

# A Study on Private Enterprises and Entrepreneurs in Transition Economies: Focusing on Russia and Vietnam

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## I. Introduction

Since Kim Jong-un became the head of North Korea in 2012, the market function of the country has expanded while state intervention in the economy has decreased. Kim's regime has adopted a series of measures to increase the rights and freedom of enterprises, beginning with the empowerment of enterprises in ten areas (e.g. granting of planning rights, product development rights, etc.) announced in the so-called "May 30th measures" and the socialist enterprise responsibility system in 2012.

The experiences of transition economies show that the core of the transition lies in increasing private ownership, privatization and the emergence of entrepreneurs. In other words, without revitalizing the economy through private business activities and participants, transition cannot be successfully completed.

This study analyzes the challenges and achievements of the transition process, particularly regarding privatization in Russia and Vietnam, and draws implications for the Kim Jong-un regime in North Korea.

## II. Russia's Transition Process and Privatization

In a broad sense, Russia's privatization began in 1985 with the policy of Perestroika and is still going on. The privatization can be divided into four stages, by period: 1) spontaneous privatization implemented with Perestroika in 1985–90, 2) voucher privatization in 1991–94 right after the collapse of the Soviet Union, 3) cash privatization targeting strategic corporates in 1995–98, and 4) renationalization under Putin's administration (Table 1).

Table 1. Features of privatization by period

	1985–90 (Spontaneous Privatization)	1991–94 (Voucher Privatization)	1995–98 (Cash Privatization)	1999– (Renationalization)
<b>Background</b>	Collapse of planned economic system leading to initial stages of market economy	Transition proceeding at fast pace	Need to solve chronic deficit while preserving reformist government policies	Start of high oil-prices era., government belief in the need to re-nationalize companies in strategic industries
<b>Agents</b>	Private enterprises established by public officials and young intelligentsia	Employees obtaining stock shares of companies	Banking institutions, which accumulated wealth from the early stage of privatization (→ emergence of oligarchs)	State-owned enterprises (SOEs)
<b>Features</b>	<ul style="list-style-type: none"> <li>- Ownership transferred to economic players recognized by the government (ministries turned into corporates)</li> <li>- Initial forms of commercial banks set up</li> </ul>	<ul style="list-style-type: none"> <li>- Massive privatization of SMEs</li> <li>- Small companies sold or leased</li> <li>- Mid-and large-sized companies turned into joint stock companies, with a part of their share temporarily owned by the government</li> </ul>	<ul style="list-style-type: none"> <li>- Privatizing strategic companies on loans for shares scheme</li> <li>- Closed auction</li> </ul>	<ul style="list-style-type: none"> <li>- Share of the government in the economy expanded as state capitalism is pursued.</li> <li>- Centralization of power</li> <li>ex. 2004 Yukos incident</li> </ul>

Note: Authors divided the periods referring to the stages presented in E.A. Medova & Larissa Tischenko (2010), "Lawless Privatization?" Working Paper No. 29. p. 5.

Source: Organized by authors based on E.A. Medova & Larissa Tischenko (2010), "Lawless Privatization?" Working Paper No. 29.

The planned economy was not efficient because it was operated by the "visible foot" of the planned system, i.e. not by the "invisible hand" of the market. The management of Soviet enterprises slowly began to deviate from the official

management model. These enterprises took advantage of legal loopholes or manipulated production in an illegal manner. This had the effect of promoting an unofficial management model within the Soviet economy.

Table 2. Duplicity of corporate management in the Soviet era

Official management model			Unofficial management model (actual management model)		
<b>Party and planned system:</b> strategic management and external control			<b>Bureaucratized system:</b> bureaucratic management and flexible monitoring		
Production factor	Plan	Output	Production factor	Plan	Output
Ideal planned economy	Optimization	Maximization	Shortage economy	Bargaining	Creative production
Delivery according to the enterprise's needs to fulfill the plan	Plan according to the capacity of the enterprise	Maximization of the production efficiency	<ul style="list-style-type: none"> <li>- Enterprise autarky</li> <li>- Hoarding</li> <li>- Bribery in production</li> <li>- Controlling production by personal network</li> </ul>	<ul style="list-style-type: none"> <li>- Plan "negotiation"</li> <li>- Administrative bribery</li> </ul>	<ul style="list-style-type: none"> <li>- Cramming for production</li> <li>- Irrational products</li> <li>- Different production-mix</li> <li>- Falsification</li> </ul>
Planned output level			Negotiated output level		
Realized output Production efficiency			Creative output Administrative Efficiency		
Internal control			Collective responsibility		
<b>Idealistic Soviet enterprise management:</b> <ul style="list-style-type: none"> <li>- Internally-oriented production supervision</li> <li>- Maximization of the Soviet society's well-being</li> <li>- Specialization of production</li> <li>- Ideological maturity of managers</li> <li>- Managerial loyalty</li> <li>- Worker participation in management equality among personnel</li> </ul>			<b>Realistic Soviet enterprise management:</b> <ul style="list-style-type: none"> <li>- Externally-shaped survival management</li> <li>- Maximization of individual well-being</li> <li>- Productional independence, political career-building by managers</li> <li>- Managerial misuses, director-centered management</li> <li>- Managerial elité</li> </ul>		

Source: Kari T. Liuhto (1999), "The Transformation of the Soviet Enterprise and its Management: A Literature Review," Working Paper No. 146. p. 55.

### Successful Privatization Case 1

The Bolshevik Biscuit Factory became the first case of privatization through public auction in December 1992. Now the factory is owned and managed by a western company Kraft but it was initially sold to Danone. After privatization, the factory successfully settled in the Russian market with global management skills, proper restructuring and the new management's in-depth understanding of Russia's organizational culture.

