies yet administrative or financial problems may prevent the overall program from being a success. Some items to be considered include:

- ⇒ average cost per trainee
- ⇒ average cost per hire
- ⇒ estimated return from wages, increased tax revenues, higher demand for various service industries
- ⇒ rate of training participation
- ⇒ effectiveness of liaison among the three Quick Start partners

- ⇒ increase in jobs for the population as a whole, for chronically unemployed, and underemployed groups
- ⇒ quality of the program plan
- ⇒ quality of the program organization
- ⇒ quality of the program management

Because the Quick Start training program development process is cyclical, results of both the course and program evaluations can be used to improve the program. The results should be made available to the individuals involved in making decisions about future courses and for further development of the Quick Start program in the community, industry or country.

Annex 1

Additional Training Manuals

A Manual for Developing Quick Start Projects in Bulgaria (USDOL, 1997)

Becker, K. (2000). *A Manual for Developing Quick Start Projects.* (USDOL), Poland Workforce Development Project, 2000, Macedonia PriZMa Project, 2000, Bulgaria Workforce Development Project, 2001.

Hanser, L.H. Traditional and Cognitive Job Analysis as Tools for Understanding the Skills Gap. Berkeley: National Center for Research in Vocational Education, University of California, 1995. (ED 383 842)

Norton, R.E. SCID Handbook. SCID: A Competency-Based Systematic Curriculum and Instructional Development Model, 2nd ed. Columbus: Center on Education and Training for Employment, The Ohio State University, 1996.

Chapter 8

Help small firms become more competitive through interfirm networking

Among the most exciting and successful entrepreneurial initiatives that have been developed and used in EU countries and North America to facilitate enterprise competitiveness and local economic development are those which promote interfirm cooperation and provide technical services to small business enterprises.

Because of the growing recognition that small firms play an important role in job creation and economic development, a number of areas have been identified as having potentially significant roles in helping them to become more efficient and competitive. Two of these—interfirm cooperation through collaborative networks, and the development of service systems—have attracted considerable interest internationally.1

8.1 Interfirm cooperation and collaborative networks

Interfirm cooperation and collaborative networks are groups of small companies in a community or region that cooperate when it is to their competitive advantage. These business networks operate from the bottom up in ways designed to maximise their joint competitive advantage in the marketplace. They can respond quickly to new market demands and product development.

Networks can consist of interfirm/multi-firm initiatives or sector specific initiatives. In short, networks are a new way for businesses to do business. They concentrate not on identifying needed services, but on seeking opportunities that are too large, too technically demanding, or too distant for their participants to undertake alone. The Aspen Group's study of the potential of manufacturing networks in America defines networks as "a form of associative behaviour among firms that helps expand their markets, increase

1Frank Pyke, *Strengthening small firms through co-operation and technical services: The roles of the Steinbeis Foundation and the Landesgewerbeamt in Baden- Wurtemberg.* Background Paper No. 2, International Conference on Endogenous Regional Development in a Global Economy: The Roles of Technical Service Institutes and Co-operation Networks in Small Firm Economies, Valencia, 17–19 November 1992, pp. 1–3.

their value-added or productivity, stimulate learning and improve their long-term market position."2

In order to compete effectively in competitive economies, small firms must have the ability to develop niche-marketing of customised products produced with the latest technology and highest skills. They can do this most easily by associating with other firms to form collective learning systems and to reduce the risks associated with specialisation. In addition to retaining their independence, the advantages of collaborative networks to small firms include economies of scale; reservoirs of expertise, increased flexibility, lowered risk, and a learning system.

Cooperation between small firms can be justified on a number of grounds. The first reason is the achievement of economies of scale—sharing marketing, research and development, or training activities. A second reason is that "sharing information and ideas, and the combination of complementary skills and technologies, can lead to new innovative products and production processes." The sharing of information can also be "an essential mechanism for keeping small firms up to date and competitive."

Interfirm cooperation can result in a more rational and efficient distribution of activities, such as firms sharing a common facility and jointly purchasing and making collective use of expensive equipment that none could afford to purchase individually. Also, a group of firms working together can offer a broader scope of capabilities—a co-ordinated range of products or services. (Customers benefit from dealing with a single source.)

Cooperation among small firms can increase the size of their productive capacity and make it possible for them to bid on larger projects. Finally, "inter-firm cooperation facilitates political cohesion amongst small firms, allowing them to press for their specific interests, whether at regional or national level."3

8.2 Technical service systems

Small firms, particularly those engaged in manufacturing, need strong service systems for the following reasons:

- In order to compete with large firms. Small firms, because of their size, need a range of services and inputs which they cannot obtain without considerable cost or undue burden.
- "Small firms can be helped by the institutionalisation of real or technical service centres or agencies that can engage on behalf of the small firm community in research and development, technology transfer, organisational upgrading and

2Brian Bosworth and Stuart Rosenfeld, *Significant Others: Exploring the Potential of Manufacturing Networks*, Chapel Hill, Regional Technology Strategies, Inc., 1993, p. 18.

3Frank Pyke, *Small Firms, technical services and inter-firm cooperation*, pp. 5–6.

information services, each centre being both industry-responsive and leading and co-ordinating the upgrading process."[4]

- Effective management and distribution of information "has become the crucial factor of competitive advantage." It is argued that "service systems act as conduits for information and as a means of acting on that information." They are an essential ingredient of development strategies designed to emphasise innovation and the introduction of new ideas.[5]

A number of examples demonstrate how the advantages of collaborative networking and technical service systems can be obtained. These examples also illustrate the linkage between interfirm cooperation and technical services.

The two oldest and best known examples are located in Italy and Germany, but newer systems have been developed in Denmark, Spain, the United States, and elsewhere.[6]

8.3 Examples of inter-firm cooperative networks and service centers in Europe

8.3.1 Italy: Emilia-Romagna

The concept of interfirm cooperation and flexible and collaborative networks was first identified and incorporated as a public-private industrial strategy in the Emilia-Romagna region of north central Italy, population four million. (Other regions and countries are attempting to replicate this concept.)[7] An activist policy on the part of the regional government facilitated the collaborative networking which helped to transform the economy of this region in Italy into one of the most prosperous in Europe.

Today, 64 percent of the manufacturing workers in Emilia-Romagna are employed in businesses with fewer than 50 employees, and 74 percent are in firms with fewer than 100. The average number of employees per unit of employment is six, and only 7 percent of the manufacturing workers are employed in firms with over 500 employees. Yet, the region is among the top ten richest regions in Europe.[8]

The regional government provided an institutional structure of service agencies, beginning with the creation of a regional development agency in 1974, to help small firms modernise and upgrade. The creation of twelve publicly subsidised hub centres encouraged small artisan firms to enter into a unique type of partial temporary mergers and other alliances for competitive purposes.

4Pyke, *Strengthening Small Firms,* p. 2.

5*Ibid.*

6Bosworth and Rosenfeld, *Significant Others,* pp. 14–15.

7Stuart Rosenfeld, *Smart Firms in Small Towns,* Washington, D.C., The Aspen Institute, 1992, p. 73.

8Pyke, *Small Firms,* p. 7.

In the 1980s, sector specific "hubs" or "real service centres" were created to help the most important industries in the region. These hubs provide a variety of services, including:

- industrial research;
- dissemination of information on markets, fashion trends, standards, and regulations;
- services for the upgrading and transfer of technology;
- training; and
- testing and certification.

Firms are encouraged to join the centres and participate in their operations. Though they pay for the services they receive from the hub centres, they also define the centres' functions. Today, membership fees from firms, trade associations, chambers of commerce, and unions provide the bulk of the support for the networking centres. The public treasury provides the remainder, about 30 percent.9

Although this Italian networking model is attractive to outsiders, some observers have questioned the replicability of this model because of the region's unique economic, cultural and historic conditions. Representatives from the region acknowledge the importance of their shared values and the face-to-face contact between firm owners and workers. They consider such personal interaction essential to achieve the information flow necessary for solving common problems and quickly converting innovative ideas into products.10

8.3.2 Germany: Baden- Wurttemberg

Baden-Wurttemberg, a regional state in south-western Germany, population 9.3 million, illustrates the development and use of a highly developed service system for small enterprises. The Steinbeis Foundation, founded by the State government in 1971, operates as a private non-profit enterprise. Its objectives are to upgrade industry and encourage innovation through a range of technical services, particularly technology and management consultancy services, and applied research and development on a company-by-company basis. The Foundation is supported by government-sponsored efforts to strengthen interfirm cooperation.

A staff of 2,500 people, headquartered in Stuttgart, co-ordinate the work of the 129 Technology Transfer Centres. The centres offer a wide range of specialised services or consulting opportunities to individual clients. The main clients are small and medium-sized enterprises. The system emphasises an interdisciplinary approach to dealing with business problems.

The Baden-Wurttemberg regional state is dominated by engineering, machine tools and, to some extent, textiles. It has a combination of large firms and a large concentration

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9*Ibid.*, p. 10.

10Bosworth and Rosenfeld, *Significant Others,* p. 25.

of small and medium-sized enterprises (SMEs). The large number of handicrafts firms, in particular, are well- known for their flexibility and productivity. The SMEs produce half of the state's product and account for 95 percent of all commercial enterprises, every second job and most trainee positions.[11]

The Steinbeis Centres are located in higher educational institutions and are run by their professors. (All Center professors are required to have three to five years of experience in industry before they can become professors.) The higher education system serves as intermediary institutions connecting researchers and scholars at Baden-Wurttemberg's fachhochschulen (polytechnics) and other research and development organisations with the industrial and commercial needs of the small firms. Students, in the form of graduates, provide the Centers and small firms in the area with a constant stream of skilled labour and are involved in many of the research projects.

The Centers receive some subsidy from the state government to obtain premises and equipment, but they are expected to earn over 95 percent of their income from their services. The Centers pay a percentage of their income to the Foundation to cover central administration costs. They rent their facilities and equipment from the host educational institutions and pay the professors a salary for the time they spend on projects and consulting.[12]

The apparent success of the Steinbeis Foundation's technology transfer system has attracted considerable attention and admiration and much interest in replicating it in other settings. The strongest indicator of its success is the demand for its services and the small subsidy it receives from the government. According to Frank Pyke, who studied this technical service centre system for the ILO, "in the context of Baden-Wurttemberg's highly sophisticated education and service infrastructure, the Steinbeis Foundation does appear to be achieving some success in bridging the gap between the world of higher education and small and medium-scale industry."[13]

Chambers of Commerce and Industry, in which membership is compulsory, encourage networking among small firms. Advice on new technology is offered through innovation consulting bureaus, market research, export assistance, new kinds of work practices, and educational and training courses to small and medium-sized firms. Voluntary self-help organisations such as employers associations, trade and industry associations and the like provide additional networking services.[14]

In addition, the Landesgewerbeamt (Office for the Promotion of Trade and Industry), a government institution, actively promotes small and medium-sized firm group activities. It provides subsidies (up to 50 percent of the cost) to organise meetings

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11Pyke, *Small Firms,* pp. 46–47.

12*Ibid.,* pp. 6–20.

13Pyke, *Small Firms,* p. 55.

14Pyke, *Strengthening Small Firms,* op cit., pp. 3–5.

and also provides a brokerage service to advise firms on the benefits of cooperation and how to organise themselves.15

Lessons from Baden-Wurttemberg experiences16 The highly developed network and service centre system operating in Baden-Wurttemberg offers a number of lessons:

- Unlike other German states that have service centres but no linking network between different polytechnics, the Steinbeis Foundation networking approach greatly increases the range of services that can be offered. It also opens an opportunity for a concerted holistic approach to problem solving by different specialists.
- The decentralized industry-driven approach and tying the income of individual centres to their services to firms in the area contribute to greater client use and willingness to pay.
- The initiative for and success of the centers, such as the Gosheim Steinbeis Center, comes from the small firms who influence the direction the centres take and from a centre-firm association that helps the centres carry out their leadership and organising functions.
- Small firms, particularly if they are not direct competitors, will collaborate; but some kind of brokerage intervention is necessary to organise, motivate, and inform them of possible advantages and strategies.
- Strong state support and encouragement that upgrades and strengthens the small firm sector is important.
- Strong, well-developed educational and scientific research complex and training systems are important to successful upgrading and networking efforts.
- Market demand for the main industrial products is also important.

8.3.4 Denmark: SME Cooperative Network Program

The largest and most widely recognised application of the Emilia-Romagna model began in Denmark in 1988.. The Danish leaders who studied that model were impressed by the way cooperation and a strong collaborative network infrastructure bring about long-term success.

Denmark, population of about five million people, is roughly comparable in size to the Emilia-Romagna and Baden-Wurttemberg regions. Its economy depends largely on small and medium-sized enterprises. Ninety-nine percent of the Danish firms have fewer than 100 employees, and most people work in small enterprises—over 70 percent work in firms with fewer than 200 employees and 60 percent work in firms with fewer than 100 employees.

Denmark's small population and the recent globalization of industry has forced the Danish firms to seek external markets for their products and to become more

15*Ibid.*, p.22.

16Pyke, *Strengthening small firms,* op cit., pp. 26–29.

competitive.17 As part of its strategy to adapt to the new global economy, the Danish Ministry of Trade implemented the Danish Cooperative Network Programme, initially conceived by the Danish Technological Institute, to promote complementary production among firms rather than trying to create Italian-style industrial districts. The Ministry of Trade authorised the expenditure of US$25 million to induce small and medium-sized enterprises to work with one another to strengthen competitiveness, encourage interfirm cooperation and promote the development of small firms.

The Danes have created a comprehensive, accessible, well-organised infrastructure that support its SME modernisation and networking initiatives.18 The Danish Technological Institute provides support to the networking effort, and the Technology Information Centres mobilise extension agents to provide information in every county. In addition, there are decentralised applied research centres, and technology application centres are located in seven technical colleges.

The Danish Technological Institute, a private foundation founded in 1906, has about 1250 employees primarily located in Copenhagen and Aarhus. The Institute operates on a commercial basis and is the leading provider of technical and technology transfer services. It conducts applied research, technological problem solving, quality, materials and environmental testing; management and organisational consultancy; and training. Other organisations also provide a variety of services.19

The Danish Cooperative Network Programme includes educating the public, selecting and training "network brokers," and offering three stages of incentives for collaboration. The objectives are "to encourage small firms to join together in cooperative networks in order to achieve economic goals that individually none of them could manage alone; implicitly, the overall aim is to increase the efficiency, standards and international competitiveness of Danish small firm industry." 20 Approximately 1,000 firms, organized into about 200 networks (with an average size of about 5 firms per network), are officially in the program; another 500 firms have formed 100 networks without any government involvement.21

Under the Danish system, interfirm cooperation takes a number of forms that can be divided into two categories:22

1. The sharing of resources—sharing labour, technology, buildings, training, etc., to reap economies of scale.

17*Ibid.*, p. 78.

18Rosenfeld, *Small Firms in Small Towns,* p. 72.

19*Ibid.*, p. 80.

20*Ibid.*, p. 84.

21*Ibid.*

22Pyke, *Small Firms,* pp. 86–87.

2. The development and utilisation of mutual complementarity— working together to exploit the complementarity of markets, products or resources, including ideas, both within the same industrial sector and across sectors.

The National Agency for Industry and Trade, administered by a staff of three and advised by a consultative group of 12 drawn from a cross section of Danish economic life (employers, trade unions, etc.), established and promoted the Danish Network Programme through a three-phase process: (1) feasibility study, (2) in-depth planning, and (3) the start-up and operation of the network. As firms passed through each of these three phases, they could receive subsidies. Upon completion of phase three, all subsidies ceased and the programme ended.23

Lessons from Denmark. The Danish experience provides a number of important lessons about inter- firm cooperation among SMEs:24 25

- *Importance of network brokers.* The Danish experience indicates that rather than relying on the spontaneous creation of networks based on mutual self-interest, brokers, leaders from businesses, associations or agencies, play a critical role in successful network formation. Brokers, as catalysts, advise on the advantages of cooperation, identify opportunities, initiate discussions, and link firms pursuing new opportunities together. This finding is similar to the Baden-Wurttemberg experience and elsewhere.

> We believe that small firms and networks compete more successfully, but Danish firms do not do it spontaneously—partly because they are not aware of the possibility; partly because they have very strong emotional and other prejudices against any type of cooperation...They are just like owners of SMEs everywhere else—fiercely independent and competitive, and by definition opposed to cooperation. From Interview carried out by DTI

- *Financial subsidies.* Financial subsidies are needed to encourage small firms to cooperate. Subsidies, given with an absolute minimum of written administration and time-wasting formalities, help them to overcome their initial skepticism by underwriting part of any perceived risk.
- *Competition inhibits cooperation.* Firms are much more willing to join a network or enter into a cooperative alliance with noncompeting firms. Thus, most cooperative networks are of the complementary kind and do not involve true competitors. However, in some instances competing firms are able to cooperate, especially when the firms in the networks agree about areas that they can cooperate on and areas or markets where they can continue to compete.

23*Ibid*, p. 89.

24Niles Hansen, *Endogenous Growth Centres: Small Firms and Flexible Production Systems in rural Denmark*, (1991), as quoted in *Communities in the Lead*, p. 195; and Danish Technological Institute, *Danish Network Program Midterm Report*, 1991, as quoted in *Communities in the Lead*, p. 199.

25Pyke, *Small Firms*, pp. 89–95.

- *Some industrial sectors are more willing to cooperate than others.* Cooperative networks operate in most Danish industries, but a few industries, such as textiles and clothing, have not overcome their prejudices and skepticism.
- *Geographical distance can pose a problem.* The Danish experience suggests that networks are more successful when firms are geographically close to one another and the workers know each other. Membership in local organisations and communities create social bonds that underpin successful cooperative network. Attempts to link geographically dispersed firms in cooperative networks have not been successful.
- *Local technical support is desirable.* Technical support should be provided at the firm by persons well-acquainted with local production conditions and the needs of the firm.
- *Cooperation must be voluntary.* Cooperation among enterprises should be encouraged, but cannot be enforced by external parties.
- *Service centres are important to network development.* Service centres, including industry associations, technical institutes, incubators and cooperatives, play an instrumental role in supporting network formation. They can serve as organisational and service hubs for similar firms, especially when the networks involve new and very small firms. They are less important to larger and more established firms.

8.3.5 Spain: Valencia IMPIVA

As part of Spain's political decentralisation process, the regional government agency set up the Institute for Small and Medium-Sized Firms (IMPIVA) in Valencia, Spain, in the mid-1980s. The 23,000 square mile Valencia region is located in south-eastern Spain. One-fourth of the population live in the capital city, the fourth largest in Spain. Valencia's economy is heavily dominated by small firms, similar to Emilia-Romagna in Italy, and Baden-Wurttemberg in Germany. Ninety-six percent of the enterprises have fewer than 50 employees. 26

The IMPIVA, with a budget of US$70 million and a staff of 80, has been upgrading and regenerating the small-firm economy and diversifying industry to remove the region's dependence on a limited number of traditional sectors. Drawing on the experiences of Emilia-Romagna, Baden- Wurttemberg and the collaborative networks in Denmark, the IMPIVA is trying to create cooperative networks and support service infrastructures to enable their small firms to compete with other regions and the rest of Europe.

After considering several alternatives, the IMPIVA rejected the option of competing on the basis of cheap labour and focused on raising standards in firms. The centrepieces of the IMPIVA Valencia program are the Technological Institutes or "real service centres." The service centres provide the impetus to develop dynamic small firm sectors in two ways: (1) providing services that individual small firms, because of their size,

26*Ibid.*, p. 11.

cannot provide for themselves; and (2) providing leaders and co-ordinators to upgrade and innovate whole small-firm sectors.[27]

Central to the IMPIVA system is an "inner network" of four components, connected by a "deliberately created web of interrelationships."[28] The four components are: (1) the IMPIVA agency located in the centre of Valencia that co-ordinates all networking activities and provides a range of training and information services that are distributed through various institutions; (2) the Business Innovation Centres that help establish new enterprises; (3) a Technological Science Park that aims to establish a growth pole of advanced innovative industries; and (4) a number of Technological Institutes which provide technical or real services.

The IMPIVA aims its decentralisation strategy through its inner network of components to encourage a grass-roots or bottom-up approach— "trying to create the conditions whereby through a complex networking process information is diffused, synergy's are encouraged, and innovation advanced."[29] The IMPIVA also works through a sphere or network of other institutions, including universities, the chamber of commerce, trade unions, private design agencies, quasi-public training agencies, etc., which are part of the Valencia service system.

During his February 1992 visit to Valencia, Frank Pyke of the ILO International Institute for Labour Studies found that the IMPIVA program was too new to evaluate, although the Technological Institutes "certainly appeared to be expanding—numbers of services demanded, numbers of staff, income from services sold, and the activities undertaken. Moreover, all the managers interviewed felt they had been successful."[30]

Pyke noted that "there were large areas involving the relationships between the Institutes and the industries they serve, the strategies they should be pursuing, and the services they should offer (and on what basis) that have not been touched upon, and further research would be welcomed." He raised the following question: What should be "the scope for the agencies developing further, from providing mainly production oriented services to other services—perhaps towards a more proactive role of network co-ordinators and organisers?" Moreover, he wondered how the Technological Institutes should be fitted into a whole Service System, including the outer network of other institutions, co-ordinated by the IMPIVA.

27Frank Pyke, "'The Last Will Be First' Small Firms, Service Centres, Networks and Cooperation in the Region of Valencia," Paper presented to a seminar held in the International Institute for Labour Studies, ILO, Geneva, March 24, 1992.

28*Ibid.*, p. 5.

29*Ibid.*, p. 7.

30*Ibid.*, p. 59.

Lessons from Valencia.31 Although the IMPIVA is relatively new, and thus difficult to evaluate, Pyke, in a more recent publication, has suggested some lessons to be learned from the Valencia approach to cooperative networking and service centres.

- Centers providing technical services should be very responsive to the stated needs of their small-firm clients.
- Centers should "lead the industry" by anticipating the needs of the small firms, preparing to meet them and perhaps even urging firms to upgrade.
- A certain level of permanent public subsidy is required to enable the institutes and service centres to carry out their role as "industry leader" to large numbers of firms. On the other hand, they can sell their services perceived to be of immediate value to individual firms at market prices.
- The development of expertise and effectiveness by focusing on specific industrial sectors is an advantage. This focus also gives each centre a strong identity with entrepreneurs in the industry.
- Sectorally specific institutes function better if they are located close to the industries they serve.
- Being part of a collaborative network of centres and institutes is perceived as an advantage.
- Institute management is critical to success, especially in decentralised systems.
- Technical service centers need highly qualified manpower to be effective.

8.4 USA: Networking in Florida, Ohio and other states

There has been a recent surge of interest in developing interfirm networks in the United States. In 1992, some 27 networks, clustered in three industries—metalworking, woodworking, and clothing, along with several additional networks in electromechanical, and mixed industries—were operating in the U.S. Most U.S. interfirm networks have multiple objectives, but some were started to provide a specific service—sharing marketing services, technology transfer activities, new product development, purchasing, and quality improvement.

American interfirm networks remain heavily broker dependent—an independent third party is required to mediate network functions and to complete most of the work to conduct the business of the network. At this stage of network development, the brokers are usually local economic development agencies, universities or community colleges, or community development organisations.32

U.S. interfirm networks are typically organised as non-profit corporations headed by a board of directors drawn from the member companies. They are financed primarily by

31Pyke, *Small Firms,* pp. 43–44.

32Kendra S. Hill, *Flexible Network in Theory and Practice: How and Why to Set up Flexible Networks in British Columbia.* Vancouver, B.C., Canada: BC Trade and Development Corp., November 1992, p. 31–32.

company contributions and grant money from economic development agencies, very few are financially self- sufficient. Levels of funding range from $10,000 to $100,000 per year.[33]

The following examples illustrate how the interfirm network process is developing in America.

8.4.1 Florida: Technology Coast Manufacturing and Engineering Network (TeCMEN)[34]

The TeCMEN network, based in Fort Walton Beach, Florida, is a good example of the type of cooperative interfirm networks being developed in the United States. It was organised in 1990 by the efforts of its broker, the president of the local community college and a member of the local economic development council (EDC). The broker became aware of the Emilia-Romagna model and thought it might be applicable to local firms. Initial efforts to organise the network failed, but a threat of reductions in defence spending catalysed the network's formation. Within a very short time, TeCMEN was organised and operating.

TeCMEN is a flexible network of 30 firms engaged in the design and production of electromechanical products. Twenty-five of the firms are manufacturers, and five are design engineers. The member companies are relatively small; the largest employs 300 people, and the smallest employs 16. Average firm size is about 60 persons.

The network has no formal legal structure, but is administered by an advisory board of 15 people, including the CEOs of 12 member companies, a representative of the University of Florida, a representative of the EDC, and the broker who represents the community college. Network activities focus on improving the individual businesses of member firms. The goal is to identify and provide opportunities to improve the bottom line of member firms by working directly with other local firms on projects of mutual interest

TeCMEN is a typical network. The independent broker contributes about 10 hours a week to the network. He works to identify public sources of financing for the network and to obtain access to staff to perform network functions. The network hub comprises both the community college and EDC. The staff is drawn from both organisations which are conveniently located in adjacent buildings. The community college staff contribute about 25 hours per week to TeCMEN.

The hub staff provide or administer three main categories of assistance to member firms:

- marketing—press releases, mail-outs, and speeches by the broker and marketing by the sales reps of the member firms;

33*Ibid.*

34*Ibid*, pp. 45–51.

- shared services—sharing purchasing and training services; and
- shared business opportunities—starting with a "keep the work home" program which resulted from a survey of member firms' business activities to identify potential synergy's.

