



## ORIGINAL PAPER

## Employee Companies as a form of dissemination of ownership within the period of state enterprises privatization in Poland since 1990

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### Abstract

Ownership transformations of the Polish state enterprises commenced upon the Act on privatization of state enterprises of 13th July 1990. The legislator determined that decision on entering the path of privatization depended in the first place on the employees of a particular state enterprise, and so did the form of privatization. The relevant application was prepared by the employees' council having consulted all employees at a general meeting. A similar document was prepared by the trade unions acting at factories. Agreement of the employees for the privatization process allowed first to transform the particular state enterprise, into a sole shareholder company of the State Treasury, and then to conduct the relevant privatization process. In Poland after 1990 the most popular privatization path was the direct privatization, consisting in liquidation of state enterprise and transforming it into the employee company. Such form of ownership transformation was considered a phenomenon of Polish privatization. The news said, "Staff and managers of the enterprise subject to such method of privatization must have enough courage to conduct company activities and bear the responsibility". Such form of privatization was selected mainly by small and medium enterprises. Popularity of the form depended on several factors. First of all, staff of the employee company was convinced that they would gain a real impact on decisions concerning the company and they would participate in managing it. They hoped to achieve significant financial profits owing to revenues generated by the company and thus hoped to get secure employment. In Poland within 1990-1997, so within the period of most intensive ownership transformations, the said privatization path was selected by 65% of all state enterprises that were subject to privatization. Basing on selected examples, the paper presents the process of creation of the Employee Company. Workers' opinions were gathered and presented. Particular attention was directed to methods of valuation of state enterprises prepared for privatization by using the aforementioned method. Moreover, economic condition and situation of these enterprises were analyzed herein.

**Keywords:** *enterprise privatization and restructuring, Employee Company, state enterprise, employee participation*

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### Introduction

According to professor E.S.Savas, privatization is the key to govern better (Savas, 1992). He thinks that this is a new way of perceiving social needs and a new way of thinking about the role of government in providing for social needs; that this is making decisions that limit participation of the government in activity or in ownership of resources to the benefit of the private sector (Savas, 1992:10). Margaret Thatcher that initiated the process of privatization in UK had often admitted that the word 'privatization' was ugly but useful. She claimed that she did not like the term, mainly because the purpose of privatization was opening the door to unlimited entrepreneurship (Yergin and Stanislaw, 2014: 199). No doubt, the concept of privatization has been since the 1970s present in the political discourse as a constant element everywhere in the world.

This paper presents one of the paths of privatization of state owned enterprises in Poland. It consisted in dissemination, generalization of private ownership by way of liquidation privatization (direct) that meant giving a property of the state owned enterprise into the employees' hands (so-called employee leasing). Despite many advantages, concerning mainly psychological strengthening of employees' motivation and providing an illusion of relative social security, that path of privatization had many flaws, since leading to weakening the company's economic condition it was followed by so-called secondary privatization- sale of shares in the company to the 'strategic investor'.

Significance of direct privatization (liquidation) for making the ownership common. Similarly to other countries with economy system directed by the state, in Poland a strong erosion of this system started in the 1980s and the attempts of reforms of that economic system, based on shortages (as Janos Kornai said), did not bring expected results. As the economic condition of the state worsened, on 23rd December 1988 the Sejm of the People's Republic of Poland adopted the resolution on economic activity (Act of 23rd December 1988). It was of extreme importance for Polish citizens. That laconic Act introduced in Poland the principle of unencumbered entrepreneurship stating that taking up and conducting economic activity was free and available to everyone on equal basis. The legislator defined the economic activity as the manufacture, construction, commercial and service activities carried out for earning purposes at the expenses of the entity conducting such activity. Symbolic meaning of that Act consisted in contradicting the socialist dogmas of economy. It was admitted that state enterprises were ineffective.

The Round Table meeting in spring 1989 and following from it parliamentary elections, when Tadeusz Mazowiecki's government was formed, opened the path to transformation of political and economic systems in Poland. In his opening speech on 24th August 1989 Tadeusz Mazowiecki announced Poland entering the "road to normality". He meant construction of the democratic state of law, state of strong institutions where the economic system based on free market and unrestricted entrepreneurship. The result of improvement of economic effectiveness and leaving the economy directed by state was to be achieved by privatization of state-owned entities.

The announced privatization and the development of unrestricted entrepreneurship demanded a change of institutions and formation of new offices providing support to entrepreneurs. The process of privatization of state enterprises was governed by the Act of 13th July 1990 on privatization of state enterprises. As a result of gathered experience, that Act was replaced by a new one, adopted on 30th August 1996 on commercialization and privatization of state enterprises. The said Acts stated that process of state enterprise privatization commenced with the consent expressed by the

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interested parties- that is by the staff. The common application to the competent minister for ownership transformation had to be submitted by the enterprise's manager and employees' council, having consulted the employees' meeting. Thus, the legislator gave advantage to the enterprises' staff giving them the right to initiate the process of ownership transformation.

Methods of privatization included: indirect privatization (capital privatization), and common privatization carried out within the National Investment Funds (since 1993) and so-called enterprise commercialization (since 1996) that is transformation into the sole shareholder company of the State Treasury.

Pursuant to the data of 31st December 1990, there were 8,453 state enterprises in Poland. Until the end of 2004 the process of ownership transformations covered 66.6% of them, which is 5,631 entities (Report, 2004: 8) Out of that number 1,562 were subject to commercialization, 2,216 were subject to direct privatization and in case of 1,853 applications for winding-up were approved for economic reasons (out of which 990 were dissolved and 673 went bankrupt). In commercialized companies (the sole shareholder company of the State Treasury) direct privatization covered 352 state enterprises and 512 companies were entered into the National Investment Funds.