### Successful Privatization Case 2

The Bolshevsky machine-building factory was also successfully privatized by a Swedish heat-transfer producer, Alfa Laval. Right after undertaking, Alfa Laval raised competitiveness by creating a modern sales department, overcoming the generation gap between employees and rearranging products. In addition, the company well understood Russian culture as it had run a Russian branch office in St. Petersburg since 1905. As a result, the factory settled in firmly not only in the Russian market but also in the CIS countries.

### Failed Privatization Case

AssiDoman, a Swedish paper-wrap producer, took management rights over the Segezha Pulp and Paper Mill in 1997 but had to leave soon after. AssiDoman thought the take-over of the mill would be advantageous for the company, considering possible changes in supply and prices of paper-wrap when products manufactured at the Segezha paper mill reached the Western European market. However, AssiDoman was not even able to begin operations at the mill and had to withdraw with losses in 1998. This was mainly due to insufficient market research and understanding of Russian business culture. Regrettably, none

of AssiDoman's management tried to learn about the Russian market or visit Russia during the whole take-over period. Also, the local government did not support AssiDoman because the company was slow in making profits, thus its contributions as a taxpayer or to the local community were insignificant.

### III. Vietnam's Transition Process and Equitization

The first stage of Vietnam's privatization, termed as equitizing state-owned enterprises and kicked off in 1992, was followed by the next stages as shown in Table 3.

**Table 3. Vietnam's equitization plans by periods (1992–2015)**

Stages of Privatization	Periods	Main Features	Number of Privatized Companies
Trial stage	1992 – 1996	Announcing first privatization plan	5
Expanding trial stage	1996 – 1998	Expanding privatization plan	25
Accelerating stage	1998 – 2011	Transferring SOEs to joint stock companies/joint stock venture	3,946
Stagnant stage (reforming the economic structure)	2011 – 2015	Reforming SOEs	508
Reaccelerating stage	2016 – present	Selling/ Equitizing SOEs	on-going

Source: Le Hong Hiep (2017), Cuong (2015) and Government of Vietnam (2016, p. 2.)

### Successful Equitization Case 1

In 1976, the Vietnamese government nationalized three dairy producers and established the United Enterprises of Milk Coffee Cookies and Candies, which was renamed the Vietnam Dairy Company later. The company produces various dairy products including milk, coffee, condensed milk, coffee, etc. It was first listed

at the Ho Chi Minh Stock Exchange in January 2006 through IPO. With this listing the company enhanced its management efficiency, leading to steady growth up to recently. The secret of the Vietnam Dairy Company's success can be attributed to its quick decision-making process and globalized management system.

## Successful Equitization Case 2

**L**IX Detergent, one of the Vietnam National Chemical Group's affiliates, was first equitized in 2003. LIX Detergent's case displays Vietnam's typical equitization style, where the government holds 51% of shares to keep control of the company. After equitization, LIX Detergent's business performance significantly improved and its stock value increased by four times.

## Failed Privatization Case

**F**ounded by the government in 1969, Vietnam Railway Signal Telecommunication (hereafter VRST) is a leader in the rail industry. Part of VRST was equitized in 2006 while 38.13% of its shares were kept by its mother company, the Vietnam Railway Corporation, and the rest held by the present and former employees. Unfortunately, business performance exacerbated afterwards due to poor management structure and slow reform process. The company's top management was appointed by the government, and heavily distorted the management structure by pursuing their own personal interests. This caused a bad reputation for the management, prompting internal disputes and lowering performance.

## IV. Conclusion: Implications for North Korea

**R**ussia's privatization took place from small enterprises, apartments, family farms to mid- and large-sized firms. Although national assets and state-owned enterprises were sold to the

private sector, the government's fiscal condition did not improve. Rather, the government revenue to GDP ratio decreased in general. Furthermore, the corporate income to GDP ratio shrank more drastically. One of the reasons behind this could be that the tax system was just formed. In addition, as privatization went on, a number of companies failed and the government provided tax offsets or tax amnesty to businesses.

**I**n terms of productivity, privatization had a positive effect. According to J. David Brown, John. S. Earle, and Scott Gehlbach (2013), privatization by both foreigners and Russians increased productivity to different extents by period.

**H**owever, privatization weakened the government's power, destroyed social order and exacerbated corruption. The opaque and monopolistic manner of privatization in Russia benefited only those who were in power. As a result, Russia became a phony capitalist economy and private companies and businessmen came to have a negative public image. The word "piratization" was also coined based on this.

**V**ietnam's equitization, which began in the early 1990s, is still underway. Even though the government has announced privatization plans on several occasions, the process has been very slow with mediocre achievements. State-owned companies in Vietnam are struggling with debt issues and diseconomies of scale, which can be connected with the country's falling industrial competitiveness. The default of Vinashin Group (largest Vietnamese ship-builder) in December 2010 was a representative

instance that highlighted the need to reform state-run companies. The World Bank also recommended that in order for the Vietnamese economy to develop into a middle-income country by 2035, privatization of state-owned enterprises will have to be accelerated.

According to these analyses of Russia's and Vietnam's cases, the following factors can be identified as determining the success of privatization. First is institutionalization of the transition process. Fortunately, it seems that the strong authority of the Labor Party and the government in North Korea can effectively accelerate the institutional reform. Second, a strong support group must be formed in the transition process. The success of on-going reform policies in North Korea also can be determined by how quickly and strongly the support group is formed. The third and crucial determinant is to ensure that benefits are evenly distributed. KIEP

## References

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