The survey disclosed that many firms were purchasing items and services, many of which could be provided by network members, from great distances. This resulted in a system being set up whereby TeCMEN firms provided the broker with the specifications of any jobs that were to go outside the network. The job specifications were then circulated within the network, minus the name of the contracting firm, to give member firms an opportunity to bid on the work. The bids were submitted to the broker who forwarded them to the potential contractor. However, this was not possible until network participants reached a level of trust with each other. Now bid opportunities are sent to all member firms via the computer network, eliminating the broker from the process.

TeCMEN has succeeded in getting firms to jointly bid on and complete shared contracts. The process of finding and dividing up work consists of several steps:

1. *Identifying opportunities.* The previously identified marketing techniques are used.
2. *Selecting a lead firm.* This is accomplished with the help of the advisory board.
3. *Selecting subcontractors.* The lead firm uses the computer network to solicit subcontractors and faxes the specifications.
4. *Submitting a bid.* The lead firm puts together a bid package with the administrative assistance of the hub. The hub then forwards the bid to the potential client.
5. *Contracting out with the client.* If TeCMEN is awarded the work, the lead firm signs the contract with the client. Subcontractors are responsible to the lead for their portion of the whole.

The $100,000 required to fund the start-up of the TeCMEN network came from the State of Florida. Those funds are supplemented by using local community college and EDC staff; their job descriptions were changed to accommodate network activities. The original grant funded one additional staff position. The network has received less grant money each year since its inception; it is expected to be self-financing at the end of four years. The return on investment is considered positive; 400 new jobs have been added to the 30 TeCMEN firms since the networks inception.

Lessons from TeCMEN. The broker reports that seven factors have contributed to the network's success:

- *Importance of a threat or crisis to facilitate organisation.* It took an external threat to force the firms to organise a network with their competitors in the industry.
- *Need for a disinterested broker.* The network would not have been established without the broker's persuasion. His impartiality helped to generate the trust needed to develop the network. Initially, confidential information was shared only

with the him. As trust developed, firms became able to deal with each other directly.

- *An industry led effort.* Though the idea for starting the network came from the community college and the EDC, the spark to organise it came from the industry. All activities and procedures are designed under the guidance of an industry-dominated advisory board.
- *Early success.* The initial "keep the work home" program provided benefits to the members within two months. This early success ignited interest in the concept and provided momentum that continues to grow.
- *CEO commitment.* CEO-level commitment is indispensable to successful networks. The CEOs attend meetings and personally interact with the broker.
- *No up-front company money.* Business firms are reluctant to invest their own money in a network until they are sure that it will provide returns and be successful.
- *A structure that is not superimposed from outside.* Each network must develop along its own needs. TeCMEN evolved in a way that satisfied the participating firms and did not force trust beyond natural levels. Its structure and range of activities developed and evolved according to the members' needs and interests.

8.4.2 OhioACEnet

ACEnet, a community enterprise and cooperative development organisation in Athens, Ohio, used networking ideas from Italy and Denmark to foster local economic and employment development through the creation of flexible manufacturing networks in rural north-east Ohio.

Serving as the network broker, the ACEnet's first project was to organise a number of small firms in a cooperative venture to design and manufacture accessible housing components for the handicapped. To do so, in January 1992 ACEnet set up a for-profit enterprise, "Accessible Designs—Adjustable Systems," to identify the niche markets and co-ordinate product design and development, production, marketing and training functions for the group. It attracted thirty small woodworking, machining, electronics, marketing, and construction firms to become partners in jointly producing, marketing and installing the new products.

The long-term objective of ACEnet is to convert the network's co- ordinating enterprise into a cooperative owned by the group and to generate more of these networks among other firms in their area.35

8.4.3 Other states

New Jersey. In New Jersey, interfirm cooperative networks are being organised in three industries—textiles, electronics and metal working—with the help of the state government and the New Jersey Institute of Technology. The first activity was the creation of a service

35Amy Borgstrom Somers and others, "Grassroots Economic Networking Takes Root in Ohio: Part 1," *GEO: Grassroots Organizing Newsletter*, January/February 1993, pp. 3–5.

centre, the Paterson Textile Centre on the Passaic County Community College campus, to provide employee, financial, planning and organisational assistance to textile, printing and dyeing firms in the Paterson area. A second activity is the setting up of Continuous Quality Improvement User Groups to facilitate networking among SMEs in manufacturing in New Jersey.

Washington and Oregon. In Washington state, WoodNet has been established on the Olympic Peninsula to foster productive relationships among wood products companies located there. A similar network has been established in Oregon through the Wood Products Competitiveness Corporation. Oregon's Key Industries program helps new industry groups to articulate their training and technology needs and then helps them meet those needs.

While marketing cooperatives have long helped agricultural producers to market standardised products and commodities in the United States, the networking idea has led other small enterprises to use them as part of their efforts to expand into high-value product and market niches. For example, in north-eastern Oregon, manufacturers of home-grown items such as pickled asparagus, beans, wheat berries; gourmet popcorn; specialty garlic products; syrup, honey, and pancake mix organised the Eastern Oregon Specialities, Inc., a marketing cooperative for specialty foods. The cooperative has helped members develop promotional materials for their products and to enter regional and national markets.[36]

8.5 Different ways to look at interfirm cooperation

8.5.1 Three types of collaborative networks

From a review of the literature on networking and the more publicised examples, such as those described above from EU countries and the United States, it appears that there are three main categories of collaborative networks:[37]

Vertical networks. In vertical networks, firms at different stages of the same production chain, or with complementary products, join together for production, product development or marketing. The underlying characteristics of vertical networks are the firms' complementarity. The network goal is to strengthen market position. Their input-output relationship is typified:

- by being a link in a particular production chain that manufactures a final product,
- by being a link in the supply chain between suppliers and original equipment manufacturers (OEMs), or
- by aggregating compatible products for more effective marketing.

36*Communities in the Lead*, op. cit., p. 187.

37*Ibid*, pp. 18–19.

Horizontal Networks. In horizontal networks, firms identify similar needs for technologies, expertise or services that exceed their individual capabilities or resources. Typically, they collaborate to share equipment or resources, purchase supplies or acquire capital. The underlying characteristic is commonalty. The Network goal is to enhance market intelligence or power, or to reduce the cost or improve the quality of their common inputs such as skilled labour or materials.

Knowledge networks. In knowledge networks, firms want to seek and use new information, want to increase their understanding of business practices, and are willing to share information with others on a *quid pro quo* basis. Knowledge network firms meet to identify and solve common problems, exchange information, and stimulate continuous learning and improvement. These firms may not be in identical or complementary markets. The underlying characteristic is *shared learning systems.* Their goal is continual improvement.

Other characteristics that delineate networks are their degree of formality, openness and the permanence of organisational structures. Distance is also a factor; the more dispersed the network, the greater the need for contractual agreements.

8.5.2 Network models for value-added development

Another way to look at the role of collaborative networking is to put it in the context of local economic development. Researchers at the University of Washington's Northwest Policy Center have searched for ways to stimulate the economies of their regional economies and have concluded that adding value to existing resources is the key to the economic vitality of communities and regions. One way to facilitate and increase value-added development is to get small and medium-sized enterprises to work together to produce goods and develop markets that individually they cannot. Thus, networking becomes an important component of a value-added development policy.38

The Northwest Policy Center has identified five value-added networking models that work in the U.S. and contribute to economic renewal and development:

Regional hubs that bring together clusters of firms to facilitate innovation in products and markets. Hubs are typically staffed, regional in scope, and membership driven. They serve as matchmakers to link firms to suppliers, producers, and buyers; and channels for management, marketing, and financial support. Woodnet, a group of woodcrafters on Washington's Olympic Peninsula, is a leading example of a hub focused on rural value-added enterprise development.

Collaborative ventures to pursue new products or markets. Collaborative venture involve shared risk, with specific circles of firms getting together to pursue a joint venture such as developing a new product, organising a distinct product line, or entering a new market. They work best when the firms have the potential to produce high value

38Harold Fossum, "Models for Value Added Development Explored," *The Changing Northwest*, Vol. 6, December 1994, pp. 1, 6.

products, have seen unfavourable changes in accustomed markets, and can identify particular opportunities to justify the time and risk involved. Oregon's Key Industries program has helped stimulate collaborative ventures in value-added wood and specialty food products.

Value-added cooperatives. Value-added cooperatives provide their members direct access to production facilities, training and a range of business services. Co-ops are a good way to help micro-enterprises compete in high-end markets. The value-added model embodies the same principles conceptualised by the ILO's Common Facilities Cooperative model described in Chapter 10.

In the U.S., Ganodos del Valle, a New Mexico-based producer co-op, has organised its members into a vertically integrated system for raising and shearing sheep; carding, spinning, and dying wool; and designing, weaving, distributing, and selling high-end woolen goods.

Targeted incubators and training facilities. Targeted incubators and training facilities make available to firms in an industry the machinery and equipment needed to develop new products or expand their production capacity. Some also train people in new processing techniques or state-of-the-art equipment. Sandpoint, Idaho, and Milton-Freewater, Oregon, are two communities that have established "kitchen incubators" to help area specialty food processors.

Value-added industry associations and commissions. Value-added industry associations and commissions promote their industries as a whole by conducting marketing campaigns and promoting trade development. Several states now have specialty food products commissions.

Frank Pyke, conducting research for the ILO, has identifed a sixth value- added network model.

Vertical networks in the supply chain between large firms and suppliers. Vertical networks are a vertical structure of supply chains for large firms that reduce their number of direct suppliers, preferring to work closely, co- operatively and long term with a preferred "first tier" of firms that may become "systems suppliers," taking on added design and development responsibilities and frequently co-ordinating further tiers of sub-contractors and suppliers.39

In Thailand, the threat of industry moving to lower labour cost countries is being countered to some extent by spreading supply chains into new areas of excess labour supply. Pyke reports on one case where intervention occurred through a partnership among Bata Shoe Company, government agencies and a leading NGO. The partnership aims to integrate the company from its base in Bangkok to the rural areas by addressing

39Frank Pyke, *Networks, Development and Change*, Paper presented at the International Workshop on Global Production and Local Jobs: New Perspectives on Enterprises, networks, Employment and Local Development Policy, Geneva 9-10 march 1998 (Geneva: IILS, ILO, 1998), p.3.

supply and demand issues simultaneously.40 This includs working with new suppliers of sub- contract labour to help them learn the skills involved in making footwear and thereby become more independent. This approach is described below.41

Example of Vertical Supply Chain Network

The Bata Shoe Company rural subccontracting project in Thailand.

The Bata factory in Bangkok produces for both the domestic market and international brand names. Shortaages of suitable labour forced the company to consider alternative production straties. While other companies with similar labour problems appear to have decided to move production to nearby lower labour cost countries, Bata has pursued a strategy of integrating with suppliers within Thailand. therefore, a new supply chain had to be created.

Bata decided to collaborate with an NGO that had an established rural institutional support network and was proficient at assisting workers to organise into production and retail co-operatives. They established a small village-based co-operative factory, designed a production line and provided the necessary equipment to sew together the upper part of canvas shoes. Bata provided the initial training.

Subsequently, other villages requested the establishment of local factories. so Bata and the NGO jointly established three more co-operatives. The co-operatives vary to the extent to which they, Bata or the NGO own, pay for or rent buildings, machinery and/or raw materials. In all cases the investment by the co-operatives appears to be significant. The NGO can assist in access to a loan fund if required as well as provide advice on financial matters, how to run a co-operative, and deal with customers.

A Local Area Co-ordinator helps to distribute raw materials, acts as an intermediary between the villagers and Bata technicians, and generally assists to improve production and machine repair, and new product lines. Bata buys the production of the co-operatives at a market price.

Results: It is reported that the quality of workmanship at these factories is much higher than the norm in Bangkok-based shoe factories, and the capabilities of the co-operatives appear to be growing. workers' wages are high for the area and about the same as at the main Bata factory in Bangkok. It has been found that two-thirds of the women employed at the co-operative factories are former migrants who returned from Bangkok when viable employment became available in ther villages.

Other major firms are interested in the Bata approach.

8.6 Lessons from networking and technical service experiences

A review of interfirm cooperation and networking systems in Europe and North America indicates that the Italian networks are the most developed, the American networks are the least well developed, and the Danish networks are somewhere in between.

In the U.S., most interfirm cooperation is limited to only information sharing and services; joint production is a rarity. Networks are highly broker dependent because of low levels of trust and company commitment in terms of time or money. Brokers mediate conflicts and do most of the work. Finally, American networks have adopted some form

40Ibid, pp. 31-32.

41Sources: ESCAP, 1995; P. Obhasanond, 1996.

of legal structure, and all draw up contracts between firms when working cooperatively.[42]

Danish networks share not just information and services but contracts. They are becoming less broker dependent as trust levels grow and hub staff are hired. Danish networks, like their American counterparts, have adopted a formal legal structure and draw up contracts between firms when working cooperatively.

The Italian model for interfirm cooperation is the oldest and most flexible; it is ever changing and highly competitive in global markets. High levels of trust within the system have reduced transaction costs, enhanced information flow, and reduced or eliminated dependence on brokers. The Italian system of networks has a much more developed and complex institutional service system that supports the emphasis on production.

European and American experiences with interfirm cooperation and collaboration through networks and technical services suggest the following lessons:[43]

- At first, government efforts to stimulate cooperation are resisted.
- Cooperation already exists in purchasing cooperatives, "handshake" agreements to share orders, and training consortia. It is possible to build on these activities to create more extensive collaboration and networking.
- European networks are more formal than American networks and focus on market penetration. Cooperation in sharing information, training, or purchasing has deep historical roots. It is encouraged, but not officially classified as a network.
- Network policies cannot work in isolation. According to Bosworth and Rosenfeld, Europeans do not isolate networks from industrial policy; they consider them as only one part of a comprehensive strategy. Government's most important policy objective is to stimulate enabling practices and to "weave the social and economic fabric that will allow networks to form, thrive, and disband organically when no longer needed."

Although few generalizations can be made about the conditions that support successful interfirm cooperation, networking experiences in Western Europe and North America suggest several:[44]

- the need for a *common crisis* in the absence of a strong history of cooperation. This seems to be more important in the U. S. than in Europe.

42Kendra S. Hill, *Flexible Network in Theory and Practice: How and Why to Set up Flexible Networks in British Columbia.* Vancouver, B.C., Canada: BC Trade and Development Corp., November 1992, pp. 68–69.

43Bosworth and Rosenfeld, *Significant Others*, p. 27.

44Pyke, *Strengthening small firms*, pp. 32–33; Hill, *Flexible Networks*, pp 72–73.

- the perception by firms of an obvious and immediate *common benefit and early success.* Initial activity that provides a benefit to members helps to maintain the interest and desire to continue networking.
- the *active involvement of an independent broker* to organise and drive the network.
- the *active involvement of a company-dominated board.* Although a broker is needed to catalyse network formation, decisions about operations must come from the members.
- the members must *choosing the network structure* rather than having it imposed on them by someone from the outside.
- *opportunities for personal contact* among the owners/managers, especially among small firms.
- a shared *commitment to cooperation* at all levels in the participating firms.
- *geographic concentration* is a prevailing, but not essential, characteristic of most successful interfirm cooperation. Some limitations imposed by a lack of spatial proximity can be overcome with modern telecommunications and information processing technology.
- *someone besides company staff is needed to do the work.* The broker and hub staff must be prepared to do virtually all the work during the first year.
- *presenting an image of quality and stability.*

8.7 Organizing interfirm cooperation and services

The Italian model is the most highly developed system for promoting interfirm cooperation currently in operation in Europe and North America. If it is the chosen model, how does a local community or region begin the process of organising to achieve that level of cooperation? The answer to this question has two parts. First, the group must know the key concepts and use them to design a suitable strategy to create a local or regional program. Second, the group must follow a step-by-step guide to carry out the organisational process.

8.7.1 Key concepts for developing interfirm networking and cooperation[45]

Share business opportunities from the beginning. Brokers should focus on starting networks to share business opportunities, not just information or services. Shared services can develop within the network hub to help access the business opportunity.

Achieve some early successes. Initial efforts should be aimed at activities that can deliver some early successes to the network members. Successes ignite interest in the concept and provide the momentum for growth and expansion.

45 Hill, *Flexible Networks,* pp. 69–71.

Get as many firms as possible into the network. Brokers should try to obtain members from both competing and complementary firms. The more firms there are involved, the more internally competitive the network. Also, with a larger number of firms, the network can change lead and subcontracting firms from one contract to the next, better distributing the benefits among the participants. Finally, the more firms that contributing financially, the more powerful and useful the hub or service centre can be.

Develop sector-specific hubs or centers. Hubs providing services to vertical industry sectors can both promote networks and improve the competitiveness of individual sector firms. If sufficient funding is available within a network program, the establishment of hubs significantly improves the effectiveness of the initiative. Firms could then draw on the services of the hub and concentrate networking activities on accessing business opportunities. The neutral hub provides administrative support for the business of the network, helps with or takes responsibility for marketing, and provides a neutral meeting ground for the network firms. Firms share the cost of services to become more competitive and access the services through the hub.

Educate trade associations. Trade associations, if they exist, have the potential to be transformed into sector-specific "neutral" hubs. If associations' services more closely resembled those of Italian service centres, perhaps, with the addition of network brokering services, flexible networks would be better able to gain a foothold in a nation's industry. Already, some of the Danish trade associations are growing and changing in response to members' networking activities.

Invest in the broker. Because early stage networks depend heavily on a broker, brokers need to be trained and adequately compensated. Universities can play an important role by establishing courses and degrees which focus on teaching the basics of community economic development, interfirm cooperation, and the technical and interpersonal skills for effective brokering. It is equally important to use disinterested organisations such as community colleges and economic development organisations to serve as catalysts for starting networks and supplying suitable persons to serve as the brokers.

Obtain seed money to start networks. Virtually all successful networks have been established with seed money from some public source.

Adopt a long-term perspective. Developing successful interfirm cooperative networks require a long-term perspective. Return on Investment (ROI) can be measured in a number of ways—by the services provided to member firms, by the number of self-sustaining networks established over a three to five-year time period, or by the jobs created by network member companies—but it must be measured in a multi-year time frame.

Market the network as a single entity. Networks are not single companies that share marketing services, but continue to act alone. The objective is to create groups that actively seek large or complex business opportunities that involve more than one member

company. Consequently, participation in a network emphasises group projects and the group's ability to quickly form project teams to provide product or service solutions.

8.7.2 A step by step guide to building interfirm networks

This section summarizes the common process of establishing successful interfirm cooperative networks. 46

Flexible interfirm cooperative networks are formed for a variety of reasons and are structured in many different ways. Some are organised to access new markets, others to share services. Regarding structure, some networks are nothing more than an informal group while others are incorporated entities.

Starting a program to promote interfirm cooperation by organising networks of small businesses can be carried out under the auspices of a local government, regional economic development agency, chamber of commerce, or other suitable institutions that are interested and capable of launching and promoting the program.

From the public sector's point of view, the first step in building interfirm cooperative networks is deciding how to start and facilitate the process. This can be done by: (1) organising independent service centres on a geographical or sectoral basis and having them serve as network brokers; or (2) recruiting competent brokers from the private sector and sending them out to promote and organise networks. The development of service centres would follow, in due course, based on the interests and needs of the network members.

In the absence of substantial financial resources to start service centres, it would probably be necessary to start the networking process by the using the latter method in most countries and communities. The following steps in the action module are based on that situation.

ACTION MODULE: Steps to build interfirm collaborative networks

Step 1: Recruit a competent broker

Despite differences in form and function, most small business networks are created by a common process. First, a business development center or some other group (e.g., local chamber, trade association, CER Team, community college, etc) sees a need or opportunity to strengthen the competitiveness of small firms in a community or industry

46 This section has been adapted from Chapter IX of Hill, *Flexible Networks.*

so they can compete for larger contracts or compete more effectively *vis a vis* national or international competitors. They conceive the idea of interfirm cooperation as one way to address the problem(s). This group identify's or finds someone (called a network broker) who is willing to help implement a number of facilitative steps to bring the network into existence. The success or failure of a new network depends almost entirely on a broker's skills and the backer's support.

Attritubes of good brokers

Experiences of networks in EU countries and North America suggest the following attributes of good brokers:

- *Independent*—Only a broker with no ties to member companies can be entrusted with confidential and sensitive information and the power to make contentious decisions.
- *A skilled mediator and deal-maker*—A broker must understand the basics of striking deals among firms. Conflict is bound to arise among competing firms working together; brokers must defuse the conflict and mediate a solution.
- *Able to impress senior management*—The broker must be able to communicate with and win the respect of the senior management in member firms. CEO involvement in networks is crucial.
- *A skilled company analyst*—Brokers need good analytical and communication skills to identify synergy's upon which to build networks and to dissect companies and understand the functional areas of a business.
- *A skilled market analyst*—Brokers bring business opportunities to potential and existing networks. To do so, the broker must be capable of researching and analyzing potential markets.
- *A good communicator and public speaker*—A broker needs to be able to communicate complex ideas using simple language; the network concept is not easy to explain. Many networks are marketed by a broker's speeches. The ability to address groups (such as the CEOs of a potential network, the employees of networked firms, or potential buyers of network products) is very important.
- *Someone who gets things done*—The broker must do more than just talk and think. Setting up a network requires much paperwork, planning and organising. A business plan must be written, money must be obtained, markets must be researched, a brochure must be printed, and on and on. Usually, the broker does the work or manages the process.
- *Someone who gets out in the trenches*—The broker needs to meet frequently with member companies, especially in the initial stages of the network, but CEOs will not travel to see a broker Someone who likes to spend all day in an air-conditioned office is the wrong person for the broker job.

A background in the prospective network's industry sector can be an asset, but it is not necessary. Industry experience may buy the broker credibility, but a fast learner and persuasive speaker could be just as effective.

Once brokers have been selected and trained in the basics of interfirm cooperation and small enterprise development, network formation can begin.

Step 2: Develop and sell the network concept

In Central and Eastern Europe, brokers face a challenging industrial landscape. Hundreds of old state enterprises and thousands of privatizing and newly created firms in dozens of industry sectors have little or no history of voluntarily cooperating with other firms.

To move from this situation to one featuring a substantial number of networks is no simple process. However, it is possible. Experience suggests that the task can be accomplished in four steps over an extended period of time.

Choosing an Appropriate Sector

The broker should examine key industry sectors in the province and select those that display some or all of the following characteristics:

- A large number of specialised, small firms.
- Fragmented, niche markets.
- Rapid technological change in production processes.
- A large, identifiable market opportunity presently unavailable to most of the firms.
- A general perception among small firms that the industry is threatened.
- Opportunities to build value-added chains.
- Opportunities to combine complementary skills or products.

A sector with a strong trade association or some history of cooperation is easier to network than a previously unlinked group.

Choosing Appropriate Firms Within the Sector

Once appropriate sectors are identified, the broker must decided which firms should make up the network. Personal meetings are the most effective means of identifying potential participants. Before the meeting process begins, the broker might screen firms (for a certain minimum sales level or some measure of export readiness) to eliminate unlikely candidates.

Before commencing the meeting process, the broker should develop a detailed interview guide. Information gathered in the interviews should be recorded in some standardised way for later analysis.

The meeting should cover:

- *Company activities.* The broker needs to understand both skills and products. Some networks combine and redeploy the skills of participants to open up new markets, others put together new product lines using the best products from various firms.

- *Management expertise.* The expertise of management and their market connections are important. Firms may be able to aggregate complementary management skills to build a strong network.
- *Suppliers and buyers.* Brokers should be familiar with a company's suppliers and customers to identify potential synergy's with other firms in the sector.
- *Financial stability.* Only companies with a reasonable level of financial stability are good network candidates.
- *Threats and opportunities.* Perceived threats should be explored. Both common opportunities and common threats provide a good foundation for a network. CEOs should be asked to provide a "wish list" during the interview. Who do they want to sell to? Why aren't they selling to them? Their wishes might be achievable through a network.
- *An introduction to the network concept.* The broker should briefly describe flexible networks to interviewees, attempting to gauge interest in the concept. However the real sales pitch should come later (see Step 3, below).

Once the meeting stage is complete, the broker must analyse the results and conduct market research, looking for potential synergy's for the network to exploit. Brokers might want to look for specific international market opportunities to catalyse new networks. Large international opportunities, often inaccessible to individual small firms, might capture the attention of potential network participants and be less threatening. Cooperating with competitors to compete internationally is often less troubling than cooperating with other firms in a home market.

Selling the Concept

Once a market opportunity is identified and researched, the broker should invite potential network participants to a meeting. The meeting should constitute a professional and convincing presentation of the network concept, followed by an introduction of the specific opportunity available to the firms in the room.

Organizing the Group

A core group of companies interested in forming a network emerges from Step 3. The group is then organised. The broker needs to set-up a Board of Directors or Steering Committee made up of the CEOs from the member companies (or key companies if the group is especially large). Generally, the broker chairs the group, at least for the first year, calling meetings and setting the agenda.

The Board of Directors define a mission for the network. Policies and procedures outlining how the network is to manage business opportunities and pay for its activities is developed. The broker should push for Board- level selection of lead firms.

Each company should submit a letter of commitment to the mission and the policies and procedures of the network at this point.

Step 3: Commence the business of the network

Prepare a detailed business plan

The network needs a business plan that turns the network mission into measurable objectives. The broker writes the plan under the direction of the Board of Directors. The plan should contain strategies for achieving the objectives, plus time and budget commitments.

The broker needs to identify a primary objective that is easily achievable in the short term. This objective should be unachievable by firms acting individually and, ideally, it should benefit all firms in the network.

During this stage, the broker should research sources of public financing. If no money is available to finance the start-up of the network, member companies should now contribute appropriate funds.

Implement the business plan

The broker, using the assistance of company staff or a public sector support organisation, begins implementing the business plan. Initial actions should be tightly focused on achieving the first objective. Once that is accomplished, another objective should be targeted for achievement

Marketing literature should be developed during this stage,. The broker should consider creating a database or catalogue of member firms' experience, skills, technology, products and market contracts that could be used to identify opportunities and select lead firms.

Step 4: Stabilize the network and achieve self-sufficiency

Once the network begins to operate, the broker should gradually shift the workload to member firms. At the same time, the broker should continue to identify and prioritise key opportunities and problems, setting and achieving specific related objectives.

After about three years of operations, the network should no longer require a broker. However, if the network continues to need an impartial manager, the network should recruit and hire that person.

Helpful Hints for Network Brokers

Brokers, not CEOs, do most of the work. Even during the early stages of network development, CEOs should not be expected to spend more than about five hours a month on network activities.

Formal meetings should be kept to a minimum. Communication lines can be kept open without constant meetings. The broker keeps communications open and maintains contact with member CEOs and appropriate member company staff. He also encourages network members to pick up the phone and talk to one another.

Networks need to grow and change. Although one market opportunity might catalyse the formation of a network, the network needs to access many opportunities. The broker is always looking for new network opportunities. Networks keep growing and changing by developing and providing services that benefit all members.

Networks should exploit complementarity whenever possible. Networks that exploit complementarity are the easiest to build. The network markets a complete product line with each firm contributing one component.

Annex 1
Additional Training Manuals and Resources

The Network Tool Kit: Vol. I and II, (Regional Technology Strategies, Inc., February 1997)

Chapter 9

Use early warning and action teams to strengthen enterprises or change ownership to save jobs

9.1 Restructuring an enterprise by changing the ownership

Among the restructuring strategies available to business owners, including governments planning to privatize state-owned enterprises, is the sale of the business to a new owner. As discussed in Chapter 5, restructuring by transferring ownership can be done through a divestiture or spin-off, a buyout by another company or investor, or through a management buyout or management-worker buyout using a "cooperative-type" joint stock enterprise structure. Each of these different approaches to restructuring has considerable employment and income implications for the workers, managers and communities where the enterprise is located.

Although all of the different buyout options have been used, restructuring leading to the creation of a "cooperative-type" joint stock enterprise has become an increasingly popular means to preserve jobs for workers and managers in communities where the restructuring is occurring, and to foster economic democracy in the industrialized market economy countries. In addition to their expanding use in North America and Western Europe, innovative management and worker buyout options have been incorporated in privatization efforts in central and eastern Europe and in some developing countries. Successful efforts by advocates of these new management and employee-owned forms of business enterprises have resulted in the adoption of legislation that modifies traditional corporate forms of enterprise and allows for joint-stock variations in addition to the traditional forms of worker-owned cooperatives.

Though there are several types of these enterprises, most of them are hybrids and are built on the foundation of joint-stock companies with the addition of some form of worker ownership, worker participation and, in some cases, democratic control. The most common types are labor-limited companies (LLCs), employee stock ownership plans (ESOPs) and "cooperative-ESOP" joint-stock companies.

Worker ownership in the form of employee stock ownership is gaining a small but growing foothold in world-wide efforts to privatize state-run businesses, preserve jobs, and make enterprises more competitive. Countries that have incorporated employee ownership as part of their privatization efforts include Argentina, Jamaica, Mexico, Pakistan, Trinidad, Turkey and the United Kingdom in the capitalist world and virtually

all the formerly socialist nations of central and eastern Europe. Two examples, one from Spain and the other from the United States help illustrate the employment benefits of restructuring through transfer of ownership

In addition to Spain and the United States, ESOPs and cooperative-type joint-stock conversions of conventional businesses have preserved or created thousands of jobs for workers in other countries, including developing countries where privatization of state-owned enterprises is taking place. There also appears to be considerable potential for these forms of ownership as part of the privatization process in Central and Eastern Europe.

9.1.1 Spain: Labor Limited Companies and Cooperative Stock Companies

During the past two decades, Spain has developed the cooperative joint-stock form of enterprise, an innovative entrepreneurial approach to enterprise strengthening, employment preservation and enterprise development based on cooperative-type concepts of worker-ownership. In addition to preserving existing jobs and businesses, this business ownership approach has been used to create thousands of new business enterprises and jobs. According to existing registration data, during the period 1983–1989, 16,757 Labor Limited Companies and Associated Labor Cooperatives were organized under Spanish law, creating 128,156 new jobs for redundant and unemployed workers in Spain.

The first labor limited companies in Spain were organized in the early 1970s when an economic crisis forced many small firms to close. Some firms went bankrupt due to obsolescent machinery, market recession, poor management, and lack of investment. The owners turned their businesses over to the workers or other creditors. The workers agreed to take control of the businesses to save as many jobs as possible. Other workers who had been thrown out of work by plant closures attempted to use their collective skills to start new enterprises in the same or other lines of business.

The substantial growth in the numbers of these conversions and the “phoenix-type” enterprise development in the next decade led the government to publish a law on 25 April 1986 to regulate this singular model of ownership and enterprise. The law spelled out the characteristics necessary for a firm to be considered a labor limited or worker limited form of cooperative stock company:

- At least 50 percent of the stock capital must be worker owned.
- No shareholder may hold more than 25 percent of the stock capital.
- The share certificates representing the capital must be registered certificates.
- The certificates representing the capital must indicate in their text the limitations to their transferability as set forth in the company’s by-laws.
- The workers must be employed full time for an indefinite period.

- In exceptional circumstances when state or local governments hold a majority or all of the stock, public bodies or corporate bodies may hold up to 49 percent of a firm's capital.
- Shares in portfolio are permitted provided they are shares reserved for workers and that the capital they represent does not exceed one-fourth of the capital of this type of share.
- When workers leave an enterprise, they are obliged to offer their shares to whoever has preferential rights to purchase.
- In addition to the legal and statutory reserves, the companies are required to set up a special reserve fund of a non-shareable nature equivalent to 10 percent of the profits each year.

9.1.2 USA: Employee Stock Ownership Plans (ESOPs)

In the United States, an employee stock ownership plan (ESOP) is an employee benefit plan that was authorized by Congress in 1974. Because ESOPs in the U.S. receive substantial tax preferences, their growth has been continuous, and impressive. Since 1974, about 11,000 ESOPs have been created, covering about 12 million workers or about 10 percent of the U.S. workforce.

An ESOP operates through a legal device called an ESOP Trust that is set up by the organizers (usually the company and, in some cases, the employees and their union). The ESOP uses the company's credit and borrowing power to borrow funds on behalf of its employees. It uses these funds to purchase new shares of company stock or to purchase old shares from existing owners (private or public). The company commits itself to pay back the loan. As the loan is paid off, shares of company stock are allocated to each employee's account in the ESOP Trust on some specified basis—usually a percentage of the employee's payroll income. When the loan is paid off, the employees own shares of stock in their company, and the company enjoys the tax savings, the increased productivity, and commitment that goes with employee shareholding.

In the U.S., ESOPs have been used for many different purposes, including several related to job preservation, economic revitalization, and strengthening enterprise competitiveness. Currently, ESOPs are being organized:

- so workers can buy their company from departing or, in many cases, retiring owner(s). If the company is sold to outsiders, many purchasers want only the "good will" and assets of the business and eventually reduce operations, lay off local workers, close the doors and leave the employees without jobs or income. About 45 percent of the ESOPs are created to provide business continuity. A March 1990 survey by a national accounting firm found that 76 percent of the privately held business owners had no succession plans in place.

- so workers can buy their company from a government agency that is privatizing the enterprise. In a few communities and at higher governmental levels, there has been a desire to privatize some public enterprises; e.g., Conrail, waste management, and other services. If the enterprise is too large to convert to a workers' cooperative, the ESOP is used as a legal means to facilitate the employees' purchase of the enterprise. About 1 to 2 percent of the ESOPs fall into this category.

- so workers and their communities can "save" or prevent the closure of a business for economic or other reasons; e.g., a change in corporate policy or the failure to reach a corporate rate of return on investment objectives. About 3 to 4 percent of the ESOPs fall into this category.

- as a means to raise capital at a lower after-tax cost to modernize or expand the business. To use the ESOP for this purpose, the company issues new shares of stock that the ESOP buys with borrowed money. The company uses the money to buy equipment or other goods to improve its operation.

- by unions as a quid pro quo for wage concessions. When unionized companies face tough financial times resulting from stiff competition, changing markets or other problems, they may seek wage concessions from their workers to prevent bankruptcy or to strengthen the company's financial position. Unions facing such demands have been willing to take a pay cut only in exchange for an equity stake in the enterprise that can be structured through an ESOP. About 3 to 4 percent of the ESOPs are used for this purpose. In recent year's worker have purchased United Airlines and several other airlines in the troubled U.S. airline industry.

- by employers to create an additional employee benefit. The objective is to reward faithful employees and to motivate them to work harder and be more committed. About 40 percent of the ESOPs are set up primarily as employee benefit plans.

Studies suggest that giving employees an ownership stake in their company has positive impacts on the company's productivity and performance when there are active programs for sharing information and soliciting employees' input into decisions at all levels of the company. A study by the National Center for Employee Ownership found that in America ESOP firms grew 3 to 4 percent per year faster than they would have without the ESOP and that this growth created almost 50 percent more jobs in the ESOP companies. More importantly, the data revealed that most of the growth occurred in the most participative one-third of the companies—those that allow relatively high degrees of employee input into job-level decision making. These firms performed about 11 to 17 percent per year better.

A study by Rutgers University researchers found that employee stock ownership also helps company performance by increasing the market value of its stock. In 1992, stocks of public companies with 10 percent or more employee ownership holdings increased in value 23 percent compared with a 4.2 percent increase for the Dow Jones industrials.

In a new study recently published by the Cornell University Press, John Logue, Jacquelyn Yates[1] conducted a study of nearly two-thirds of the Employee-owned businesses with ESOPs in Ohio. The major conclusions of their study are: (1) giving employees information about their business, training them to understand that information, and empowering them to act on their understanding is the most reliable path to successful business performance; (2) the key to it all is employee interest—engage them and the rest will follow; unions and ESOPs can and do prosper in the same firm; and (4) federal tax policies in the United States are channeling most of the benefits to companies that do the least to promote economic growth, broad participation and widespread ownership of wealth.[2]

Regarding the first point, that ESOP firms do better if employee-owners are given more information about the business and trained to understand it results in better enterprise performance, confirms the results of an earlier study by the General Accounting Office. "Doing a little" when it comes to sharing information with employees does not seem to have much impact on any of several measures of firm performance, but "doing a lot" makes a difference. The study found that employee ownership and employee involvement are a "recipe for success." (This is one of the reasons why concepts such as "Open Book management," discussed in Chapter 5, and providing economic education for workers and managers, discussed in Chapter 10, are so important for restructuring enterprise managers to consider.)

During times of economic downturn and recession, employees and their communities are using ESOPs more extensively and successfully to prevent the arbitrary closure of plants by employers who have little concern for the future of their workers and the economic health of their communities. In 1988, the U.S. Congress passed federal worker adjustment legislation that encourages the use of employee ownership through ESOPs and other cooperative-type enterprises for these purposes. The legislation also authorizes local government agencies to use federal worker adjustment funds allocated to states to finance feasibility studies to determine whether ownership transfers and management and worker buyouts are economically sound. As a result, ESOPs are being used more frequently to structure management and worker buyouts to save jobs and prevent closures. Box 1 provides a recent example of how an ESOPs has been used to save 2,500 jobs in Ohio and Wisconsin.

After initially opposing the use of ESOPs to facilitate worker buyouts, several trade unions in the United States now promote the creation of democratic ESOPs among their members as part of economic renewal strategies to preserve jobs and prevent plant closures. These unions now provide organizational and financial support, consulting services, and suitable information and training materials to educate workers about what ESOPs are and how they can serve workers' interests. Some unions are also training workers to identify the early warning signs of plant closures so preventive measures such as a worker buyout can be initiated well in advance of a planned shutdown.

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[1] *The Real World of Employee Ownership*, 2001.
[2] "How to Manage an ESOP to Success: The Real World of Employee Ownership," *Owners at Work*, Winter 2001/2002, p. 15

Box 1

Employees Buy Appleton Papers in $810 Million Deal

A West Carrollton, Ohio, paper mill and recycling facility is part of an $810 million 100 percent employee buyout of Appleton Papers, a very successful subsidiary of a British company. Last year (2000), the parent, Arjo Wiggins Appleton, announced that the U.S. subsidiary was up for sale. After the usual parade of potential buyers, the employees decided they like themselves better than anyone else they had seen come through their plants and concluded that their futures would be more secure if they bought the Appleton, Wisconsin-based manufacturer of carbonless copy paper. So, the company's 2,600 employees bought all of the company stock and took the company 100-percent employee-owned as of November 9, 2001. The transaction ranks as one of the largest employee buyouts in history and marks the third paper industry employee buyout in three years, after the 45% employee stake in Blue Ridge Paper and the 40% employee stake in Blue Heron Paper.

In Ohio, the roughly 350 hourly employees at the Appleton's West Carrollton plan are members of Paper, Allied Industrial, Chemical and Energy Workers International Union (PACE) Local 5-266. "We're excited to be involved in the buyout because it gives our members a say in their future and it also gives them an opportunity for a nice return on their investment," says Larry Richardson, PACE representative servicing the local . Richardson added, "Faced with the possibility of an investment group buying the company, we felt cmployee ownership was the best alternative."

Appleton Papers is a billion-dollar company that holds about 60 percent of the world market for carbonless paper, which is used for checkbook registers and credit card receipts, among other things. It is also a worldwide market leader in thermal papers that are used to print items like lottery tickets, airline tickets and sales receipts. The company has the West Carrollton facility, a pulp and paper mill in Roaring Spring, Pennsylvania, a converting plant in Appleton, and a small micro-operation in Portage, Wisconsin. With the exception of the Portage facility, which is non-union, all the plants are organized by PACE, representing about 1,500 workers.

To make the deal go, the employees, both management and non-management came up with a $107 million down payment by electing to transfer some or all of their individual 401 (k) accounts to buy company stock. The employees hold all the equity in the company. The other $700 million needed to finance the purchase was leveraged. According to news reports, over 90 percent of the employees participated and turned over an average of 75 percent of their 401(k) balances. The union members are also covered by a defined benefit pension plan.

Stability is very important to the success of any venture. In the case of Appleton Papers, a considerable degree of stability was provided by the union's decision to renegotiatecontracts as all three locations together. The new 5 year labor agreements gave leaders the confort level they needed to provide the rest of the finances.

The new employee-owned company was formed as a Sub Chapter S corporation, which essentially means that it does not have to pay corporate income taxes. Taxes will be paid by employee owners when they receive gains from selling their stock or from dividends. No corporate income tax means that the company will be able to pay off its debt more quickly. It also gives the company more opportunity to invest in developing new products, which is part of the long range game plan given a shrinking market for carbonless papers.

According to Bill Ven Brandt, Manager, Corporate Communications, "Appleton Paper has had a participative culture for the last `10-15 years, so it was relatively easy for employees to make the transition to employee ownership, to think and act like owners.

Source: *Owners at Work*, Vol. XIII, No. 2, Winter 2001/2002

9.2 Strategies and tools to identify competitiveness problems, assess restructuring needs and facilitate business ownership transfers

If the owner of an enterprise seeks to divest, sell or transfer the ownership, or the workers and managers of an enterprise seek to improve the competitiveness of the enterprise and preserve their jobs, how can these objectives be accomplished? Unfortunately, there are no easy answers to these questions. First of all, changing the ownership of an enterprise is a difficult and time consuming process. Second, it is an expensive process. Finally, it requires good leadership, and considerable skill and expertise on the part of those seeking change and the consultants they hire to assist them.

The experience and procedures developed in the United States over the past 20 years to evaluate the potential and facilitate business ownership transfers to save jobs and strengthen enterprises provide a useful guide to how this process works.

The first tool used to facilitate the transfer of ownership at the community level is to develop an "early warning" network to identify the problems experienced by an enterprise or the circumstances leading to a decision to sell or close it down in time to take suitable action. The second tool is the use of a pre-feasibility study to assess the potential for success of the proposed ownership transfer.

9.2.1 Use "early warning" indicators to identify "at risk" firms with restructuring needs

[*The material in this section has been adapted from the Early Warning Manual. A Guide, published by the Midwest Center for Labor Research. (Chicago: 1996)*]

It is extremely difficult to save jobs and enterprises or complete the transfer of ownership to another group of investors or the employees once a decision to close is made or an enterprise is allowed to deteriorate or run into the ground. But jobs and enterprises can be saved when intervention occurs well in advance of the planned closing, divestiture, or downsizing.

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But how can those seeking to save an enterprise or their jobs know when to intervene before it is too late? Based on experience in the U.S. during the past 20 years, the Midwest Center for Labor Research has identified early warning signs and developed strategies to help community, state and local Dislocated Worker Units, unions, and workers identify employers and situations that may justify further study or intervention to cut costs, improve productivity, preserve jobs, transfer ownership, or provide adjustment assistance to displaced workers.[3]

[3] Greg LeRoy, Dan Swinney and Elaine Charpentier, Early Warning Manual Against Plant Closings. Chicago: Midwest Center for Labor Research, 2nd ed., 1988; and Early Warning. A Guide, 1996.

15 Early Warning Signs

1. Ownership problems
   - No successor for an aging or sick owner
   - Change of ownership/new investment strategy
   - Ownership by conglomerate
2. Disinvestment
   - Lack of equipment and building maintenance
   - Profits used to improve or buy other plants
   - Excess dividends or other payouts
3. Declining Sales/Declining Employment
   - Three-year trend declines
   - Loss of major customers
   - Trend counter to (or worse than) the rest of industry
4. Mismanagement
   - Poor quality control, Poor product design
   - Nepotism, cronyism, irregularities in promotions
   - Antagonistic labor relations
5. Duplicate Capacity
   - Twin plant with ability to make same or related product
   - Outsourcing of least-skilled work
   - Whipsawing against twin plant
6. Management Instability
   - Poor treatment of plant by corporate parent, and poor managers
   - High turnover in plant manager, engineer, and labor relations positions
   - Mysterious new "consultants" directing personnel
7. Business "Climate" complaints
   - Management complaints about taxes, energy prices, unions, poor workers Indications that a company is looking for enterprise zone, tax breaks
8. Changes in Land Use
   - Rising land prices due to commercial or residential redevelopment
   - Location in a trendy riverfront or oceanside area
   - Neighboring plants being sold and converted to non-manufacturing uses
9. Inadequate Research and Development
   - Lack of new products
   - Losing product design and quality to other companies
   - Lack of research to cut energy costs, overhead, and inventory
10. Changes in Management behavior
    - Increased labour relation problems
    - Lack of company "roots" in the community
    - Actions by managers that indicate they won't be staying long
11. Removal of equipment
    - Equipment moved to a twin plant or sold to a competitor
    - Loss of key equipment or minor pieces
12. Cash crunch/Irrational Cutbacks
    - Supplies arriving C.O.D.
    - Shortages in supplies causing production snags
    - Paychecks bouncing
13. Unusual Bargaining Positions
    - Management asking for shorter or longer contracts than usual
    - Company offering to initiate severance pay clause
    - Management proposing "backloaded" money language
14. Unidentified Visitors/Cosmetic Improvements
    - Equipment or building being surveyed or appraised
    - Cosmetic improvements such as office spruce-up, landscaping
    - Consultants or other visitors the company will not identify
15. Real Estate and Property Tax Delinquencies

Source: Midwest Center for Labor Research

In addition to the signs identified by the Midwest Center, the Canadian Industrial Adjustment Service (lAS) uses a "repeated use" of worksharing unemployment insurance as one indicator that a firm may be in trouble.

The innovative approaches developed to preserve jobs and prevent plant closures are based on the principle that governments, employees, communities and local businesses have a stake in the stability and health of local businesses

Key element of early warning is monitoring existing businesses. The key element of community involvement is monitoring existing businesses for the purpose of preventing shutdown of potentially viable businesses. This involves creating an early warning network comprised of community leaders, labor, economic development agencies and business organizations. Early warning networks provide a means by which these groups can gather and organize information about a community's existing businesses with sufficient lead time to:

- ⇒ identify those companies at risk of moving or closing
- ⇒ provide assistance to companies in need of resources or skills
- ⇒ identify opportunities for increasing corporations' performance and stability

The early warning network gathers information on companies through extensive research and from its members' first-hand knowledge. Using this information, the network can develop effective strategies for assistance and intervention to prevent the loss of jobs..

Why so many businesses close or downsize. As noted in Chapter 5**,** there are many reasons why firms downsize or close their operations. Some do it to maximize profits and reduce labor costs. Sometimes companies shut down because of poor planning or lack of access to necessary resources or markets. No matter what the reasons for the shutdown, without an early warning network stakeholders usually hear about a problem after it is too late to do anything except make efforts to meet the financial and social needs of those employees who will shortly lose their jobs. With an early warning network in place there is a chance to retain the enterprise and rebuild the local economy.

A survey of businesses that closed in 1985 carried out by the U.S. General Accounting Office (GAO) found that only 7% of the closures were caused by bankruptcy; 93% resulted from other causes:

- ❖ divestitures of business units that no longer fit corporate objectives;
- ❖ profits that fell below the level parent companies required (even though the units were earning a profit);
- ❖ the owners of closely held businesses retired; and
- ❖ units purchased by firms wanting only the units' trade name or market.

The Midwest Center for Labor Research conducted a survey of small privately held manufacturing firms in the Chicago area. They found that nearly 50 percent of the owners were over 59 years of age and only one-sixth of them had identified a logical successor. The researchers concluded that this places the future of many firms in jeopardy.

What steps are necessary for business and community leaders to take in order to develop an effective early warning network to monitor existing businesses, identify actual or potential problems they may have, and then to address the problems that may be identified? The following ***Action Module*** sets out how this objective can be accomplished.

ACTION MODULE: Establish an "early warning" network to identify "at risk" enterprises and organize action teams to provide assistance

Step 1: Create an early warning network to identify "at risk" companies

The key element of community involvement in business retention and strengthening is monitoring existing businesses to prevent departures or shutdowns of potentially viable businesses. This involves creating, formally or informally, an early warning network comprised of key community, business and labor leaders, economic development agencies and business support organizations. The structure of the network can be informal or formal, with someone identified to be the network coordinator and/or secretary (e.g., IA Specialist) to receive the information and organize it for subsequent discussion and use by the network members. The network members should meet periodically or be on call to discuss the information developed and decide on a course of action to address any issues or problems identified. In some communities the early warning network is part of or has evolved into a formal Business Retention and Enterprise Competitiveness Program.

The objective of the early warning network created by these leaders and organizations is to gather and organize information about a community's existing businesses with sufficient lead-time to: (a) identify potentially viable companies that are at risk of becoming uncompetitive, or because of other circumstances may be considering moving or closing; (b) consider action steps, and, if appropriate, arrange for or provide assistance to companies needing or wanting help; and (c) identify opportunities to increase corporations' performance, competitiveness and stability.

The members of the early warning network gather information about companies through extensive research and members' first-hand knowledge. This information helps community leaders develop effective strategies for providing timely assistance and intervention to strengthen the competitiveness of threatened or "at-risk" businesses and prevent job losses. It enables the network members to:

- ⇒ facilitate an effective working relationship with community and other agencies;
- ⇒ identify problems and barriers that make the local business climate less favorable;
- ⇒ provide access to new and improved management personnel;
- ⇒ provide access to capital;

- ⇒ offer business planning assistance;
- ⇒ offer technical assistance to improve productivity and cut costs;
- ⇒ offer turnaround assistance;
- ⇒ train and develop the local workforce;
- ⇒ identify a qualified community friendly buyer who is committed to keeping the business in the area; and
- ⇒ help arrange an employee buyout.

Step 2: Collect and analyze published and unpublished information

Early warning focuses on two types of information: published and unpublished. Published information on companies can be found in annual reports, databases, trade journals, the business press, and public records. Unpublished information comes from people with first-hand knowledge of the company, including employees, customers, residents of the community, service providers, local economic development officials, utility companies, and local governments. Often these people see signs of trouble without knowing how to interpret them. Educating the workers, community leaders and others about how to read the warning signs can provide critical information for effective intervention.

Using both published and unpublished information, community leaders can identify potential problems at a company, analyze the particular problems and opportunities, verify the information, and develop a course of action to encourage and assist a company to keep its doors open. (Companies or enterprises that are beyond repair and assistance can also be identified and the stakeholders informed to prevent misinformed public investment and misplaced expectations.) Systematic analyses of local companies can result in as much as two years' notice of potential problems that could result in closures.

Step 3: Form an action team

If the information collected and analyzed by the early warning network coordinator (e.g., IA Specialist) and the network participants indicates that assistance or intervention may be required, the network coordinator should put together an action team. The team should include members with experience handling the specific issues the company faces.

The action team should determine the best way to approach the company, introduce itself, and offer assistance. If the company is open to the team, they can work together to save the company and its jobs. If the company is hostile to the network, the team must determine how to intervene, perhaps by waging a campaign to prevent a closure. (see number (5) under Step 4 below).

Step 4: Consider alternatives and take appropriate action(s)

The whole purpose of early warning is to secure timely and accurate information about companies so the community has time to take action to help the enterprise improve its performance and reduce job losses or even prevent closures.

Enterprise and job retention network actions include encouraging employers and trade unions to use PI/CS teams and the other tools discussed previously in Chapter 6. Additional enterprise strengthening actions are designed with the company's stakeholders (managers, employees, community members, government officials) in mind. The members of the enterprise and job retention network can take actions in five areas or categories:

(1) business climate and infrastructure improvements
(2) management and technical assistance
(3) financial assistance
(4) ownership transition assistance
(5) intervention

Determining the appropriate action needed for any given enterprise depends on the warning signs, the results of the business analysis and the network participants' capacity.

The community enterprise and job retention action team can use any of the above categories of actions depending on the kinds of problems firms are experiencing, the types of help firms need to solve their problems, and what will provide the greatest chance of strengthening the enterprise and preserving jobs in the community.

(1) Business climate and infrastructure improvements

Before community leaders can help local businesses, they must first identify community problems resulting from infrastructure, bureaucratic rules and regulations, and other issues that affect business growth and effective operations. For this reason many communities include, as part of their business retention efforts, actions that improve the local business environment and eliminate as many business barriers as possible. By identifying the needs and concerns of local businesses, the network can help communities set economic renewal priorities and activities while working to strengthen individual enterprises and save jobs.

Based on the information gathered by the network, communities can assist and encourage local businesses to stay in the community and to grow and expand by reducing their costs and increasing their productivity and competitiveness through:

⇒ infrastructure improvements;
⇒ quality of life changes;
⇒ workforce training
⇒ government procurement;
⇒ networking;
⇒ marketing assistance, and

⇒ tax breaks and other incentives.

Some early warning signs may reveal serious business climate problems that can be solved by infrastructure improvements and other changes. The enterprise strengthening and job retention network can use early warning information to lobby the appropriate government officials and agencies to make needed changes or improvements.

(2) Management and technical assistance

Some early warning indicators reveal problems that can be solved by good technical assistance, management consulting, worker training, and improved access to local resources.

Management assistance. Enterprise strengthening and job retention networks often find companies have trouble because their management has difficulty keeping up with technological advances and changes in the economy. An important resource for the business and job retention network is to develop access to professional management assistance as the current management may need to be strengthened with new talent or replaced. Equally important is linking the early warning network to the programs and activities of other technical assistance programs to strengthen enterprise competitiveness.

Technical Assistance. Many companies need corporate planning assistance to meet new pressures in the market place, keep pace with technology, or make adjustments in their production or management processes. They may require small adjustments or a complete turnaround of management. Whatever the problems, it is important to find and use local experts who have the same values and priorities as the job retention network members—preserving enterprises and jobs in the community.

Skill training. Some early warning indicators may reveal that the workers' skills are inadequate or outdated relative to the needs of the enterprise. The workforce may require retraining or upgrade training such as Quick Start[4] training -- short, intensive vocational training custom tailored to the specific needs of the employer (See Chapter 7). Such training programs can focus directly on the skills employers need their workers to have to remain competitive or develop and produce new products or services.

(3) Financial assistance

Providing financial resources to a company can be a real opportunity to further anchor a company in the local community and strengthen its linkage with the development objectives of the community. Good businesses need access to capital under the right terms. They may need more equity or loans for capital investments or working capital. Local enterprise development funds or economic development agencies may have staff with the skills to assist companies in securing capital under favorable and

[4] Quick Start training was the name given to this form of employer-centered vocational training by the US Department of Labor when it introduced it into Central and Eastern Europe as part of rapid response projects in the mid-1990s.

useful terms.

A good early warning business strengthening and job retention network must establish contacts with various sources of funds that can make a difference in the success, expansion, or failure of a business. But all types of financial assistance must include a careful examination of the company, its books, and its financial management practices to ensure that the investment is needed and will be used effectively. It is important that the financial assistance terms require the company to first strengthen the business and, hopefully, complement the objectives of the job retention network.

Common and creative sources of capital that the network might access for a company include:

⇒ loans from banks, government, or individuals;
⇒ equity from other investors, investment banks, or a community network;
⇒ an ESOP (equity from the employees);
⇒ investment from a community investment fund.

(4) Ownership transition assistance

The early warning business and job retention network may be able to help a company resolve specific problems related to business ownership such as:

- lack of a successor;
- sale of the company;
- an acquisition offer to save the company.

These conditions present opportunities to provide qualified, committed, and preferably local ownership to a company. They also provide a chance to develop the local economy and anchor the local company for generations to come. These ownership transition situations also open up opportunities for employee ownership or purchase by other local groups.

When arranging for a transition in ownership, companies need to be matched with an owner who will preserve the company at the local site and meet the qualifications of the network members. The owner must be competent to protect the interests of local investors and lenders.

If there are indications of ownership problems, the enterprise strengthening and job retention network must take the following steps:

- ***Determine the viability of the business*** by conducting a pre-feasibility study that examines the company's markets, finances, management structure and capacity, machinery and assets, sales and marketing capacity. The following Action Module discusses how to conduct a pre-feasibility study. (If a company is beyond salvage, the network should turn that information over to the appropriate rapid response worker adjustment component, discussed in the IA RRWA Handbook, to address employee displacement benefits, retraining, and job placement.)
- ***Identify the right buyer***—a group of employees, a group of individuals or

managers, or a single entrepreneur

- ***Using suitable intermediaries, provide assistance in negotiating the sale***,

When considering possible buyers for a company, think about:

- employee ownership;
- existing local ownership; and
- non-local ownership committed to keeping the business and jobs in the area

There is no absolute formula for employee ownership. It can take the form of workers as cooperative partners in a business (worker cooperative), or an Employee Stock Ownership Plan (ESOP).

Recent studies show that employee ownership increases the growth rates of these companies by 8-11 percent over non-employee owned companies[5] and enables them to out-perform competitors on job growth measurements 49 percent of the time.[6] Employee ownership::[7]

- creates shared interest between workers and outside stockholders;
- unleashes the employee-owners' creativity and productivity;
- maintains a long-term perspective;
- increases employment and job security;
- provides a supplementary income source from ownership equity;
- anchors jobs and capital in communities.

Acquiring a local company may be good for another company in the same geographic area that wants to increase its capacity or broaden its range of business activity. Under the right terms, clustering and combining small companies can be a positive development for the community while meeting the network's development objectives—access to better jobs at a livable wage, housing, health care, and schools.

If employee ownership is not a viable option and there is no appropriate match among buyers in the local community, the network should seek out an owner who is committed to keeping production located in the community. A person living in or near the community is more likely to share that commitment, but other entrepreneurs and investors in the regional, national, and international arena might be willing and able to be excellent partners with the local workforce and community. In all situations, be concerned about a potential buyer's commitment to sustain local production and further develop the business into a profitable enterprise**.** ***Never be so desperate that you fail to check out new owners***.

Some businesses, regardless of their ownership situation, will need other forms of assistance, financial, management or technical, to help them become competitive and continue operations without resorting to mass layoffs or closure.

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[5] National Center for Employee Ownership

[6];Northeast Ohio Employee Ownership Center, 1993.

[7] Charles Edmundson, et al., "A practical Solution: Employee Ownership and the Democratization of the American Economy."

(5) Intervention

In some situations the job retention network can solve a company's problems by providing a solution that is supported and embraced by management and the owners. Sometimes, company will not only refuse to work with the job and business retention network but will refuse to act on its own for the good of the worksite and the employees. If all possibilities of persuasion fail, intervention becomes necessary to bring about a negotiated settlement that meets the needs of both parties. The enterprise and job retention network should not sit idly by and watch an uncooperative company harm the social and economic fabric of the community.

Most interventions take place when a plant closing is imminent, either the company plans to move or shut down. Such interventions typically include one or more of the following:

- a legal challenge,
- a capital challenge, or
- a campaign to pressure or persuade in the public press.

While some interventions achieve positive outcomes, others may not. The action team must determine what strategy to use based on the particular situation and the potential costs and benefits.

Step 5: Monitor the progress of the enterprise and evaluate the results of the actions taken

The action team (and early warning network) should continue to monitor individual enterprises or workers assisted by them and note the actions taken, the outcomes, and whether the enterprise and jobs have been preserved.

The network members should:

- ⇒ assess the relevance and success of the strategy the action team used to avert layoffs or save the enterprise;
- ⇒ determine any changes that could be made in the strategy or approach to make it more successful;
- ⇒ assess the need for additional resources and take appropriate action to access or obtain them; and
- ⇒ incorporate any insights or recommendations arising from the action team's work that would improve the network's ability to accomplish its business retention/layoff aversion objectives in the future.

9.2.2 Use pre-feasibility studies to facilitate restructuring and ownership transfers

Having advance notice of the intent to downsize or close an enterprise is necessary but not sufficient to save an enterprise and jobs in a community. What can managers, workers and a community do after learning about the possibility of a plant closure? What steps can be taken to determine the economic viability of an enterprise and prevent its closure or departure?

Twenty years of experience in the United States demonstrates that changing the ownership structure of some business enterprises threatened with closure or major layoffs can preserve jobs and prevent layoffs. Therefore, the national worker adjustment assistance legislation (EDWAA) allows state rapid response Industrial Adjustment Specialists to authorize and finance the conduct of a pre-feasibility study to determine whether the purchase of a plant by the workers or other buyers is economically feasible.

A pre-feasibility or business viability study has been defined as "a preliminary assessment of the advisability of conducting a comprehensive study exploring the feasibility of having a company or group, including the workers, purchase the plant and continue it in operation." It is a preliminary assessment of both the financial risks and job retention.

From the perspective of a Project IA Specialist, a pre-feasibility study identifies likely failures. From the perspective of the potential buyers, a pre-feasibility study is an early and important part of the total process of considering the economic viability of a firm or enterprise as well as a prelude to formal discussions about purchasing it.

Components of a pre-feasibility study

The pre-feasibility study:

- analyses financial statements;
- roughly estimates the value of the company;
- outlines the financing required for a proposed buyout;
- identifies logical sources of financing and potential financing structures and costs;
- determines the suitability of the firm for a buyout (either employee or otherwise);
- analyses conversion issues;
- reviews the market for the firm's products or services, how the firm's products are marketed and other relevant marketing issues;
- assesses management strengths and weaknesses;
- analyses the age and quality of the workforce and labor relations issues;
- considers production issues such as capacities, product quality, and the age, the condition, and the quality of equipment and facilities;
- summarizes findings and makes recommendations.

Upon receiving a request from employees, managers, or some other group, a Project rapid response IA Specialist carries out a sequence of activities before approving and providing financial support for the conduct of a study to determine the feasibility of a management or employee buyout or purchase of a business enterprise in order to preserve jobs in a community.

ACTION MODULE: Conduct a pre-feasibility study to assess viability of the enterprise and its suitability for ownership transfer

Step 1: Establish criteria for approving pre-feasibility studies

When a group of workers, managers, or community leaders approach a Project IA Specialist for technical and financial assistance to conduct a pre-feasibility study, the Project IA Specialist considers the following as part of the approval process:

- ⇒ Is the pre-feasibility study being requested to save a company and workers' jobs? Or is it a tax strategy to reorganize a company to achieve higher profits or fend off a hostile take-over?
- ⇒ Is a company, managers, group of workers, or organization (e.g., a union local) interested in purchasing the firm? Is the present ownership willing to sell?
- ⇒ Is retaining the employees a priority of the group interested in conducting the pre-feasibility study?
- ⇒ Is there adequate time to conduct not only the pre-feasibility study but also a formal feasibility study and to obtain financing for the purchase prior to a planned closing or layoff?

Step 2: Initiate contact with the group requesting assistance

Contact can be initiated by the Project IA Specialist, employees, management, union, local leaders or others desirous of changing the ownership of an enterprise. If initiated by the IA Specialist, the initial contact is to examine the utility of purchasing a company to save workers' jobs.

The IA Specialist initial client contact data collection form asks for:

- ⇒ general information (company name, address, telephone number, contact name and position, a basic description of the company and its products/services);
- ⇒ information to determine whether the requesting group or buyout situation meets Pilot Project conditions (identified in Step 1 above);
- ⇒ conversion issues (current owners and are they willing to sell, potential buyers, the number of employees and are they aware of or involved in the buyout option, is the company unionized, the annual volume of sales, the profitability of the company, any immediate cash problems, etc.); and

⇒ next steps (requesting financial statements for the past three years, scheduling an initial client meeting, etc.).

Step 3: Make a site visit

Unless there are obvious reasons for terminating the process, the Project IA Specialist makes a site visit to observe firsthand the situation and talk to the individual or group seeking assistance. The primary purpose of the site visit is to obtain information not gathered in the first contact and to get the financial statements and other materials needed to make a decision about funding a pre-feasibility study.

Step 4: Review information obtained and make a decision

If initial efforts find that the situation meets Pilot Project conditions and sufficient evidence warrants further study and commitment of funds, arrangements are made to conduct a pre-feasibility study. Unless the Project has adequate resources in-house, or available from a sister agency (such as the Economic Development or Restructuring Agency), it typically makes available to the group or organization a list of competent consultants who will contract for the pre-feasibility study.

Step 5: Prepare and sign an agreement to authorize the conduct of a pre-feasibility study

The Project IA staff prepares and signs an appropriate agreement or contract with the group or individual selected to conduct the feasibility study. The agreement spells out the cost, work to be done, contents of report to be submitted, the timeframe, deadlines for completion of the work, and other pertinent information.

Step 6: Monitor the progress of the study and review report

A Project IA staff member monitors the study and reviews the completed report. Periodically, a file of completed studies is reviewed to determine the correlation between pre-feasibility study recommendations and buyouts, conversions, or failures that proceed to a formal feasibility study (sometimes called a business plan).

Step 7: Provide follow-up assistance and training if appropriate

If the pre-feasibility study indicates that the transfer or buyout of an enterprise would save it and the workers' jobs, the Project may provide, within its mandate and resources, whatever additional assistance is appropriate to assist the employees, managers, and present owners to achieve their objectives.

(In the United States, the cost of a pre-feasibility study can range from $5,000 to $20,000, depending upon the size and complexity of the firm, the level of analysis, the availability of information, the time available, and the type of group that conducts the study.)

A pre-feasibility study normally takes several weeks to complete. However, it may take longer for a very large firm because of the complex organizational and financial issues.

If the pre-feasibility study concludes that a buyout or transfer of an enterprise is feasible, the individuals or groups initiating the process can move to the next stage of the buyout process—a formal feasibility study that carries the process to its conclusion.

The formal feasibility study (or business plan as it is sometimes called) is a comprehensive and in-depth study of the risks and opportunities of the firm and determines whether the buyout or transfer of ownership will be successful. It also is used to convince potential lenders or others to provide the financing for the buyout or transfer.

Usually, several experts are needed to prepare the formal feasibility study (business plan) and guide the required follow-up activities. It is also the blueprint for organizing and operating the enterprise once the buyout or ownership transfer is completed.

The ownership transfer process consists of series of steps and actions of increasing complexity, time, and cost. It starts with the pre-feasibility study and, in many instances, ends with the purchase of the enterprise.

9.2.3 Use an ESOP to buy an enterprise and save jobs in the community

What is the typical process used when a group of employees and managers want to save their jobs by buying a threatened local business from its present owners? Although there are many ways that the ownership in an enterprise can be changed, one innovative and increasingly popular way this can be done is by buying the business and converting it into an employee-owned enterprise.

There is no simple answer to determine which approach to ownership change is the best one—for the workers, managers and community. Each situation is different, and must be carefully analyzed and the decision based on the potential viability of the enterprise, the willingness of the present owner to sell, the receptiveness of potential buyers, the laws and regulations existing in the country where the question arises, and the ability of the buyers to come up with the funds and strategy to purchase the business. As noted earlier in this chapter, one of the most popular ways this objective can be accomplished in the United States and some other countries is through the process of organizing an Employee Stock Ownership Plan (ESOP) as part of the buyout process.

The process of ownership transfer in which the workers buy the business and organize an ESOP as a basis for the new ownership arrangements is somewhat complex and time consuming. It usually requires considerable lead time to accomplish. Therefore, it is

important for the community to have an early warning system in place to allow the workers and managers sufficient time to accomplish the various steps needed to complete the transfer before an enterprise is sold or closed.

If the potential buyers are workers and managers of the threatened facility, and they plan to set up an ESOP as part of the buyout process, they will need the assistance of an experienced consultant or consulting group that is familiar with ESOPs and the employee ownership conversion process. They will also need information about what an ESOP is and how it works, and a roadmap that outlines the essential steps to accomplish the buyout process.[8]

There may be variations in the steps for accomplishing a worker buyout. The steps followed will depend on the status of the business.. For example is the enterprise in bankruptcy or not, is it closed or still operating? How do the present owners feel about selling the enterprise to the employees? What is the existing financial condition of the enterprise? While each of these situations may require some different steps or variations in the approach used to accomplish a worker buyout, the basic steps followed in most ESOP conversions are quite similar. The following Action Module outlines the general steps that have been successfully used in the United States during the past twenty years.[9]

ACTION MODULE: Steps to establish an ESOP as part of an employee buyout to save jobs

Step 1: Determine objectives of the employee ownership conversion.

What are the objectives of the ownership transfer to the employees—and others who may be involved? For example, one objective is probably to try and make the creditors of the enterprise whole. Another objective might be to accomplish the first objective, thereby providing maximum protection in the long term for those who are seeking to effect the transfer (e.g., the group of workers and their union (if one exists) and creditors committee) and who will be engaging the consultants to help complete the ownership transfer and creation of the ESOP.

[8] For additional information about how ESOPs work in the United States and what those considering using one need to know see the publication: *ESOPs and You*, by Gary B. Hansen and Frank T. Adams, or the 4th edition of *ESOPs, Unions and the Rank and File*, by the same authors (SACCO, 2000).
[9] The material for this Action Module has been adapted from "Establishing an ESOP" and other materials supplied by Frank Adams and The Southern Appalachian Center for Cooperative Ownership.

Step 2: Determine if all owners are agreeable to the sale.

The successful transfer or sale of an enterprise (or unit thereof) to the workers and managers cannot go forward unless the parties are willing to actively participate in the process. If the owner is unwilling to even consider the sale, or at least passively allow it to go forward, it is a much more difficult process to accomplish.

Step 3: Select a qualified consulting group and negotiate an agreement.

It is important that the consultant or consulting group hired to conduct the feasibility study and complete other work required to complete the sale and conversion of an enterprise to employee ownership is experienced in facilitating employee ownership conversions and in setting up ESOPs. Once a suitable consultant or consulting group is selected the parties seeking to buy the enterprise should negotiate the terms of the agreement under which the work will be accomplished. The buyout group of stakeholders (e.g., workers their union, creditors committee, etc.) hiring the consultants typically make an agreement with the consulting group that spells out exactly what they are being hired to do. For example, the consulting group will be hired to prepare or coordinate "the preparation of a two phase comprehensive reorganization plan that uses Employee Stock Ownership as its central features."

If possible, the agreement between the buyers and the consulting group should set out the assumptions that will guide the feasibility work of the consulting group and their efforts in designing the ESOP. For example, the agreement might include the items identified in Example 1 below.

The agreement should also set out the steps that the consulting group will follow in completing their work. For example, the agreement might specify that the work will be carried out in two phases, the first phase being the feasibility and financial studies, and the second phase being the preparation of the business plan and documents needed to establish the ESOP and the new incorporation of the enterprise (NEWCO), informing workers of their rights and responsibilities, under the law and collective bargaining agreements, presenting documents to the proper authorities for approval, and, if approved by appropriate parties, assisting the new owners to identify suitable managers, etc...

Example 1

Assumptions that will guide the consulting group's work with a bankrupt firm

As we now understand the situation, we think the design should include these components:

(1) that the facilities or support units determined to have the potential to add continued value to these assets that will be incorporated into an employee-owned corporation (NEWCO) through establishment of an ESOP;

(2) that the valuation of the firm will be made by an independent third party analysis, i.e., by a CPA or lawyer/CPA certified to do evaluations and independent of any of the parties to the sale;

(3) that the goal of the NEWCO is to become a majority ESOP as soon as possible, meaning that employees own 51 percent of stock, thus making NEWCO eligible for tax credits available to employee-owned manufacturing corporations in the political jurisdiction (take advantage of whatever provisions the current laws allow),

(4) that training costs for employees who may have to learn new job skills will be financed under current laws and programs in the political jurisdiction;

(5) that the consulting group will work with any creditors whose debt is directly attributable to the unit(s) or division(s) being purchased in order to convert debt into equity. Furthermore, the consultants will work with appropriate financial institutions to frame business, marketing and finance plans necessary to establish the NEWCO ESOP, and for subsequent operating or capital investment;

(6) that the units or divisions being bought will be converted to Majority ESOP NEWCOs, provided these assets are determined to project earnings sufficient to repay ESOP debt. Current creditors with debt directly attributable to these units shall convert that debt to equity;

(7) that the creditors committee continues to sell assets or close clearly unprofitable facilities;

(8) to seek further protection for creditors and to assure employee owners their ESOP investment is a prudent risk, any NEWCO incorporated in this reorganization will share these common characteristics:

- ❑ Senior management compensation will be industry competitive but bonuses will be determined on objective evaluation of abilities to focus on quality, service and value of NEWCO products, and profitability of operations. Each NEWCO will "carve out: ESOP stock to be retained for senior managers, but this stock must be negotiated at each NEWCO according to each NEWCO's financial circumstances, and all stock must be sold back to each NEWCO upon termination of employment at fair market value.
- ❑ Employee compensation will be industry competitive but supplemented with profit sharing, gain-sharing , or a specifically designed means to share earnings.
- ❑ Each NEWCO established in this manner will have a joint labor-management PI/CS Study Team with authority to propose to the board of directors and then to develop and implement efficiency or cost-saving programs without the layoff of any workers.
- ❑ NEWCO ESOPs will be "directed trustee or democratic" meaning that all employees will have one vote to elect one person from each of the following "job" categories, hourly union, hourly non-union, and management to the board of directors. Creditors shall have seats on the board of directors. No NEWCO board of directors shall exceed 11 members.

Source: Southern Appalachian Center for Cooperative Ownership

Step 4: Sign a confidentiality agreement and set up a secure data room.

The buyers and sellers should sign a confidentiality agreement to ensure that during the period of the feasibility study and conversion process, proprietary and confidential information will not be disclosed to anyone other than those specifically authorized to participate in the feasibility study and conduct other work being carried out as part of the feasibility study or conversion process.

.In order to protect the confidentially of the data and process, it is also important that the data needed and used by the consultants be available, and protected by placing it in a secure data room, where authorized individuals may have access to the data needed to complete the feasibility study and other necessary activities, but others who are not authorized are prevented from having access or removing the materials.

Step 5: Complete pre-feasibility and other business and financial studies

The consulting group, augmented by individuals or firms with direct experience in the industry, but with no ties or conflicts of interest with any creditors or the enterprise, conducts the feasibility study elements. There are several elements:

- ***A preliminary feasibility analysis*** to screen out inappropriate cases. Its purpose is also to determine the financial risks and potential for job preservation.[10]
- ***A market analysis*** to determine whether there is a (growing, stable, declining) market for the products produced by the enterprise, who the major competitors are, and whether the enterprise can be an efficient producer in the industry. etc.
- ***Debt analysis*** and ability to repay loan
- ***Profit and earning ratios***,
- ***Earnings before interest, taxes, depreciation and amortization***.
- ***Payroll analysis*** to determine if payroll is adequate for employee deductions
- ***A repurchase liability analysis***
- ***A fair market valuation*** to determine what the enterprise is worth, what price should be placed on its assets and good will, and what the price of its stock should be if the company is not publicly traded
- ***An environmental audit***
- ***Undertake due diligence***, including environmental audit if necessary

The nest step and those that follow will be undertaken with the Creditors' Committee or other partners' approval.

[10] For a sample of a pre-feasibility assessment format, see Appendix B in *Putting Democracy to Work: A Practical Guide for Starting and Managing Worker-owned Businesses*, by Frank T. Adams and Gary B. Hansen. (Revised Edition, 1992)

Step 6: Design the NEWCO ESOP and prepare summary plan document

The design of the NEWCO ESOP and summary plan documents are completed. This would includes a summary of all anticipated tax credits that would be available for an ESOP company, and would meet the second objective (listed in Step 1 above) of protecting the long-term future of the workers and their unions. The ESOP design process and preparation of ESOP documents is normally done with the help of an attorney who is experienced or specializes in ESOP conversions. This step includes the following activities in addition to completing the ESOP plan and summary plan document:

- ❑ Select a Trust Administrator and write Trust Agreement
- ❑ Complete all necessary lending agreements
- ❑ Present final summary plan description to employees
- ❑ File ESOP plan with tax authorities and other appropriate government agencies

Step 7: Prepare a complete Business Plan.

It is necessary to prepare all of the customary business plan, containing all of the production, marketing and financial components or documents necessary for the formation of an ESOP and a new incorporation (NEWCO), including audits of all units or divisions as well as an environmental audit of each manufacturing, transportation or other such facility proposed to be included in the transaction.[11]

Step 8: Inform employees about their rights and responsibilities.

It is important to inform all employees of the enterprise of their rights and responsibilities under ESOP laws in the country, but particularly those employees covered by any existing labor agreements, as they must agree by ballot to the terms of any new labor agreement with NEWCO.

Step 9: Present Business Plan and documents to officials for approval.

The business plan and related documents, including lending and renegotiated labor agreements, are submitted to the appropriate persons and groups (e.g., creditors' committee, shareholders committee, lending agency, etc.), and, if approved, then to the final approving agency (SOE restructuring agency, bankruptcy court, etc.).

[11] For samples of the questions and contents of a formal feasibility study and a sample of a business plan see Appendices C and H in *Putting Democracy to Work: A Practical Guide for Starting and Managing Worker-Owned Business*, by Frank T. Adams and Gary B. Hansen. (Revised Edition, 1992).

Step 10: Assist the new owners to identify and recruit a management team.

If the refinancing and reorganization plan is approved by the final authorizing group (bankruptcy court, SOE Restructuring Agency, or shareholders, etc.) the consulting group typically assists the new stakeholders (Creditors' committee, lending agency, or other persons) to identify and recruit appropriate corporate managers and assist all parties to any collective bargaining agreement to organize and carry out balloting by eligible employees.

Step 11: Design and implement an educational plan.

Once the ownership conversion process has been completed it is important for the new employee owners and managers to carry out at least one addition step—the design and implement an educational plan. Owning and working in the same enterprise that was previously run as a traditionally managed enterprise requires some new skills and tools for both managers and workers if it is to succeed. Thus, it is very important that this step be included in the conversion process to teach the owners and managers these new skills they will need, and help them to learn how to use the tools that are available. Unfortunately, the failure of some employee ownership conversions can be directly attributed to the failure to include this important post-conversion step.

In some cases the employee owners will build in this step at the outset, and will retain the ESOP consulting group that provided theme with assistance to complete the conversion to continue on with this step. In other instances they may engage another competent ESOP or employee-ownership training group to help them carry out this step.

The typical elements of an educational plan for a NEWCO ESOP are as follows:

- ❑ Design and budget "Introduction to ESOPs Education Plan" with workforce leaders
- ❑ Implement ESOP Education plan
- ❑ Draft ESOP Summary plan description with workforce
  - ⇒ Write "Owners' Participation Plan Policy" (to be implemented as ESOP is starts)
  - ⇒ Design "Profit sharing Plan" (to be implemented as ESOP starts)
  - ⇒ Design "Annual Owner ESOP Performance Program" to be implemented after ESOP starts)

Annex 1

Additional training manuals and resource materials

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Adams, Frank T. and Hansen, Gary B. *Putting Democracy to Work: A Practical Guide for Starting and Managing Worker-owned Businesses*, by. (Revised Edition, 1992)

Early Warning Manual. A Guide. Midwest Center for Labor Research. (Chicago: 1996)

Hansen, Gary B. and Adams, Frank T. *ESOPs and You*, (Ashville, NC: SACCO, 2000).

Hansen, Gary B. and Adams, Frank T. ESOPs, Unions and the Rank and File. 4th edition (Ashville, NC: SACCO, 2000)

Annex 2

The following material, entitled Appendix B and Appendix C, has been reproduced from Frank T. Adams and Gary B. Hansen, Putting Democracy to Work, Revised Edition, 1992)

Appendix B

A Preliminary Feasibility Assessment for a Worker Buyout: Screening Out Inappropriate Cases

(Adapted from Julia Parzen, Catherine Squire, and Michael Kieschnick, Buyout: A Guide For Workers Facing Plant closings, Sacramento: Department of Economic and Business Development, State of California, Second Printing, September 1983, *pp* 27-35. *Reproduced from Frank T. Adams and Gary B. Hansen, Putting Democracy to Work, Revised Edition, 1992*)

Because the preliminary feasibility study's purpose is to be quick and inexpensive, it is only a means of identifying those cases where an employee buyout is very inappropriate (or appropriate) . The preliminary feasibility study should take less than a month to complete and cost very little (usually less than $5,000). If funding is not easily available, it can be prepared by qualified volunteers from community or government offices (such as the State Office of Economic Development) on a pro bono basis by university business school faculty and students, consulting firms, or by public interest or non-profit groups with low overhead. Finally, the preliminary feasibility study should employ readily available sources of data that answer the specific questions described in the following sections:

A) ***Are the present owners amenable to an employee buyout?***

1 Is there language in your union agreement giving you first option to buy? (See Union Agreement)
Yes No

1 Is the standard language in union agreements giving management exclusive rights to manage and terminate employees removed from your agreement? (See Agreement)
Yes No

1 Has management been publicly willing to entertain an offer from employees or at least been neutral about such an offer? (Meet with management, read press clippings)
Yes No

1 Is management willing to contribute a nominal sum toward the feasibility study or to consider a decision to dedicate land, structures or equipment to the employees currently or in the future? (Meet with management)
Yes No

If the answer to the first question is yes, then lack of support by management should not be a problem. If it is no, then the answers to the other three questions are more critical. If the answers to questions 2 through 4 are also no, then management will probably be unwilling to negotiate a

buyout with employees. As a result, a successful buyout is unlikely, and will be possible only if there is both significant media and public support, and a feasibility assessment indicating very clear benefits to employees and investors.

B) ***Is your firm organized in such a way that a smooth transition to employee-ownership is feasible?***

1. Do you have an experienced manager, or group of experienced managers, who are willing to manage your employee owned firm?
   Yes No

2. Do the skills of your workforce meet the needs of your employee owned firm?
   Yes No

3. Does your plant have on-site personnel, marketing, finance, and general administration functions?
   Yes No

4. .Is your plant operated as a profit center? (Is it required to document both its revenues and costs?)
   Yes No

5. Does your plant produce its products without receiving inputs from other management-owned plants or transferring outputs to other management owned plants for finishing?
   Yes No

All of the above questions indicate whether a smooth transition is possible. The commitment of skilled top and middle managers is crucial. Nevertheless, if potential managers exist, expert economic and legal advice by an outside consultant can substitute up to the point that a final decision to proceed is made. If the answer to one or more of questions 2 through 5 is no, then it is important that there be time to reorganize the firm before it closes and that there be committed management. If there are only a few months available (not enough time to reorganize), then an employee buyout is only advisable if plant market factors are both very positive, improving the chances of continued interest once the plant closes.

C) ***Are the products produced at your plant facing declining, stable or growing markets?***

To answer this question in the preliminary feasibility analysis, you should rely on published analyses and industry experts. Prime sources of data on your industry available in libraries (such as public business libraries, university libraries, or major bank libraries) or from your company are as follows:

- ❑ Standard & Poor's Industry Surveys

- ❑ Value Line Investment Survey

- ❑ Department of Commerce's U.S. Industrial Outlook (Annual)
- ❑ Moody's Industrial Manual for your corporation or other firms in your industry (Annual)
- ❑ Walker's Manual of Western Corporations
- ❑ Dun & Bradstreet, Inc. , Key Business Ratios
- ❑ 10k report of your corporation (look at statement of President)
- ❑ Market studies prepared for your corporation
- ❑ Trade journal articles on your industry located through the Business Periodical Guide and F&S Guide

Industry experts whose opinions you should seek out include the following:

- ❑ The analyst for the appropriate industry from the Bureau of Industrial Economics, Department of Commerce, Washington, D.C.
- ❑ The trade association staff for your industry's trade association.
- ❑ Market analysts from market research firms or security analysts for your industry (ask reference librarian at a business library or get names from articles in trade journals).
- ❑ If possible, sales and production managers at your firm.

Using these data sources and others that become available, it should be possible to find sufficiently good answers for screening purposes to the following questions:

1. Do industry sources anticipate stable or growing demand for your industry's products?
   Yes No
2. If there is a recession or slump in your industry, is it projected to end within 6 months to a year?
   Yes No
3. If there are new or existing products taking market share away from (replacing) your product:
   Yes No
   a) Can your plant possibly produce the competing product?
   Yes No
   b) Are there possible new markets or niches for your product?
   Yes No
4. Are other producers of your product maintaining or increasing capacity or production levels?
   Yes No
5. Are foreign firms or plants expected to maintain constant or declining share of U.S. sales over the next few years?
   Yes No

6. If your product is sold to other industries (rather than consumers), do industry sources indicate strong demand for these industries' products?
   Yes No
7. If there are obvious alternative uses for your plant, are the answers to the above questions for the alternative uses or products affirmative?
   Yes No
8. According to industry analysts and plant managers, how does your product compare to that of other domestic and foreign producers:

   a) Average quality equal or better
   Yes No

   b) Average prices equal or lower
   Yes No

   c) Perception by customers equal or better.
   Yes No

It is important that most of the eight screening questions be answered "yes". It is imperative that at least the answers to I, 2, 3 and 8 be positive for your product or for alternative products.

D) ***Is it possible for your plant to be an efficient producer in your industry?***

To answer the following questions, historical data will be needed on your plant. For part (I) of D in particular, it may be difficult to obtain the necessary data. Thus, if you cannot obtain data on your plant's current profitability, skip part (1) and go directly to part (2).

1) How does the profitability of your plant of firm compare with other firms in your industry?

a. Data needs include one to three years of historical data for your facility on profits before taxes, sales revenue, net worth, and Robert Morris industry-wide financial data (for the SIC code that most closely corresponds to your firm*) on profit/sales and profit before taxes/tangible net worth.

b. Procedures for performing the comparison are provided in worksheets 1 and 2.

c. Criteria for judging the results are as follows:
   Has your average profit/sales ratio for the last three years been positive? (See line 4 of worksheet 1).
   Yes No
   Is the average profits/sales ratio for your firm less than 50 percent of the industry average? (Your firm may not be competitive in your industry.)
   Yes No
   Is the average profit before taxes/tangible net worth ratio for your firm less than the industry average for the lower quartile? (Your firm may not be competitive in your industry.)

Yes No

Exhibit 1

ROBERT MORRIS DATA

	Current Data					*Comparative Historical Data*		
	O-25M	*150M-1MM*	*1-10MM*	*10-50MM*	*ALL*	*6/78- 1/77*	*6/77- 1/78*	*6/78- 1/79*
	2	*9*	*21*	*6*	*38*	*All 36*	*All 38*	*All 45*
	%	*%*	*%*	*%*	*%*	*%*	*%*	*%*
INCOME DATA								
Net Sales			100.0		100.0	100.0	100.0	100.0
Cost of Sales			72.1		68.5	63.7	65.1	66.5
Gross Profit			27.9		33.5	36.3	34.9	33.5
Operating Expenses			22.7		28.3	29.3	28.8	28.3
Operating Profit			5.3		5.2	7.0	6.2	5.2
Other Expenses			5.0		6.0	9.0	5.0	5.0
Profit Before Taxes			4.8		4.6	6.1	5.7	4.6
% Profit Before Taxes/			35.2		22.0	38.7	37.2	35.2
Tangible Net Worth			20.9		22.0	24.5	27.5	22.0
Profit Before Taxes			9.0		9.0	10.9	9.9	9.0

**The SIC code for your firm can be determined from descriptions in Standard Industrial Classification Manual, 1972, available at any business-oriented library. Examples of the two rations from Robert Morris that are needed are indicated with arrows in Exhibit 1.*

Worksheet 1

PROFIT BEFORE TAXES/SALES RATIO YOUR FIRM

($s in 000's)		*Years*		
		19__	*19__*	*19__*
1) Total Sales Revenue	$			
2) Profit before Taxes	$			
3) Profit/Sales Ratio: Line (2) / Line (1) multiplied by 100	$			
4) Average of the three years for firm	$			
5) Industry Average Profit/Sales Ratio	$			
6) Average of the three years for the industry	$			
7) 50% of the Industry Average	$			

Explanation for Worksheet One

Line 1) Total sales from top line of the firm's income statement for the last three years years.

Line 2) Profit before taxes located on the firm's income statement for last three years.

Line 3) Line (2) divided by Line (1) multiplied by 100.

Line 4) Sum of Line (3) divided by 3.

Line 5) Industry Average Profit/Sales Ratio from Robert Morris data for same three years.

Line 6) Sum of Line (5) divided by 3.

Line 7) One half of Line (6).

Worksheet 2

PROFIT BEFORE TAXES/TANGIBLE NET WORTH RATIO YOUR FIRM

($s in 000's)		*Years*		
		19__	*19__*	*19__*
1) Stockholder's Equity	$			
2) Intangible Assets	$			
3) Tangible Net Worth: Line (1) minus Line (2)	$			
4) Profit before taxes	$			
5) Profit before taxes/ tangible net worth: Line (4) / Line (3) x 100	$			
6) Average of three years for firm	$			
7) Industry Average Ratio (lower quartile)	$			
8) Average of three years for the industry	$			

Explanation for Worksheet Two

Line1) Stockholder's equity from the firm`s balance sheet for last three years; include common stock plus paid-in surplus and retained earnings and subtract the value of any treasury stock.

Line 2) Sum of all intangible assets shown on balance sheet for last three years such as "goodwill" and "cost in excess of net assets of acquired companies."

Line 3) Line (1) minus Line (2).

Line 4) Profit before taxes located on the firm's income statement for last three years.

Line 5) Line (4) divided by Line (3) multiplied by 100.

Line 6) Sum of Line (5) divided by 3.

Line 7) Industry Profit before taxes/tangible net worth ratio for the lower quartile of firms from Robert Morris data for same three years. This figure should be taken from the bottom row of figures because this row represents the lower quartile.

Line 8) Sum of Line (7) divided by 3.

2) *Has your plant been maintained and can major capital expenditures be avoided?*

a) Data needs include plant maintenance records, plant capital spending budget, industry data on technologies employed and new facilities built, and data on profit after tax and depreciation expenses. If these data are not available, use your best judgement.

b) Criteria for evaluating these data are as follows:

- ❑ If your plant and equipment are older than the average for the industry , have they been maintained?
  Yes No
- ❑ Have all major capital expenditures that are necessary to maintain the facility, or meet government regulations (especially pollution) been made?
  Yes No
- ❑ D Does your plant have processes and technologies at least as current as those used by the majority of your industry (based upon your market research)?
  Yes No
- ❑ *If your plant has not been maintained or has not met government regulations, would the cost be reasonable to make necessary expenditures? A benchmark is whether the cost crudely estimated to get your facility in good condition would be less than six times your plant's average cash flow (profit after tax plus depreciation expenses) for the last three years.
  Yes No
- ❑ *If your plant's processes and technologies are not current (based upon your market research), would the cost be within reason to make necessary expenditures? A benchmark is whether the cost crudely estimated to make required maintainance on your facility and obtain the new technologies would be less than six times your plant's average cash flow (profit after tax plus depreciation expenses) for the last three years.
  Yes No

* *Skip this question if data on the profitability of your plant is not available. If these data are available , add together profit plus depreciation expense for last three years and divide by three. Then multiply the result by six.* The *capital cost of new equipment should be smaller than this result.*

If the answers to the first three questions above are yes, then your plant is in good condition and up to date. If the answers are no, then you need to consider how costly it will be to bring it up to date. A benchmark is provided in the fourth and fifth questions. If the answers to all five questions are no, then a successful buyout is unlikely because of poor plant maintenance combined with high capital costs. A minimal requirement is that either the plant is adequately maintained or that costs of achieving adequate maintenance are not exorbitant.

E) *Summary of the results of the preliminary feasibility study*

At the completion of the preliminary feasibility study, the following questions should have been

posed and answered:

- ❑ Is there enough time before the closure? (See Factors for Success)
  Yes No
- ❑ Are the present owners amenable to an employee buyout? (See Section A)
  Yes No
- ❑ Is your firm organized in such a way that a smooth transition to employee-ownership is feasible? (See Section B)
  Yes No
- ❑ Are the products produced at your plant facing stable or growing markets? (See Section C)
  Yes No
- ❑ Is it possible for your plant to be an efficient producer in your industry? (See Section D)
  Yes No

In an optimal buyout situation all of the answers will be yes. This will rarely be the case. In most cases the most important questions are the last three. While there will often be special circumstances beyond the scope of this manual t in general affirmative responses to the last three questions and in particular those about efficiency of production and market for the product are crucial.

Worksheet 1

PROFIT BEFORE TAXES/SALES RATIO YOUR FIRM

($ in 000's)

1) Total Sales Revenue
2) Profit before Taxes
3) Profit/Sales Ratio: Line (2) / *Li*ne (1)
   multiply by 100
4) Average of the three
   years for firm
5) Industry Average
   Profit/Sales Ratio
6) Average of the three years
   for the IrdJstry
7) 50% of the lOOustry Average

Explanation for Worksheet One
LIne 1) T otal sal9$ from top line of the firm's Irx:ome state ment for the last three years years.
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Line 4) Sum of LIne (3) dlvkled by 3.
Une 5) lOOUstry Average ProfIt/Sales Ratio from Robert Morris data for same three years.
Line 6) Sum of LIne (5) dlvkled by 3.
LIne 7) One half of LIne (6).

Worksheet 2
PROFiT BEFORE T AXES/T ANGIBLE NET WORTH RA TIO YOUR FIRM

($sinOOO's) Years

1) Stockholder's Equity
2) Intangible Assets
3) Tangible Net Worth:
Line (1) minus Line (2)
4) Profit before taxes
5) Profit before taxes/ tangible net worth: Line (4) / Line (3) x 100
6) Average of three years for firm
7) Industry Average Ratio (lower quartile)
8) Average of three years for the industry

Explanationfor Worksheet Two
Line 1) Stockholder's equity from the firm . s balance sheet for last three years; include common stock plus pakj-in surplus and retained earnings and subtract the value of any treasury stock.
Line 2) Sum of all intangible assets shown on balance sheet for last three years such as "goodwill" and "cost in excess of net assets of acquired companies."
Line 3) Line (1) minus Line (2).
Line 4) Profit before taxes located on the firm's income statement for last three years.
Line (4) divided by Line (3) multiplied by 100.
Sum of Line (5) divided by 3.
Industry Profit before taxes/tangible net worth ratio for the lower quartile of firms from Robert Morris data for same three years. This figure should be taken from the bottom row of figures because this row represents the lower quartile .
Line 8) Sum of Line (7) divided by 3.

Appendix C

THE FORMAL FEASIBILITY STUDY FOR A WORKER BUYOUT: WHO TO DO IT, HOW TO PAY FOR IT, AND WHAT BELONGS IN IT

Adapted from Julia Parzen, Catherine Squire, and Michael Kieschnick, ***Buyout: A Guide For Workers Facing Plant Closings,*** *Sacramento: Department of Economic and Business Development, State of California, Second Printing, September 1983, pp 27-35.*

If the preliminary feasibility study indicates that an employee buyout is potentially feasible, a full-scale feasibility study is needed. The purpose of the feasibility study is to provide a comprehensive assessment of risks and opportunities for the employee-owned firm.

Several experts are needed to perform the study and guide the necessary follow-up:

- ☐ Financial consultants to do the study;
- ☐ ESOP or co-op experts to structure the buyout; and
- ☐ Lawyers to negotiate the purchase of facilities.
- ☐ Teachers to help set up educational program.

In addition, in some cases a real estate appraiser will also be needed. The costs of obtaining these experts and the way in which their services will be used is described in the following paragraphs.

Costs That Will be Incurred and How to Finance Them

The cost of the feasibility study will depend upon the specific case, but some estimated costs as of 1985 are provided in Table 1. This table assumes no free services or below market cost services.

The feasibility study and follow-up will cost at least $20,000 and may cost more than $100,000.

Table 1

COST OF FEASIBILITY STUDY

For cost analysis using available data and review of public market research			$ 20,000
If market research is required	+$20,000	=	$ 40,000
If must generate new cost data because of anticipated changes in products and markets	+$20,000	=	$ 60,000
If must appraise assets	+$15,000	=	$ 75,000
If need lawyer and Coop/ESOP expert	+$40,000	=	$115,000

Costs can be minimized by seeking out consultants with low overhead and firms willing to do pro bono work. It can also be done by using consultants who have a good reputation, but do not have a well-known reputation. These consultants can be backed up with an oversight committee. This committee should include local bank officials, co-op/ESOP experts, a law firm, city officials, union representatives and management consultants.

There are a number of sources of financing for the feasibilty study. The main ones are described below.

1) Raise money from union members—it is a good idea to request at least a small contribution as a sign of commitment—and from existing owners.

2) Obtain a grant from federal agencies such as the Economic Development Administration—while this approach is time-consuming, it worked for the U.S. Steel Youngstown employees who received a grant to hire a consultant.

3) Obtain technical assistance grants from State agencies—the State of California approved a grant to help General Electric workers in Ontario perform a feasibility study.

4) Local economic development department grants.

5) Local benefactors, perhaps located through the mayor's office.

6) Foundations and churches.

7) Making use of pro bono work by business schools, firms and universities.

How to Find and Choose the Consultants

The most likely sources of consultant support for the feasibility study are management consulting firms, other financial consulting firms, The ICA Group, groups specializing in worker-ownership, and university business schools (for both faculty and students).

Finding appropriate people can be difficult, but there are several good starting points. You can ask (1) state economic research offices that have contact with economists and business analysts or state departments that service your industry (Department of Forestry, Energy Commission, etc.), (2) Chambers of Commerce or Industry Trade Associations, whose members may have used business consultants, (3) university MBA programs where you can ask the dean of students whether students undertake business consulting projects and (4) department heads of university marketing, finance, and business policy departments who may know the faculty who do this kind of work. In an attachment there is a list of resources for employee ownership that offers advice on sources of assistance (there is also a list of guidebooks, etc.).

Once you have found one or more likely individuals or groups, there are several questions that you should ask them. These are listed in Table 2.

The Feasibility Study: Content and Interpretation

The purpose of the following discussion is not to describe how to do the feasibility study. The specific steps vary significantly from case to case, and the employees certainly don't need to be able to perform the analyses. Nevertheless, they do need to be concerned about whether the feasibility study deals with the relevant issues, and they need to know how to interpret the results. There are two basic parts to a feasibility study:

1) Market Factors—demand for the product.

2) Plant Factors—viability of the plant with a small investment.

Table 2

WHAT TO LOOK FOR IN POTENTIAL CONSULTANTS

1) Have they done other cost analyses of plants?
2) Have they done any market studies?
3) Have they done financial modeling or prepared business plans?
4) Have they had other business clients?
5) Have they done feasibility studies for plant buyouts or divestitures?
6) Do they have backgrounds with extensive business/finance experience?
7) What are the names of some of their clients, and can you call them to get their opinion of the individuals?
8) Is overhead less than 100% of their hourly cost?
9) Can they get the study done within a few months (depending on your time pressures)?
10) Are they willing to give caveated opinions about issues for which all the data they would like is not available?

While a related area is financing, whether financing is obtainable will depend on the market and plant factors. Thus, financing is discussed separately in a final section.

Relevant Issues to Analyze in Feasibility Study

The following sections describe the relevant points that the consultant should investigate and the results that employees should seek. It may be desirable to have a contract with a consultant that requires the following analyses:

A) *Market Factors*

1) **Future Market for Each Product Produced.**

- ☐ Short-term and long-term demand outlook.
- ☐ New uses for your products.
- ☐ New substitutes for your products.
- ☐ New potentially profitable product lines.
- ☐ New competition from abroad.

- ☐ If your product is an input for another product, short-term and long-term outlook for industry using your product.
- ☐ Your market share by product line.
- ☐ Shifts in your market share.
- ☐ If market changing, niches for your product.

Results sought: Whether you can expect continued demand for your products and, if so, approximately how many units can you expect to sell.

2) **Concentration/Competition in the Industry.**

- ☐ Type of market (local, regional or national).
- ☐ Number or changes in number (new plants, plant closures) of firms in market.
- ☐ Names of dominant producers and estimates of their market shares.
- ☐ Changes in imports.
- ☐ New production technologies; whether your plant has them and their importance.
- ☐ Integration of your facility relative to competitors.
- ☐ Distance from markets relative to competitors.

Results sought: Whether your firm has any unique advantages or disadvantages relative to competitors.

3) **Feasibility of Competition By a New Entity.**

i) Basis of competition for customers in your industry.

- ☐ Importance of brand name.
- ☐ Number of brands.
- ☐ Homogeneity of product.

- ☐ Effectiveness of price cutting.
- ☐ Whether existing firm is major brand.
- ☐ How existing firm has competed.

Results sought: Whether the employee-owned firm will be able to compete for customers.

ii) Normal Industry Distribution Channels.

- ☐ Do most firms in industry use factory direct sales, distributors or manufacturers' representatives?.
- ☐ Channels existing management has used.
- ☐ What distribution facilities (ex: warehouses) will the employee owned firm need, and are they available?
- ☐ Can the firm keep its existing distribution channels and contacts? If not, are there channels it could easily adopt?
- ☐ Will the firm need to obtain a large new sales force?
- ☐ Are customers willing to purchase goods from the new employee-owned firm?
- ☐ Are any large customers willing to provide letters of intent to purchase from the new firm?

Results sought: Whether there is a means of distribution available to the employee-owned firm that will not require a complex, new network.

iii) Sources of Inputs at Competitive Prices.

- ☐ Current suppliers of inputs (raw materials, etc.).
- ☐ Potential new sources of inputs.
- ☐ Do current suppliers serve other facilities owned by your corporation?
- ☐ Will you be able to keep suppliers?

- ☐ Will the employee-owned firm purchase a sufficient amount of inputs to command competitive prices?
- ☐ Are there any very large suppliers of inputs?
- ☐ Are any large suppliers willing to provide letters of intent to sell to the new facility?

Results sought: Whether the employee-owned facility can expect to have reliable sources of supply at a competitive price.

B) ***Plant Factors***

1) **Physical Condition of Plant and Equipment.**

- ☐ Historic maintenance schedule and changes in maintenance.
- ☐ Historic reinvestment plan and changes in plan.
- ☐ Average age of major capital equipment and remaining useful life of equipment.
- ☐ Age of facility relative to average age for other plants owned by parent firm and by other firms.
- ☐ Need for major capital expenditures for maintenance, modernization, and/or regulation compliance.
- ☐ Estimated value of plant and equipment to be purchased.*

** A well-qualified appraiser of assets may be needed for this analysis. The appraisal will cover land, buildings, inventory, and equipment that will be useful for the new company. The business is worth the market value of its assets that are necessary to conduct business plus a premium if the business is especially profitable or minus a discount if it is unprofitable.*

Results sought: Whether the facility has been maintained enough to allow continued productive use. Whether large capital expenditures can be avoided, at least in the first three to five years. Which of the facilities for sale are needed by the employee-owned firm, and their maximum value to the new firm.

2) **Organizational Structure: Leadership, Functions and Facilities.**

- ☐ Is facility a profit center or a cost center?
- ☐ Functions that would be included in purchase of facility, including personnel, marketing, sales, finance and general management.
- ☐ Personnel needed to fill gaps in functions.
- ☐ Are the facilities at the plant complete or would additional facilities be required, such as warehouses?
- ☐ Ability to keep top and middle management on board or attract new experienced management.
- ☐ Does the existing work force have the necessary skills to operate the employee-owned facility? Is it willing to do so?
- ☐ Products or services transferred from other plants.
- ☐ Products transferred to other plants.

Results sought: Whether the employee-owned firm can have a smooth transition. This is determined by whether it can function as an independent facility without needing to be reorganized; whether it can be separated from current ownership without losing key suppliers or markets, and whether it can depend on having a committed management to lead it.

3) **Historical viability of the plant.**

a) Economics of the plant/company

i) Cost structure for last three to five years: for each product line, including costs of materials, labor, energy, maintenance, allocated overhead and number of units of output.

- ☐ Whether any unit costs are assessed at transfer prices (if so, revalue them to market prices).
- ☐ Changes over time in the shares of costs and reasons.

- ☐ Changes over time in the usage of any input and reasons.
- ☐ Historical capacity utilization and efficient utilization levels.

ii) Operating margins, computed using historical prices and costs.

- ☐ Trend in prices and reasons.
- ☐ Product lines with largest margins.
- ☐ Adjustments to mix that would increase plant margins.

iii) Break-Even Volume.

- ☐ Minimum volume of output at which revenues equal costs.
- ☐ Volume of output that maximizes profit margin.
- ☐ Implications of optimal output for necessary changes in current output and employment for employee-owned firm.
- ☐ Feasibility of being able to sell optimal output given market projections about size of total market.

iv) Profitability, computed based upon earnings data for facility for last five years or by subtracting from operating margins, unallocated fixed costs, estimated corporate charges, current interest costs and depreciation expenses.

- ☐ Trends in profitability.
- ☐ How changes in mix identified above would change profits.

v) Cash flow, for the last five years using the data above on profits (after tax computations), adding back depreciation expenses, and subtracting out changes in working capital, debt repayment and capital expenditures.

- ☐ Whether cash flow provided by operations has been

sufficient to support necessary expenditures (compare profit plus depreciation to capital expenditures and debt repayment).

- ☐ If there are costs hanging over the plant for deferred maintenance, deferred replacement or regulatory compliance, has plant cash flow been sufficient to finance them? If not, how much outside capital would be needed to finance them?

- ☐ If the prospective buyout has been an independent business, additions to debt or equity capital in the last five years.

- ☐ Whether any of the facility's assets are secured by debt.

Results sought: Whether the facility historically has shown economic viability, including whether it has been able to control its costs and maintain profit margins; whether it has operated at optimal levels of output and with an optimal mix of its products; whether the new worker-owned firm could expect a market for the volume of output at which it breaks even and for the volume of output at which it maximizes profits, whether it has been able to finance through internal cash flow its own working capital and at least some of its other capital needs; and whether it has been able to raise any outside capital in the past. For all of the above, what were the reasons why the firm did or did not achieve these profit, output, and financing aims?

b) Plant strengths and weaknesses (based upon the previous market and cost analyses).

- ☐ Reputation of the facility, including whether it has long-term suppliers and customers and their statisfaction with the facility.

- ☐ Willingness of suppliers and customers to deal with the new firm.

- ☐ Quality or efficiency as a producer relative to other producers.

- ☐ Low or high cost producer in its industry for each product.

- ☐ Unique product offerings.
- ☐ Other strengths and weaknesses.

Results sought: Whether the facility has the good will of its suppliers and customers; whether these suppliers and customers will deal with the new firm; and whether its competitiveness with other facilities is enhanced or reduced due to specific strengths or weaknesses.

c) Feasibility of Improving Operating Margins, Profitability, and Cash Flow.

i) Ability to Control Costs.

- ☐ Cost reductions that could be made and their effect on profit margins; in particular, feasibility of reducing overhead, improving inventory control, reducing spoilage and waste, reducing absenteeism, finding cheaper suppliers, and willingness of employees to trade off ownership for wage reductions (level of deferrals they are willing to consider); generally it is not advisable to trade the pension plan for ownership of the company.

ii) Ability to Change Mix and Level of Output.

- ☐ Change in mix that would raise overall profits.
- ☐ Changes in output that are within the limits of the market that would raise overall profits.

iii) Ability to Raise Prices.

Based upon market study, is it possible to raise prices and roughly by how much?.

iv) Ability to Introduce New Products.

- ☐ What are compatible new products (see market study)?.
- ☐ Operating margins on these products versus existing products.

Results sought: Whether profits can be increased by moderate cost reductions, changes in mix, changes in level of output, the introduction of new products, or price increases.

d) How Economics Would Change for the Employee-Owned Facility.

i) Analyze the effect on profitability and cash flow of:

- ☐ The feasible changes in costs, prices, product mix and products investigated above.
- ☐ Different levels of capacity utilization.
- ☐ Required replacement of management staff and/or corporate functions.
- ☐ Training costs for new employees.
- ☐ Lower wages.
- ☐ Initiating new sources of supply and/or customers.
- ☐ Making deferred replacement, maintenance, and modernization expenditures.

ii) Compute estimate of *future* operating margins, profits and streams of cash flows for three years, taking into account the effects of the changes in (i) immediately above.

iii) Compute working capital needs. If there is no good basis to estimate working capital needs, an approximation would be total operating expenses for four months (including rent, inventory, wages, leasehold improvements and known interest costs) plus reserve to carry accounts receivable plus petty cash.

iv) Estimate costs of purchasing necessary facilities from existing owners or others (see Plant Factors). Also estimate financing costs based upon your expectations as to sources of financing and potential cost (see Financing Section).

v) Compare the estimated cash flows to the sum of the costs estimated in (iii) and (iv) using net present value analysis.* This step will need to be repeated once financing costs are more exactly estimated.

** Net present value analysis is a technique that allows you to compare income you receive in the future to cash you pay out now to buy the plant. It takes into account the fact that both inflation and the ability to invest money now and earn a return, rather than spending it, reduce the value of income received in the future.*

Results sought: Whether the employee-owned firm can achieve a rate of return high enough to maintain an efficient facility, pay back its lenders, and repay the employees for their investment.

Evaluating the Results of the Feasibility Study

Once the results of the feasibility study are obtained, the employees must decide whether to proceed with the proposed employee buyout. In those cases where the results concerning market factors, plant factors, and potential improvements in these factors are overwhelmingly negative or positive, the decision may be easy. Because this will generally not be the case, it will be necessary to weigh the results carefully, considering the difficulties posed by each problem. The following rules will be of some help in this task. Other sources of advice include the consultant that prepared the feasibility study and potential investors in the firm.

The questions in Table 3 below should be answered in the course of the feasibility study. For an employee buyout to be advisable, either:

1) The answers to all of the "market" and "plant" questions in Table 3 should be affirmative; or

2) The answers to all of the "market" questions in Table 3 should be affirmative and any answers to "plant" questions that are negative should be cancelled by positive options under "potential improvements."

Of course, there will be situations in which a decision is made to proceed when these preconditions are not met. The employees in these cases must present to investors and themselves convincing reasons why the new firm will succeed. The document used to convince investors to participate in the buyout is the business plan. This document, as well as financing options, is discussed in the last section on Financing a Worker Buyout.

Table 3

RELEVANT QUESTIONS IN BUYOUT DECISION

Market Factors	*Yes*	*No*
1) Can you expect continued demand for your products and, if so, approximately how many units can you expect to sell? Number ☐	☐	☐
2) Is it likely that your firm will be able to compete for customers?	☐	☐
3) Is there a means of distribution available to your firm that can be put into place in time to ensure uninterrupted distribution?	☐	☐
4) Can your firm expect to have reliable sources of supply at a competitive price?	☐	☐
Plant Factors		
1) Has the facility been maintained enough to allow continued productive use? Can large capital expenditures be avoided in the next few years?	☐	☐
2) Does your firm have or can it obtain necessary staff and facilities to function independently as soon as a transition is made to a worker-owned firm?	☐	☐
3) Can your firm retain current key suppliers and markets?	☐	☐
4) Does your firm have, and can it continue to keep, the good will of its suppliers and customers?	☐	☐
5) Does your firm have a committed management to lead it?	☐	☐
6) Has your firm historically earned a profits? If not, was it due to causes that can be reversed?	☐	☐
7) Would your firm break even given expected sales volume from the "Market Factors" section, question 1?	☐	☐

8) Can your firm expect to be able to finance its own working capital and some part of its other capital needs after one year of operation?	☐	☐

Potential Improvements

1) If your firm historically has not earned a profit, can profits be improved through moderate cost reductions or price increases?	☐	☐
2) Can profits be improved through changing levels of output, mix of products, or introduction of new products?	☐	☐
3) Can profits be improved through taking better advantage of unique characteristics of your firm?	☐	☐
4) Can your firm achieve a rate of return sufficient to maintain an efficient facility, repay its lenders and repay employees and investors for their investment?	☐	☐

Chapter 10

Understand the Free Market Economic System and Private Enterprise Development[1]

10.1 Understand The Playing Field

When you are a member of a team and play a game, your team's success depends on how well you and your team members understand the rules of the game and the conditions that affect it. You also need to understand the characteristics of the playing field. You need to understand the strengths and weaknesses of your opponents. In other words, to win the game you and your team members need to understand your playing field well.

As a member of a business enterprise team (that consists of workers, managers and owners), you want your team to be successful in their undertaking—operating the business—so that you will have a job and receive income from the enterprise in the months and years ahead. In order for them and you to achieve your objectives, the enterprise must make profits and grow over time. To achieve this goal, you and your fellow team members need to understand the social and business environment in which your enterprise operates and the external conditions that will affect its operation.

The enterprise in which you and your co-workers and managers work undertakes economic activity, i.e. it produces goods or services and sells them to customers in exchange for money. To produce those goods or services, you and your co-workers and managers obtain and use various resources such as materials, energy, manpower, etc. The business also has some place or salespersons to sell the goods and services for money -- the market. The money exchanged for the goods or services your firm sells -- the price -- should be enough to recoup the money your firm paid out in producing and marketing those goods and services – the production and distribution costs -- and at the same time to give the owners of the business a surplus -- profit.

The availability of resources to produce goods and services and the place and/or persons who will exchange them for money (market) depends on the state of the National Economy. The state of a nation's economy depends on the level of a nation's economic output and its actual

[1] The material in this Chapter has been adapted from the *Start your Business Handbook* (Bulgarian Edition) by Arvind Nande (ILO, 1997) and *Understanding the Nature of Small Business* (National Center for Vocational Education, Ohio State University) R&D Series 240 BB1)

consumption. The economic output is measured by the amount of value added to the basic assets and resources of the nation. "Value added" is the difference in the monetary values of the resources used in an economic activity and the output of that economic activity.

For example, making a piece of furniture from timber (wood) to exchange for money (sale) is an economic activity. When the enterprise in which you work makes a piece of furniture from timber (wood), you add value to the basic resource, timber, because you have increased the monetary value of the timber used in making that piece of furniture. That added value is reflected in the difference between the monetary value of the timber used to make the piece of furniture and that of the furniture itself.

The survival and growth of the enterprise in which you work, i.e. the success of your employer's business will very much depending on the manner in which you and your co-workers and managers are able to:

- ❑ undertake the production of the goods and services in question
- ❑ acquire the needed resources (raw materials, energy, equipment, manpower, etc.) for this production
- ❑ exchange those goods and services for money and, on
- ❑ the ability and willingness of the customers in the market to pay money in exchange for those goods and services.

In other words, the success of your employer's enterprise will depend on the manner in which you and your fellow workers are able to undertake the economic activity in question.

The National Economic system determines how and through which laws the economic activities of individuals are coordinated, i.e. the exact manner in which the businesses, households and government react. In simple words, the economic system regulates

- ❑ the nature and type of economic activity that businesses can undertake
- ❑ the manner in which a business person could undertake such economic activity
- ❑ the manner in which the required resources are made available to undertake the economic activity and
- ❑ the available opportunities to exchange your firm's goods or services for money.

☑ ***The National Economic System determines how, through laws or conditions, the economic activities of individuals and businesses are coordinated. Therefore, to survive and succeed in a business enterprise, the first essential step is for the employer and workers to understand the basic principles of the nation's economic system.***

For many years, the economies in CEE countries were based on the principles of centralized planning. However, starting at the beginning of the 1990's, most CEE countries undertook to transform their economic systems into Free Market Economic systems. The 'rules of the game' under these two systems are radically different -- hence, it is essential for you and your fellow workers and managers to understand these two systems.

10.2 The Centrally Planned Economic System

Under the earlier Centrally Planned Economic System, private economic activity, for the most part, was eventually eliminated. All economic activity was planned and implemented by the Central Structures of the State (i.e. the state, and the municipal and other economic structures established by the State). Perhaps the only exceptions were in the fields of culture, arts and crafts, the legal profession, and some small retail services. The central structures had an established monopoly on all other economic activity. They:

- employed nearly all the able-bodied population
- set the wages of each category of employees
- controlled all production assets (e.g. factories, mines and farms)
- controlled allocation of resources (e.g. raw materials, labor)
- controlled the distribution channels (e.g. super-stores, marketing organizations, etc.)
- determined the level of individual consumption of goods and services -
- planned which goods and services were to be produced (e.g. which product, what quality, etc.)
- planned the amount to be produced
- set the exchange values of those goods and services
- allocated the resources for the planned production of goods and services, and
- distributed the goods and services.

In other words, under the Centrally Planned Economic system, the State controlled the Supply, Demand, and Prices. Under this system, there may be no competition. Prices of goods and services were determined simply on the basis of the cost of production and levels of State subsidies.

10.3 The Free Market Economic system

The economic system in the developed countries is decentralized and is normally described as being a Free Market Economy or economy of competition, since competition is relied upon to regulate all economic activity except in limited areas requiring government intervention, such as national defense and public safety, and regulated monopolies like public utilities. A main characteristic of the decentralized economy is the coordination of production and distribution of goods and services by the market, and their regulation through pricing. Under this system, the State is not directly involved in the economic process but merely facilitates national economic activities. The government typically guarantees

- the freedom of contracting
- free competition, and
- an effective (i.e. operating as designed) monetary policy.

The basic structural principles of Free Market Economies are:

- private ownership of property
- independent Central Bank and stable currency

- official policy protecting competition which, in turn regulates the market
- free pricing
- free wage bargaining
- terms of trade established by the buyers and/or sellers
- conditions of work set by employers within a framework of labor and other health and safety laws
- government economic policy is limited to issues concerning the structural framework and to interventions within the rules of the market principles.

These principles are associated with the provision of a number of programs and services designed to provide active labor measures and a social safety net—such as unemployment insurance, employment services, and retraining for displaced workers, etc. Through the operationalization of these principles, the government provides an environment that allows a great deal of free competition among enterprises.

For healthy and free competition among enterprises, the government guarantees the freedom of individuals and enterprises to make economic decisions. Such guarantees mean that:

A. individuals have the right to choose

- how they wish to earn their livelihood (e.g. work as an employee, undertake freelancing", start a business, operate a business, etc.)
- the type of employment
- the employer
- the place and conditions of living (e.g. rent or own the property, etc.) and
- the goods and services for their own consumption or trade

B. enterprises have the right to choose

- the type, quality and quantity of goods and services to be produced (unless they are declared illegal by law, e.g., certain drugs)
- types, quality and quantity of resources to be acquired (e.g. raw materials, equipment, technology, human resources, etc.)
- the place from where to operate their business
- distribution channels for their products and services and
- distribution prices

In short, under the Free Market Economic System:

- consumers have the freedom to choose the goods and services they need and want, and, therefore,
- their choices influence the choice of goods and services to be produced and made available by businesses.

However, it is important to understand that the quantity of the goods and services that can be exchanged for money is directly dependent on the consumer's ability to pay for them, i.e. on the purchasing power of the consumers. Therefore:

☑ ***The demand for goods and services depends on the choices of consumers and the amount of their purchasing power.***

The purchasing power of consumers depends on the health of the National Economy and the nation's monetary policies. They therefore play an important role in the general growth or decline of demand for goods and services.

Enterprises can exchange their goods and services only for the amount of money that consumers are willing and able to pay. In this race, enterprises compete with each other for the actual purchasing power of consumers. They compete with each other mainly in how they meet the needs of their customers, in terms of the prices, customer service provided, product quality and manner of distribution of goods and services. As such, competition among enterprises (i.e. producers and suppliers of goods and services) is relied upon to regulate nearly all economic activity.

In short, under the free market economic system

- "supply" and "demand" depend entirely on the choices and purchasing power of the consumers, and they
- are regulated by the system of, "prices" that change because of "competition" among enterprises for the business of consumers.

☑ ***Accordingly, to succeed in business an employer operating in the Free Market Economic System will need to:***
- ***produce only those goods and services that consumers want and are able to pay for***
- ***make those goods and services available in a manner in which consumers will want to acquire them, and***
- ***sell those goods and services at the prices that consumers are willing to pay***.

Clearly, the ability of an enterprise to survive and grow under the Free Market economic system depends on how well it is able to fulfill the wishes of the consumer, and achieve minimum production and distribution costs. Accordingly, the business enterprise in which you work will need to produce goods and services at costs that will enable your firm to compete with others and still make adequate profits.

☑ ***The most important thing to understand is that in a Free Market Economic System the nature and volume of an enterprise's economic activities will depend on the forces governing demand and supply—the market forces.***

10.4 The Elements of Free Market economic systems

10.4.1 The Circular flow of goods and services and money

Economic activity in every economy is based on division of labor, and there is a constant exchange of goods and services for money and vise versa. The complex picture of countless separate processes of exchange is simplified if all participants of the same kind (e.g. households, businesses, etc.) are viewed as parts of sectors, and only the flow of money and goods and services between them is examined.

Private households supply labor services to businesses that produce goods and services -- They receive wages (money income) from the businesses for their labor services. -- They pay part of this money income to businesses when they buy goods and services produced by those businesses.

In this way, the money paid to the households by businesses goes back to the latter through the households' consumption of goods and services produced by those businesses. The flow of goods and services and the flow of money are thus circularly connected. The above model of this circular flow (first developed in 1758 by French economist Francois Quept'snay on the basis of principles of human blood circulation) aptly illustrates the above mechanism.

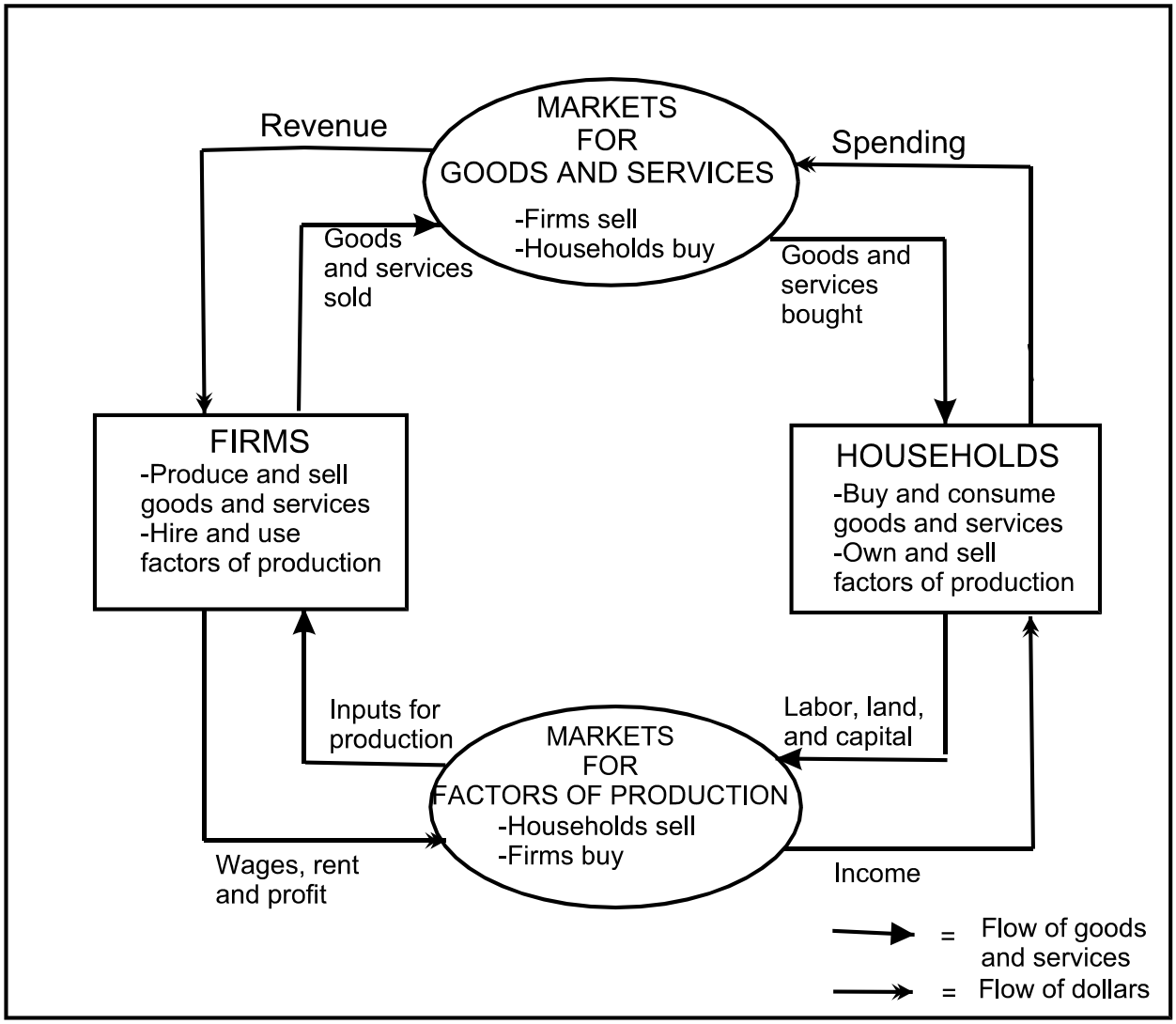
In reality, households do not use all their money income for consumption but put aside part of it in the form of savings. They also use part of it to pay taxes to government and collectively "purchase" the public services they consume (education, police and fire protection, national defense, etc.). On the other hand, the produced goods are not consumed in full by households. Part of them are used by businesses to expand their production capacities. In other words, part of those goods are invested in new plant and equipment.

The accumulation of savings and their investment is handled by the banking system.

The savings from incomes are placed in the hands of the banks. -- The banks use the accumulated savings to make loans to help finance business firms expanding their production. -- More money flows to businesses in exchange for expanded production. -- Businesses pay money to the banks for the financing they get (loan repayment). -- From this money, the banks pay the household's interest for their savings placed with the banks and for labor (services) which the households provide to the banks for managing their savings and onward financing -- The households use the increased income to pay for more consumption and savings.

Thus, through savings and investment, the volume of goods and services in the circular flow is increased. This means, that economic activity is increased and the Nation Economy shows growth.

The Circular Flow



The Circular Flow Diagram: This diagram is a schematic representation of the economy. Decisions are made by households and firms. Households and firms interact in the markets for goods and services (where households are buyers and firms are sellers) and in the markets for the factors of production (where firms are buyers and households are sellers). The outer set of arrows shows the flow of dollars, and the inner set of arrows shows the corresponding flow of goods and services.

The inclusion of the government or public sector (national, administrative regions, municipalities, social security, etc.) in the model broadens the picture. The government is in charge of redistribution of income and transfer payments to households (e.g. pensions, social security payments, unemployment insurance payments, etc.). As noted above, the government supplies public services which the private sector might not be able to supply in the desired volume (e.g. education, health, law enforcement, environmental protection, etc.).

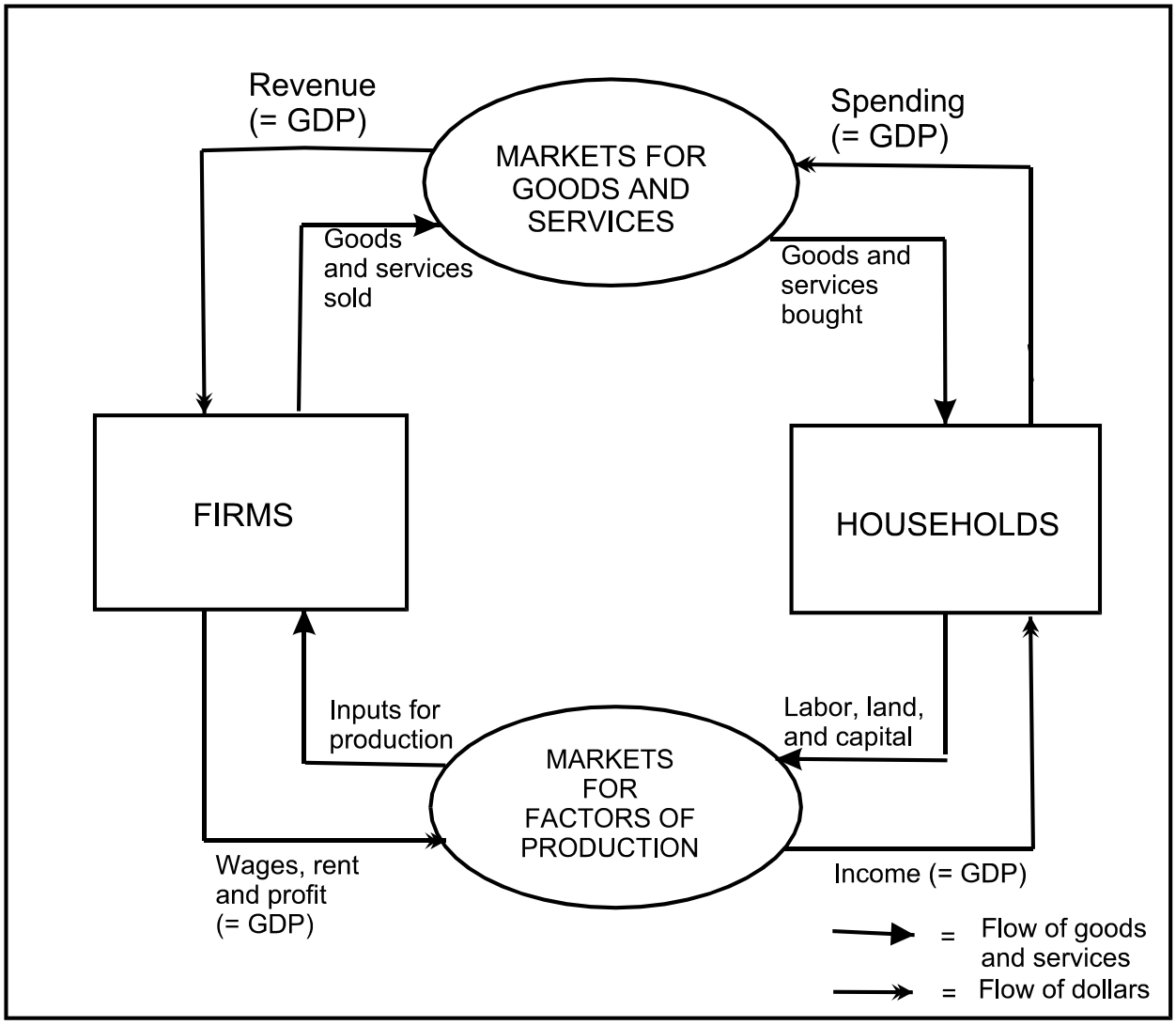
International trade broadens the playing field of the economic process and thus accelerates the economic output—and also increases competition and creates more uncertainty and instability.

10.4.2 National (or Domestic) Product

The overall economic output of the national economy is defined by the term "National Product" or "Domestic Product." The Gross National Product (GNP) or "Gross Domestic Product" (GDP) as it is sometimes called, includes the monetary value of the total annual flow of goods and services in the national economy. It provides a measure of the overall economic growth and a way to compare the nation's economic performance with that of other countries.

The Circular Flow Diagram can also be used to illustrate the composition of GDP.

The Circular Flow and GDP



The computation of the Gross National Product encompasses the production, distribution and consumption of goods and services, and focuses on the value added in every sphere of the economy. Value added is computed by totaling the values created in all products in the course of manufacturing and processing, and in all services. To avoid duplication, the costs of raw materials, packaging, overheads, etc. are deducted from overall production in every sphere of the economy. The resulting net production value equals the net value addition created in that sphere of economic activity, and is part of the 'value-added' produced by the whole economy. The national economic growth is measured and its structure is determined on the basis of the comparisons of the total value added and the share of each sector in it.

The part of activity in the production of goods and services that involves monetary remuneration is part of National Income. The Gross National Income is the total income created in the course of production of goods and services. It consists of wages and salaries, profits to owners, interest on capital and rent for land.

The component of the added value available for distribution is computed by deducting from the Gross National Product the indirect taxes included in the market value of the production as well as the decrease in the service potential of the invested capital assets. The extent (monetary value) of this decrease (called depreciation) corresponds to the physical wear and tear of the production assets.

The larger part of the goods and services produced each year are for personal and public consumption. Personal consumption includes all purchases made by households. The consumption of the State (public sector) includes operating expenses in providing various public services, viz, administration, education, law and order, defense, etc. Other parts of the National Product in the form of investments are used for the renewal and expansion of the means of production, buildings and stocks. Finally, a certain part of the goods are exported to foreign countries (for sale to households, businesses and governments).

To understand how the economy is using its scarce resources, economists are often interested in studying the composition of GDP among various types of spending. To do this GDP is divided into four components: consumption (C), investment (I), government purchases (G), and net exports (NX).

$$GDP = C + I + G + NX$$

Consumption includes spending by households on goods and services, with the exception of purchases of new housing.

Investment includes spending on capital equipment, inventories, and structures, including household purchases of new housing.

Government purchases include spending on goods and services by all levels of government.

Net exports include spending on domestically produced goods by foreigners (exports) minus spending on foreign goods by domestic residents (imports).

When a domestic household, firm or government buys a good or service from abroad, the purchase reduces net exports—but because it also raises consumption, investment, or government purchases, it does not affect GDP.

When the government pays the salary of a soldier in its national army, that salary is part of government purchases. What about government payments for medical or retirement benefits. Such government spending is called a transfer payment because it is not made in exchange for a currently produced good or service. Transfer payments are like a tax rebate. Like taxes, transfer payments alter household income, but they do not reflect the economy's production. Because GDP is intended to measure income from (and expenditure on) the production of goods and services, transfer payments are not counted as part of government purchases.

10.4.3 Regulation of competition

As explained before, the free market economy relies on competition to regulate nearly all economic activities, i.e. supply and demand are regulated through price changes arising from competition among the producers of goods and services.

Since producers of goods and services compete for the existing purchasing power of society, the efficiency of production, i.e. productivity, plays an extremely important role in the success or failure of a business enterprise in this system. Competition in improving productivity provides the momentum for the advancement of science and technology.

Competition in a free market economic system presupposes, first and foremost, the freedom of individuals to make economic decisions. The nation's Constitution and special laws guarantee freedom of production, trade and consumption, choice of employment and place of work. Appropriate laws that regulate the competition and prevent its restriction or substitution are created by the government to ensure the free supply of goods and services and independence of parties involved in their exchange for money.

The government's policy in this respect and the objectives of such laws are not to create "totally unrestricted" competition, but to create "functioning" competition among a large number of effective and dynamic businesses for the benefit of the public.

Anti-trust laws or Promotion of Competition laws are usually passed by legislative bodies to prohibit activities that could ultimately limit competition in the country, e.g. creation or abuse of monopolistic position, unfair competition, etc. A special judicial body – a Federal Trade Commission or Commission for Protection of Competition – is usually set up to enforce these laws and apply some of the sanctions provided in them.

Under these anti-trust laws in some countries, e.g., Bulgaria, any person on the national market who has the exclusive right de jure to perform certain economic activity, independently or together with other independent persons that amounts to a share larger than a certain per cent of

the market, is deemed to be in a monopolistic position. The individuals in monopolistic position and those who become such through the acquisition of shares, are obliged to notify in advance the Commission for the Protection of Competition in writing and receive its permission. Agreements that provide for the overt or covert creation of a monopolistic position or practically lead to it (cartels) are outlawed.

The laws specify a number of actions qualified as abuse of monopolistic position, e.g. restricting the access of third parties to the market, approach to partners in business deals based on inequality, imposing monopolistic prices, etc.

Unfair competition is not allowed either. Under these types of laws, any action in the performance of an economic activity that is in conflict with the well-intentioned business practices and damages or could damage the interest of competitors in their relations among themselves or with consumers, is deemed to be an act of unfair competition.

In free market economies, the meeting point of supply and demand is defined as the market. The market performs the balancing act between the interests of participants, namely, the interests of sellers to receive the highest possible price for their goods and services, and the interests of buyers to receive those goods and services at the lowest possible price. The market thus performs the intermediary function of making exchange of goods and services for money possible.

The price is the exchange value expressed in monetary terms, for the exchange of goods and services. A number of factors influence the price -- the most important factor being the cost of production. The businesses set the prices for their goods and services so that they recover costs of production and get a surplus as will that will give them some profit and additional money required to finance future investments.

However, in a free market where fierce competition prevails, there is no guarantee that goods and services will sell at the prices set in that way. The price the seller can obtain for a product or service depends on two factors, namely:

- the purchasing power of buyers
- the demand and supply balance.

If their purchasing power is high, buyers may be willing to pay higher prices. However, the price level will be determined by competition between suppliers of the same products or services, i.e. based on the balance of demand and supply.

If supply exceeds demand, i.e. if the total quantity available for exchange at any time exceeds the quantity the buyers are willing and able to pay for at that particular time, sellers are forced to lower their prices to affect the exchange. On the other hand, if demand exceeds supply, sellers can obtain higher prices for their products.

Low prices can ultimately lead to curtailment of production, i.e. decreasing supply, and high prices can lead to expansion of production, i.e. increasing supply. Such developments constantly change the balance between demand and supply and create a pendulum effect, swinging from one extreme to another. An equilibrium may be reached occasionally, i.e.. supply and demand

more or less match. This position is called "market equilibrium". A true price based only on the purchasing power of buyers is reached under market equilibrium conditions only.

How effective this equilibrating mechanism is depends very much on the prevailing market forces. Free pricing is doubtful under certain conditions which make it possible for supply and demand to exert pressure on the market. For example, in some sectors of the economy there are business firms that wittingly or unwittingly control the market and are therefore able to influence prices in their industry. They are the so called "price leaders".

It is also possible to manipulate prices through informal agreement among business firms in the same industry (e.g. cartels), although this is against the law. The extreme form of "manipulated" prices occurs when all supply is in the hands of a single seller (or group of few sellers), i.e. when the seller (or the group of sellers) has a monopoly.

In practice, there are often some "public" monopolies which are politically controlled to a certain extent, e.g. power supply, telecommunications, postal services, etc. In theory, such "public" monopolies are created in the "public" interest and cannot use their leading position in the market to set prices arbitrarily. Their prices are usually set by public regulatory bodies, e.g., a public utility commission, based on the costs of providing the products to households and a "reasonable" profit for the enterprise.

10.5 The legal framework for establishing and operating business enterprises in a Free Market Economy

10.5.1 RIGHT OF OWNERSHIP

The distinctive feature of the Free Market Economic System is the individual's right of ownership. Private persons can own not only goods for their personal use and consumption, but also the means and resources of production, e.g. land, buildings, machinery, raw materials, etc., used to produce goods and services for sale in the marketplace.

10.5.2 INVIOLABILITY OF PRIVATE PROPERTY

Constitutions in most CEE countries now proclaim the inviolability of private property. The Constitutions also guarantees the right of inheritance and transfer of property to others. This means that the individuals can inherit the property owned by their parents or other relatives, and can also transfer the ownership of their property at will.

Regardless of these provisions however, government infringement of private property is possible in cases when the government decides that public interests take precedence over the private interests of individuals. For example, there are legal provisions in most countries that prohibit juristic or natural persons from owning certain property or items, e.g. military arms and

ammunition, etc., or that allow for the legal expropriation of private property for public purposes in exchange for equal or fair market value.

10.5.3 LAWS AND COMMERCIAL CODES

An enterprise is a legal entity (or juristic person) that undertakes an economic activity. It denotes an organizational structure established with the aim of selling goods and services and making profits. The ownership of an enterprise is governed by the same statutes that guarantee the right of ownership. However, the principal legal forms of enterprise are specified in the laws passed by the national parliaments, and sometimes called Commercial Codes. These laws introduce the term of "Proprietor" or "Trader"-- any person who has established an enterprise that by its objectives and scope undertakes activities for personal financial gain (commercial business). In other words, business activity is conducted as an occupation and with the objective of making a profit.

10.6 Legal Forms of Private Business Enterprise

The principal regulations governing the legal forms of registration of private businesses are specified in the "Commercial Codes" passed by the national parliament in a country. There are essentially four types of business enterprise, sole proprietorship, cooperative, partnership, and corporation or joint-stock company. However, there are variations of these basic forms of business organization some countries. In addition to the four basic forms of business organization, another business concept, franchising, has become an important form of business organization during the past 50 years in Western Europe and North America. Because of its widespread use and growing importance, franchising is included in this discussion.

10.6.1 Sole Proprietorship or Sole Trader

The most commonplace form of registration of private businesses in most countries (including CEE countries) is the proprietorship or sole trader. Such an enterprise is not a juristic person. In most countries it is registered simply by entry in the commercial register of the entrepreneur's community if required by local law.

The main features of this form of enterprise are:

- The owner/entrepreneur has absolute and unlimited freedom (within the limits of the laws of the land) in his/her business activities
- He/she is the sole owner of all assets of the enterprise and has the sole authority in respect of the disposal thereof
- He/she takes all decisions independently
- The entrepreneur pays his/herself on the same conditions as a natural person
- The taxation of sole proprietor is typically lighter compared to other forms of business activity.

The main disadvantages of this form of enterprise are:

- The owner/entrepreneur bears full financial liability in his/her economic activity. This means that if he/she is declared insolvent by the court, he/she may lose not only the property (assets) of the enterprise, but also all his personal property such as real estate, household items, personal belongings, valuables, savings, etc., and all his/her personal earnings from other sources of income
- When applying for loans and credits from banks or other lending institutions, he/she has to offer his/her own personal assets as collateral for mortgages and/or deposit his/her personal valuables with the bank/lending institution.

10.6.2 Cooperative

Although not specifically listed in some publications as a form of business enterprise, the cooperative form of business is an important and widely used legal form of business organization, especially in Western Europe and North America.

The cooperative is a legal form that has been well developed in most countries over the past century and a half. Unfortunately, the use of cooperatives under the centrally planned economic systems operating in CEE countries from 1945 to 1990 was somewhat distorted from the internationally recognized cooperative standards. Consequently, this form of business enterprise has been somewhat discredited, and its use has not been widely promoted in CEE countries since they adopted free market economic systems after 1990.

What exactly is a "cooperative business?" According to the International Labor Organization,

> ☑ ***A cooperative...is an association of persons who have voluntarily joined together to achieve a common end through the formation of a democratically controlled organization, making equitable contributions to the capital required and accepting a fair share of the risks and benefits of the undertaking in which members actively participate***.

A cooperative is an enterprise that is owned and controlled by the people buying its products or using its services or working in it to mutually increase their income or enhance their standard of living.

Essentially, the incorporators of a cooperative decide to carry on a business activity by pooling their material and financial resources and organizing their labor and legal relations with other enterprises on that basis.

People cooperate—work together—to achieve things they cannot achieve alone. Many people view cooperatives as a way to gain greater control over their working lives through democratic decision-making and ownership.

One way to classify cooperatives is according to the relationship of the members to the cooperative they set up and own. Is their relationship that of clients of the enterprise, i.e., buying its products or using its services, or are they workers in it? When viewed this way, there are two basic categories of cooperatives: (1) ***client-owned cooperatives***, and (2) ***worker-owned cooperatives***. Each type has somewhat different objectives and structures, although both types subscribe to internationally recognized cooperative principles.

Client-owned cooperatives are widespread and diverse in nature. They range from child-care cooperatives, consumer cooperatives, craft cooperatives, credit cooperatives, producer cooperatives organized by farmers and fishermen to purchase their supplies and market their products, housing cooperatives, and marketing, service, and secondary cooperatives created by small businesses and individuals, who organize these forms of cooperative to provide themselves with services and marketing expertise they cannot afford individually.

Worker-owned cooperatives are unique because groups of worker-entrepreneurs form them to provide themselves with employment and income along with ultimate ownership and control of their business enterprise. Through their ownership and control they receive a fair share of the profits (usually based on hours worked) and enjoy greater workplace democracy. They also jointly share the risks of entrepreneurship. Today, worker cooperatives are found in manufacturing, services, shipbuilding, food products, restaurants, computer software, etc., in many countries.

General Cooperative Principles of Organization. There are seven internationally recognized cooperative principles that guide the organization of cooperatives. They are:

1. **Voluntary and open membership.** Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religions discrimination.
2. **Democratic member control.** Cooperatives are democratic organizations controlled by their members, who actively participate in setting policies and decision making. In a worker co-op, worker-members have a right and obligation to participate in the decision making that affects them.
3. **Member economic participation**. Members contribute equitably to, and democratically control, the capital of their cooperative. In a worker co-op, all worker co-op members gain or lose together. No single member benefits at the expense of other members.
4. **Autonomy and independence.** Cooperatives are autonomous self-help organizations that are controlled by their members.
5. **Education, training, and information.** Cooperatives keep their members informed and provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives.
6. **Cooperation among cooperatives.** Cooperatives serve their members most effectively and strengthen the cooperative movement by cooperating with one another.
7. **Member Equity**. A cooperative assumes member equality in all decision making, equity in the valuation of each member's work contribution, and mutual self-help. Co-operatives are concerned about people, responsibility and business success.

Worker Cooperative Principles. Because of their unique nature as worker-owned businesses, the articles of incorporation for worker-owned cooperatives typically include four additional worker cooperative principles:

1. Worker cooperatives must be owned only by the suppliers of labor, the workers
2. All workers in the enterprise must become worker-owners
3. The workers, as owners of the enterprise, must decide on the disposition of new income from the business
4. Worker-owners, in their capacity as suppliers of labor and not as suppliers of capital, must control the enterprise and the benefits must be divided among them.

The members of a client-owned cooperative are entitled to receive "patronage" dividends at the end of the year on any profits generated, based on their purchase of the goods or services provided by the cooperative. In a worker cooperative the worker-owners receive monthly advances (equivalent to wage payments based on hours worked) on their enterprise's expected profits after expenses are paid. At the end of the year, part of the remaining profits above that amount already advanced during the year (if any) are paid out as dividends.

Cooperatives are a democratic form of business enterprise, in which the members all have one share of ownership and one vote in the selection of the directors. In addition, cooperative members have limited liability. They are not liable for the debts of the cooperative beyond the amount of their ownership share and the assets of the enterprise. Finally, in most countries the tax laws impose a lower level of taxation on cooperatives to encourage their development.

10.6.3 Partnership

General (Unlimited) Partnership. This form of enterprise is not a juristic person. It is a partnership of two or more persons for carrying out joint economic activities under a common name (name of the company) by pooling their financial, material and intellectual resources. By combining their resources, the partners stand a better chance of achieving their goals and objectives.

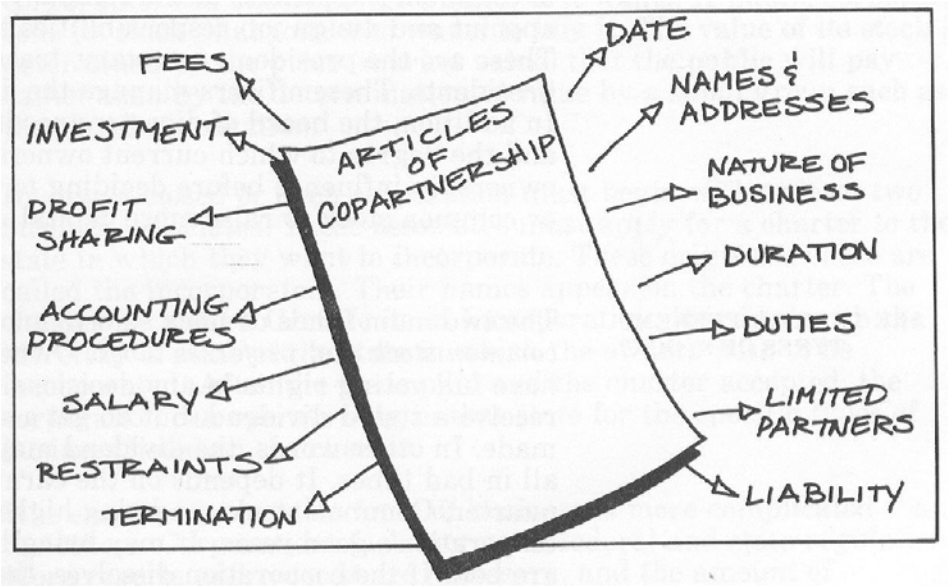
The principal features of general partnerships are:

- All property and assets of the enterprise are jointly owned by all the partners
- In principle, all partners are involved in making decisions (in practice, the partners may divide the jurisdiction and scope of decisions among themselves by mutual agreement)
- They bear joint and unlimited liability to creditors and partners themselves. This means that if the partnership is declared insolvent by the court, all partners may lose their entire personal assets and personal earnings from other sources
- Although in some countries tax treatment of this form is lighter than of other forms (except sole proprietors) of enterprise, in a few countries the tax treatment of general partnerships is aligned to that on the other forms of business and enjoys no specific preferences.

For this form of enterprise to be successful and to operate without problems, a high degree of mutual trust and understanding and cooperation among the partners is essential.

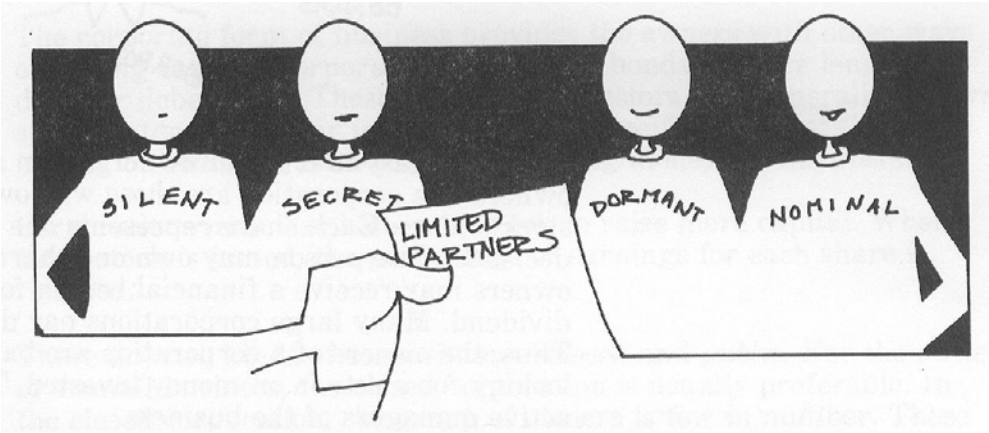
The inherent risk in this form of business lies in the fact that if any partner makes an unsuccessful business move on behalf of and at the expense of the partnership, all partners must carry the losses and bear the liability.

To insure that the profits of a partnership are shared and to define the type of partners the business will have, the partnership needs a written contract. This contract is called the Articles of Co-partnership. This contract also defines duties and division of profits. With all the possible partner arrangements available, it is easy to see why a written contract is necessary.



Limited Partnership. This form of partnership was developed as a result of the problems encountered by the unlimited partnership. In CEE countries the limited partnership form of enterprise has been borrowed from Western European economic law. The limited partnership is a juristic person. Limited partnerships are formed by several persons for the purpose of carrying out joint economic activity. However, all partners do not bear the same legal liabilities and obligations.

One or more partners (called the general partner/s) undertake to accept individually, jointly or severally an unlimited liability and full obligations of the partnership, and certain others (called limited partners) are liable only to the amount of their contributions as agreed in the Deed of Partnership signed by all partners, which is the main instrument for interpretation of each partner's obligations.



The general partners usually make all decisions and manage the activities of the enterprise. However, this does not mean that the limited partners are excluded from the process of decision-making, management and supervision of the activities of the enterprise.

The advantages of this form of enterprise are:

- pooling of the resources, expertise and efforts of many people, including professionals and specialists, by limiting their risks and
- a legal and higher potential for raising more capital in under the two previous forms of enterprise.

Generally, this form of enterprise is preferred when undertaking more complex activities that require greater competence and resources than those that the general partner is able to provide.

Limited Liability Company. Another variation of the Partnership is the Limited Liability Company. Although only a small number of the private enterprises in CEE countries are registered as limited liability companies, this form is very popular in the developed countries.

A limited liability company may be formed by two or more persons with authorized (declared) capital of a specified level. The minimum capital subscription by any partner must not be less than a specified level. Usually, two or three partners subscribe the bulk of the capital. Each partner's subscriptions are called "shares", and each partner is issued a "share certificate" that is a legal instrument confirming the partner's investment in the company.

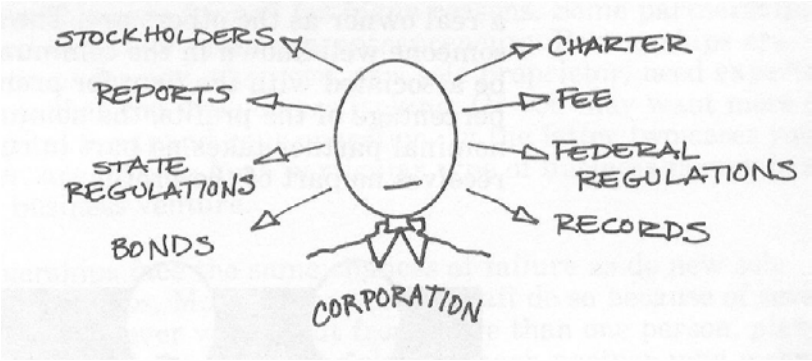
Decisions are taken collectively by the partners. Each partner carries liability and obligations arising out of the economic activity of the enterprise in proportion to his/her share. In case of insolvency of the enterprise, each partner's personal liability is limited only to the value of his/her subscribed shares.

Taxation on the limited liability company is the same as on other legal forms of enterprise.

A single member company may also register as a single-member limited liability company. This form of registration is a convenient way of limiting the individual liability of the sole proprietor while allowing him/her unlimited freedom and independence in the management of his/her enterprise.

10.6.4 Corporation or Joint-Stock Company

A corporation or joint-stock company is a typical "company of capital." It is a corporate form of ownership. This form is suitable for raising considerable amount of capital required for executing ambitious, large-scale and complex business undertakings. Most corporations are large and have extended markets. Many corporations are former sole proprietorships or partnerships that became so successful that expansion was both profitable and necessary. This form of enterprise is commonplace and supported by major banks and lending institutions in the other developed countries. To form a joint-stock company or corporation, a number of legal requirements have to be met.



The authorized (declared) capital of the company is divided into shares of stock (securities) called "shares", each of small equal (par) value. The company is liable to its creditors up to the value of its total property (shares of stock/securities). Any person or entity may buy the shares of the company and upon doing so; they become owners of the company, or,"shareholders". Their interest in buying shares lies in sharing the profits made by the company which may be distributed periodically in the form of "dividends". The individual liability of each shareholder is limited to the value of his/her shares.

A corporation or joint-stock company is a juristic person and is taxable as such.

It is quite easy to transfer ownership in a corporation. A new company can sell its shares to investors with the help of investment bankers through Initial Public Offerings (IPOs). The shares of existing companies may be listed and traded on a stock exchange.

The actual owners of a corporation are those who own shares of stock—the "stockholders" or "shareholders." Each share owned by a stockholder represents one vote in management decisions. One person may own one share or millions of shares. Share owners may receive a financial return for their investments called a dividend. Many large corporations pay dividends four times a year. Thus, the owners of a corporation are basically investors who are looking for a return on money invested. They do not desire to be active managers of the business.

It is the job of the stockholders to elect the board of directors. Usually the board is made up of some of the more active or important stockholders. It is the board's job to make all the major decisions and to establish the policies of the company. These stockholders also appoint and assign job responsibilities to the officers of the company. These chief executive officers (CEO) include president or managing director, secretary, treasurer, and various vice presidents. These officers manage the day to day business operations. In addition, they the board of directors needs to look closely at the rates and the degree to which current owners want to spread control and ownership influence before deciding to issue bonds, preferred stock, or common stock to raise more capital.

The two main kinds of stock sold by most major corporations are common stock and preferred stock. Owners of common stock usually have full voting rights in any decisions of the company. They do not receive a stated dividend, but do get a share of any profits that are made. In other

words, the dividend may vary or may not be paid at all in bad times. It depends on the earnings of the corporation that quarter. Common stock can bring higher dividends during the corporation's good years. It may bring little or no income when times are bad. If the corporations dissolves, the common stockholders are the last to be paid back their investment after all debts and preferred stockholders have been paid.

The preferred stockholder gives up voting rights in order to get certain preferential treatment in other areas. Any time a dividend is declared, preferred stockholders are paid in full. They are paid before the common stockholders receive any dividend. The preferred stockholder is usually paid a set amount. For example, he or she may receive 6 percent of par when par is $100, which means a 6 percent profit for each share held. Par value is an arbitrary value assigned to stock (both common and preferred) when it is issued by the company. It does not represent what the stock would bring in the stock market, if sold. It is just a stated amount for bookkeeping and dividend purposes.

Thus, the holder of preferred stock is guaranteed a steady dividend. However, instead of being a percentage of par, the percentage is usually a set dollar amount per share. It is paid only when dividends are declared.

Are there other means for corporations to raise capital than selling stock? The answer is yes. The corporate form of business provides the owners with other ways of raising capital. Corporations may issue bonds that are long-term debts or debentures. These are sold to investors who generally receive steady interest on their investments for a specific period of time. The issuing of bonds is just a way of borrowing money for the business. The bondholders are not owners, but are creditors who have loaned money to the corporation at a specified rate of interest and repayment terms.

Corporations may also issue (and sell) new stock to raise more capital. When more stock is issued, the ownership of existing shareholders is diluted and the percentage of earnings for each share is reduced.

There are two types of corporations—*closed* and *public*. For the owner of a small business, the closed corporation is usually preferable. In the closed corporation, the group of owners is few in number. These are usually relatives, friends, or partners. If stock is sold, it is sold to someone who already owns part of the stock and, therefore, does not expand control beyond existing stockholders. The option of issuing bonds and new stock is still present, but is not usually used. A closed corporation can chose to "go public" if it wants. A public corporation sells its stock to anyone who wants to buy it. The value of its stock is determined by the price (market value) that the public will pay rather than by the determination of value by a small group such as in the closed corporation.

The management of the company is vested in the Board of Directors. Shareholders with common stock vote for the Board members, having one vote for each share of stock they own. Thus, those individuals who have large numbers of shares can cast more votes when electing the directors. The Articles of Incorporation of the company and by laws prescribe:

- the number of persons who will constitute the Board of Directors
- the rules governing the increase or decrease in the number of persons on the Board of Directors
- the terms of appointment of the persons to the Board of Directors and
- the powers and authorities vested in the Board of Directors.

By law, a corporation must begin with a least two business associates. These associates must apply for a charter to the appropriate government office in which they want to incorporate. These original owners are called the incorporators. Their names appear on the charter. The charter is called a Certificate or Articles of Incorporation. It is filed with the appropriate government office in the jurisdiction that the owners want to incorporate. After the fee is paid and the charter accepted, the corporation can operate only in that state or province for the specific types of business listed on the charter.

The Articles of Incorporation are initially adopted by the founding members who invite others to join the company on basis of the adopted Articles. The operation of the company is subject to relevant provisions in the initial Articles that may subsequently be amended through a democratic process of majority consensus of the members.

The founding shareholders elect suitable persons to the Board of Directors at a General Meeting in accordance with the provisions of the Company's Articles. Each shareholder of the company is eligible to vote the number of his/her shares for any of the candidates...

In a two-tier company management system, that is common in some European companies, the shareholders elect a Supervisory Board and the elected Supervisory Board elects or appoints a Managing Board, in which the management of the affairs of the company are vested. In the United States, the shareholders elect the board of directors, who in turn appoint the key management officials of the company.

The corporate form of enterprise attracts large capital investment in developed countries where stock-markets (called Stock Exchanges) are effective and well managed, since individuals can invest small amounts for profit with limited risk and, at the same time, have the possibility of accessing their savings in times of need by selling their shares or shifting their investments to other more profitable companies. In CEE countries, however, the development of the stock markets is still in its infancy and there are many gaps in the relevant legislation. Consequently, the formation of this form of enterprise and attracting shareholders poses some problems and risks.

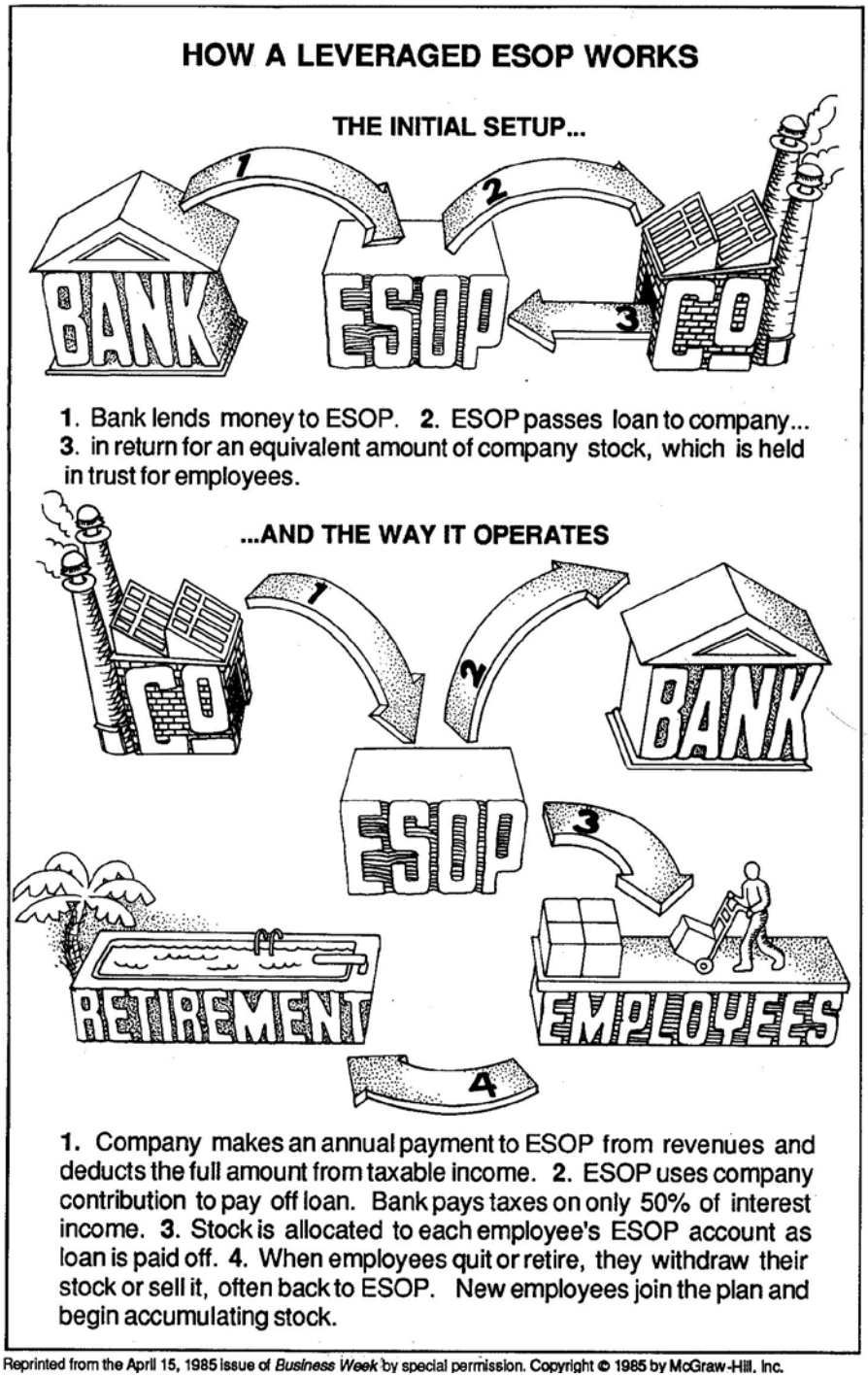
10.6.5 Employee Stock Ownership Plans

During the past two decades a unique use of corporate form of ownership, called an Employee Stock Ownership Plan (ESOP), has been developed in the United States and a number of other countries. (The use of ESOPs as a part of enterprise restructuring for competitiveness and job preservation is also discussed in Chapter 9.) ESOPs were initially designed in the United States as an employee benefit plan to provide a way to reward employees and enable them to obtain

ownership of some stock in the companies in which they worked. Although the ESOP is a legal device created in the 1950s, it became popular as a result of changes in the tax laws in 1974. Creating an ESOP enables employees to obtain stock in their employer's business without having to pay for it out of their own pocket.

An ESOP operates through a legal device called an ESOP Trust that is set up by the organizers (usually the company and, in some cases, the employees and their union). There are two types of ESOPs: leveraged and non-leveraged. In a leveraged ESOP the ESOP Trust uses the company's credit and borrowing power to borrow funds on behalf of its employees. It uses these funds to purchase new shares of company stock or to purchase old shares from existing owners (private or public). The company commits itself to pay back the loan. As the loan is paid off, shares of company stock are allocated to each employee's account in the ESOP Trust on some specified basis—usually a percentage of the employee's payroll income. When the loan is paid off, the employees own shares of stock in their company, and the company enjoys the tax savings, the increased productivity, and commitment that goes with employee shareholding.

The leveraged ESOP process typically works as follows:



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ESOPs are non-leveraged when they do not borrow money. In this case the company makes cash or stock contributions to the ESOP Trust. This money is allocated to individual employees' accounts. If the company makes cash contributions, the Trust uses the money to buy stock from the company or outside shareholders at fair market value. A non-leveraged ESOP is a form of stock bonus plan.

Either leveraged ESOPs or non-leveraged ESOPs can be used to finance management-initiated or worker-initiated buyouts. Both have been used to save jobs, to buy out a retiring owner, or to gain control of the company.

Since its inception in the U.S., ESOPs have been used for many different purposes, including several related to job preservation, community economic revitalization, and enterprise restructuring—including strengthening enterprise competitiveness. As noted in Chapter 9, ESOPs are currently being organized:

- ☑ so workers can buy their company from departing or, in many cases, retiring owner(s). If the company is sold to outsiders, many purchasers want only the "good will" and assets of the business and eventually reduce operations, lay off local workers, close the doors and leave the employees without jobs or income. About 45 percent of the ESOPs are created to provide business continuity. A March 1990 survey by a national accounting firm found that 76 percent of the privately held business owners in the U.S. had no succession plans in place.

- ☑ so workers can buy their company from a government agency that is privatizing the enterprise. In a few communities and at higher governmental levels, there has been a desire to privatize some public enterprises; e.g., Conrail, public transit, waste management, and other services. If the enterprise is too large to convert to a workers' cooperative, the ESOP is used as a legal means to facilitate the employees' purchase of the enterprise. About 1 to 2 percent of the ESOPs fall into this category.

- ☑ so workers and their communities can "save" or prevent the closure of a business for economic or other reasons; e.g., a change in corporate policy or the failure to reach a corporate rate of return on investment objectives—even though the firm may be making a profit... About 3 to 4 percent of the ESOPs fall into this category.

- ☑ as a means to raise capital at a lower after-tax cost to modernize or expand the business. To use the ESOP for this purpose, the company issues new shares of stock that the ESOP buys with borrowed money. The company uses the money to buy equipment or other goods to improve its operation.

- ☑ by unions as a quid pro quo for wage concessions. When unionized companies face tough financial times resulting from stiff competition, changing markets or other problems, they may seek wage concessions from their workers to prevent bankruptcy or to strengthen the company's financial position. Unions facing such demands have been willing to take a pay cut only in exchange for an equity stake in the enterprise that can be structured through an ESOP. About 3 to 4 percent of the ESOPs are used for this purpose. In recent year's worker have purchased United Airlines and several other airlines in the troubled U.S. airline industry.

- ☑ by employers to create an additional employee benefit. The objective is to reward faithful employees and to motivate them to work harder and be more committed. About 40 percent of the ESOPs are set up primarily as employee benefit plans.

While ESOPs have been promoted as a form of worker-ownership and workplace democracy, unfortunately there are some problems in achieving these objectives. In some cases a small group of managers or investors have used ESOPs to accomplish a “leveraged buyout" of a firm without any real concern or interest in the workers other than to use them and their money to make the deal. In many early ESOP buyouts, very little worker control was included with the employee stock ownership.

In privately held firms, voting rights do not need to be “passed through” to employees unless the firm is sold. In firms where the stock is publicly traded, voting rights must be passed through to ESOP shareholders. However, until the Trust allocates stock to individual workers’ accounts, which occurs annually (usually for five to seven years—the customary length of a loan), the Trustee or Trust committee holds the voting rights that go with the stock. Consequently, in many early employee buyouts that used the ESOP process, the bankers who loaned workers and management money to buy the firm chose the ESOP trustees. The workers had no say in managing the business until the loan was paid off—usually in five to seven years. (However, the participants receive the financial benefits of owning their stock, if the company prospered during this period and pays dividends and its stock and increases in value.)

Another problem with ESOPs is cost; they are somewhat expensive to install, making them uneconomical for small firms.

Because of the foregoing problems with ESOP use in the United States, some changes have been made in organizing ESOPs to make it possible for employee-owners to participate more directly in the control of their enterprises. Changes incorporated in the 1986 Tax Reform Act made it easier to use a more democratic system of corporate governance *and* take advantage of the ESOP financial and tax benefits. ESOPs can now be set up so that employees have the right to direct the trustee, or trust committee, how to vote all the ESOP stock. These are called “an instructed trustee” model, and are found in most majority ESOPs (where the employee participants own the majority of stock in the company).

But it should not be forgotten that while ESOPs in countries such as the United States have primarily been evaluated "as a tool of corporate finance, a means to motivate employees and improve corporate performance, and a way to make business more democratic," their basic purpose "was and is to broaden the ownership of wealth" and not to extend workers' control. Consequently, ESOPs are not widely organized for this purpose.

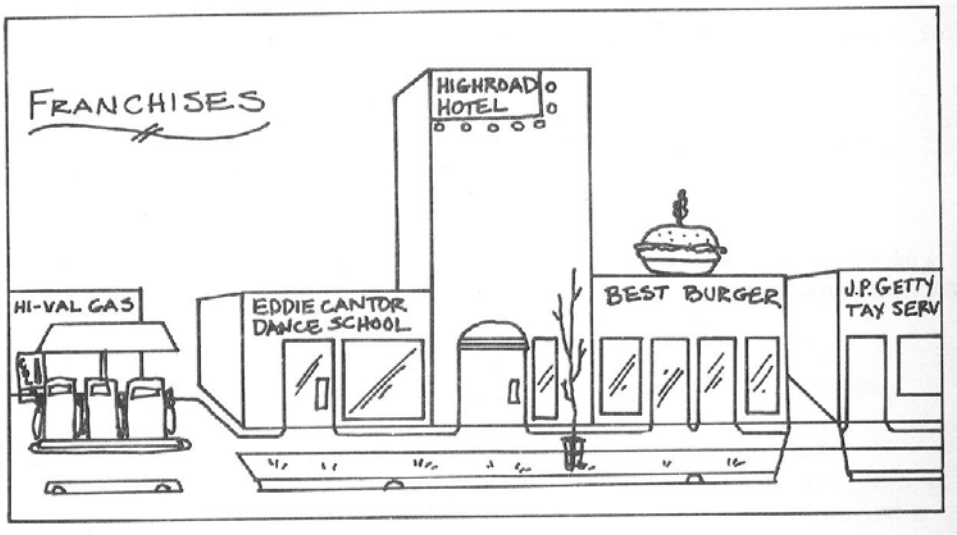
10.6.6 Franchising

Although not usually considered a basic form of business, franchising is the fastest growing form of business in many countries. The franchising boom started after World War II in the United States. It now accounts for about 30 percent of retail sales there. Many types of businesses lend themselves to the franchise type of operation.

A franchise represents a continuing relationship between the franchisor and franchisee. The franchisor’s knowledge, image, success, and manufacturing and marketing techniques are

supplied to the franchisee—for a price. The entrepreneur who buys a franchise buys a "prepackaged" business that is operated under a contract with the franchisor. As far as the public is concerned, the business is indistinguishable from a company-owned outlet.

Most franchisors provide many services to the franchisee. One of the most important services a franchisor provides is credit to the franchisee. Credit can be in the form of inventory or in the form of cash loans. This means that franchisees need less operating capital at the outset.



Franchisees normally receive special training before opening the business, and receive continued managerial assistance, such as audits, recordkeeping systems, and tax advice. Franchisees also receive merchandising assistance and the benefit of national advertising and promotion by the parent company. All these services are helpful to entrepreneurs who want to be their own boss but who may lack expertise in some areas of management, marketing, finance, or personnel.

Territorial and operating Franchises. There are two main types of franchise operations. The first is the territorial franchise. The area of the "territory" may be very large (a whole city or province). The second is the operating franchise. The operating franchise is granted to a business owner who wishes to operate one business in a specific area.

Conventional Franchise. There are four basic forms of franchise. The conventional franchise is made between a manufacturer and a retailer. The retailer/franchisee is relatively free to maintain a sales force and individual advertising and management techniques. Conventional franchises are often found in automobile dealerships and petrol stations.

Distributorship. In a distributorship form of franchise, the franchisee is a wholesaler who supplies the manufacturer's products to various retailers in a geographic area. The distributor is free to manage the operations and to select and serve customers in any manner s/he chooses. Beer sales are generally distributorship franchises.

Licensed franchise. A third type of franchise is the licensed franchise. This is the most common type of franchise, consisting of businesses such as fast food restaurants, print shops, and

food markets. Licensed franchises are more closely linked to the parent company and are required to maintain certain standards. They receive more advertising, merchandising, and technical advice from the franchisor than do conventional or distributorship franchises.

Manufacturing franchise. In the manufacturing franchise, the franchisee is a manufacturer as well as a distributor. The franchisee makes the product locally, according to company standards, and usually distributes it to retailers. National soft drink manufacturers often use this form of franchising.

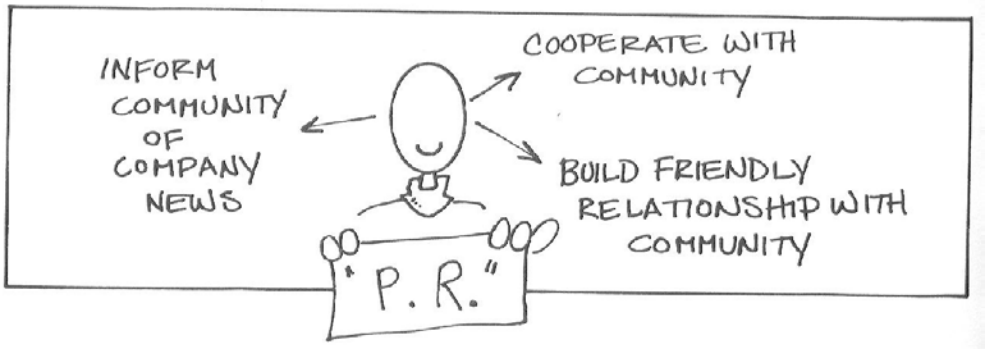
The drawbacks of franchise operations include: the franchisee loses a certain amount of business control that a sole proprietor has. An initial fee, as well as monthly fees, must normally be paid to the parent company. Fees are generally a percent of gross sales, a fixed fee per month or year, or a combination of the two.

10.7 Social Partners and obligations businesses have to them

A business enterprise operating in a free market economy does not operate in isolation. Consequently, the key stakeholders in the business (workers, managers, and owners) will need to constantly interact with a number of social partners, namely:

- Community leaders
- Government and the Law
- Consumers (the market)
- Banks and lending institutions
- Industry and commerce
- Agriculture
- Providers of infrastructure (e.g. transport assistance, information, etc.)
- Insurance and protection
- Employers' associations
- Workers' associations and trade unions
- Professional associations
- Media
- Others

Generally speaking, the public relations objectives of a company are achieved by (1) informing the social partners of all company news that affects the social partners; (2) showing cooperation with community growth, improvement and welfare; and (3) building a friendly relationship between the community, social partners and the company.



It is not always easy to achieve these objectives. However, developing a good public image must include establishing carefully defined and organized goals and developing the strategies that will best achieve the goals. Key business stakeholders must remember that good relations with social partners and community are a very important part of a business's success.

☑ ***Long term success in business will very much depend on two things, (1) how well everyone in the enterprise, the workers, managers and owners interact with their social partners and (2) how well they fulfill their obligations to them.***

10.8 Summary

The success of a business will depend on how well the workers, managers and owners understand the principles underlying the free market economy and the social and business environment in which their enterprise will operate, and the external conditions that will affect the way it is operated.

An enterprise operating in a Free Market Economic System in which consumers and buyers have a wide choice of goods and services, and therefore competition among enterprises regulates demand, supply and price. As key stakeholders in the enterprise, workers, managers and owners will need to compete well with other enterprises that offer goods and services similar to those your enterprise produces. Therefore, productivity will play an important role in the eventual success of your enterprise.

The market for your enterprise's goods and services will depend on the specific choices of consumers, their purchasing power and price competitiveness. Your firm will therefore succeed in business only if you produce those goods and services that the consumers and buyers want, at prices they can afford or are willing to pay, and make the goods and services available to them in the manner in which they want to acquire them.

The Right of Ownership and the Commercial Code in the country allows your enterprise's owners to choose the legal form for the business that suits them best. The choice of legal form for a business should be made in consultation with professional practitioners, and should be based on the considerations of:

- ❑ applicable tax treatment
- ❑ extent of personal liabilities the owners are willing to accept

- extent of the business assets the owners wish to own
- extent of personal powers the owners, managers and workers wish to have in the management of the enterprise and
- how the investors wish to protect their and their family's interests.

Finally, a business does not operate in isolation. It operates within the social framework of the community and nation. The success of a business will therefore require that the key stakeholders (owners, managers and workers) constantly interact with their social partners.

The long term success of any business enterprise will, in part, depend on how well everyone in business enterprises interact with their social partners and how they fulfill their obligations to them.

Check your understanding of private enterprise development in the Free Market Economic system by completing Test Yourself Exercise Number 1.

Table 1
Advantages and Disadvantages of basic types of Business Ownership

Forms of ownership	Advantages	Disadvantages
Sole Proprietorship	1. Low start-up costs 2. Greatest freedom from regulation 3. Owner is direct control 4. Minimal working capital requirements 5. Tax advantage to small owner 6. All profits to owner	1. Unlimited liability 2. Lack of continuity 3. Difficulty in raising capital
Partnership	1. Ease of formation 2. Low start-up costs 3. Additional sources of venture capital 4. Broader management base 5. Possible tax advantage 6. Limited outside regulation	1. Unlimited liability (except in limited partnerships and LLCs 2. Lack of continuity 3. Divided authority 4. Difficulty in raising additional capital 5. Difficulty in finding suitable partners
Cooperative	1. Limited liability 2. Specialized management 3. Transferable ownership 4. Continuous existence 5. Legal entity 6. Possible tax advantages 7. Incorporates democratic values	1. Difficulty in raising capital 2. Lack of suitable legislation in many countries for worker-owned cooperatives 3. Power-sharing may impede timely decision making
Corporation	1. Limited liability 2. Specialized management 3. Transferable ownership 4. Continuous existence 5. Legal entity 6. Possible tax advantages 7. Ease of raising capital	1. Close regulation 2. Most expensive form to organize 3. Charter restrictions 4. Extensive recordkeeping 5. Double taxation
Franchising	1. Specialized training and technical assistance 2. Transferable ownership 3. Continuous existence 4. Ease of raising capital 5. Low start up costs	1. Loss of some business control that a sole proprietor has

Test Yourself Exercise Number 1

Check your understanding of private enterprise and the Free Market Economy System

Read each of the following statements carefully and check the appropriate box to indicate if according to your understanding the statement is True, Partly True, or False.

#	The following statements are:	TRUE	PARTLY TRUE	FALSE
1	A good understanding of how the Free Market economy system functions will enhance my company's chances of success in our industry			
2	If people need the products or services sold by our company, they will always pay the price that our company needs to make a profit			
3	If we make good products or provide good services, there will always be enough buyers for our products or services			
4	The inviolability of individual property guaranteed by the Constitution in our country means that my employer's rights to his business property cannot be infringed without due process.			
5				
6				

Annex 1

Additional Training Materials and Resources

Focus Economic Systems. (Washington, D.C.: National Council of Economic Education, 2001)

Mankiw, N. Gregory. *Principles of Macroeconomics* (Second Edition, 1998)

Nande, Arvind, Editor. *Start your Business Handbook*. Bulgarian Edition (ILO, 1997)

Understanding the Nature of Small Business. (National Center for Vocational Education, Ohio State University) R&D Series 240 BB1)