Indirect privatization (capital privatization) was the path meant for large state enterprises that possessed the significant productive assets. There were two forms of that privatization path. The first form was related to the sale of the majority shareholding to domestic and international investors as a result of negotiations started in reply to a public invitation to negotiations or tender. The second form was the sale of shares by way of public issue. Capital privatization allowed to acquire the so-called "strategic investor" for the enterprise that would be eager to contribute significant amounts to investments aiming at adapting the former state enterprise to the free market needs. The State Treasury selling the shares obliged the purchaser to sign an additional document named the investment package. In that package all investor's obligations, including amounts necessary to fulfill them, were specified. They referred both to modernization of production technology and construction of installations protecting natural environment.

Direct privatization in 1990-2004, covered 2216 state enterprises, as it was said above. Out of that amount, by the end of 2004 the amount of 1,379 enterprises were given to the staff for payable use and by the end of 2012 there were 1,563 enterprises covered by privatization. (Bałtowski and Kozarzewski, 2014: 228). The main idea of that form of privatization was striving for dissemination, generalization of ownership (making ownership common). To make the abovementioned data more detailed: within 1990-1991 the referred path of giving the enterprise's property into the hands of staff for payable use was selected by 86.8% of all enterprises subject to direct privatization, and in 1992- by 78.7% of them (Krajewski, 2009: 53). The feature distinguishing direct privatization from other methods of privatization was the short period between taking decision on privatization and termination of the whole process. On average, within 1990-2005 that period was about 8 months, and after 2006 it shortened to 5 months. Such rapid process resulted from the fact of limiting to minimum the negotiations with the staff interested in establishing the employee company (Krajewski, 2009: 52).

Method of direct (liquidation) privatization of state enterprise by giving it for payable use to the employees was the most popular form of privatization in Poland. A different situation was observed in the Czech Republic or on the territory of the Eastern Germany, where such form of privatization was applied only to small shops, hotels and restaurants. The Polish government might have assumed that such method of privatization

in Poland would be of the same character as in other countries. The governing bodies were convinced that such path of privatization was a kind of privilege and only staff of smaller enterprises, where the largest resource of creative potential was personnel qualifications, would benefit from it. Thus, it was assumed that the direct privatization would cover design offices, land survey services and research and development centers. (Bałtowski and Kozarzewski, 2014: 227). Nobody expected a different possibility. In the payable use of employees, together with small enterprises employing up to 49 persons, also medium enterprises were included, employing between 50 and 249 workers.

Act on privatization of state enterprises of 1990 gave a possibility to combine several paths of privatization. Genesis of such practical solution bases on the fact that the multi-unit enterprise operating in the People's Republic of Poland within the period of transformations started in 1990, as part of the process of adaptation to the free market conditions, underwent a deep restructuring process thus dividing into smaller economic units. Therefore, it was potentially possible to divide one enterprise, operating before 1990, into several smaller ones that were privatized by way of direct privatization in its various forms, including fast sale, making contribution in kind or giving it into the hands of staff for payable use. Passing the enterprise property to payable use of employee company required fulfillment of several conditions, pursuant to the Act of 1996. First, more than a half of employees or workers or farmers or fishermen had to join the company; shareholders of the company could only be the natural persons; the paid up share capital could not be lower than 20% of the statutory fund and enterprise fund; and at least 20% of shares was to be taken up by persons not employed at the state enterprise subject to privatization. It should be pointed out that in "Polish employee companies ownership of shares is of personified character, so they are subject to trading" (Kozarzewski, 1998: 26). The employees could sell their shares in case of resignation from work or for other cause. They were also entitled to increase their share package. For that reason the Polish employee companies varied much from the employee companies formed in Russia and Belorussia. In those countries the owner was a collective, referred to as the "workers' team". No separate ownership right was distinguished there (Kozarzewski, 1998: 26).

Passing the enterprise property to payable use of employee company was always conducted on the basis of agreement concluded between the State Treasury and the transferee for the period not exceeding 10 years. After the lapse of period determined in the agreement and fulfillment of conditions specified there the enterprise ownership right could be transferred onto the transferee. The legislator also provided a possibility to transfer the ownership right earlier, when the transferee was to pay 1/3 of expenses following from the agreement (Dowżycki, Sobolewski, Tłuchowski, 2003: 144-145). We should also emphasize that, according to the legislation, the established employee company took from the State Treasury the organized part of the company property- that is the tangible and intangible assets (Act of 13th July 1990). As a result, apart from the industrial plant, the employee company obtained the ownership rights to the company intangible assets, such as its logo and trademark. In case of food manufacturers that was usually a very important intangible asset of the company. It is interesting that limiting the free market in the People's Republic of Poland by way of administrative decisions did not alter the market orientation of consumers, who, similarly to consumers in countries with developed free market economy, positioned products and had own opinion on their manufacturers. Thus, consumers built the company image and created its brand. As the everyday life showed the said intangible assets created in the People's Republic of Poland were invaluable property elements for the created employee companies. In my opinion,

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transformation of state enterprises into employee companies to a wider range than it had been expected by the Polish government, or even against the government's will (Kozarzewski, 1998: 22), was justified by staff entrepreneurship. Such form of privatization, popularizing the ownership, woke up the entrepreneurship minds that, combined with practical assessment of reality could effectively benefit from the state enterprise property. This is confirmed by information from the Ministry of Ownership Transformation of 1994. It was said: "at the start of transformation period there was a strong pressure over privatization because of which both managers and staff wanted to save the mother company without taking care of particular benefits" (Snopek-Rybak, 2004: 32). Another remark made in 2000 corresponds with the previous observations: "before taking decision on privatization the enterprises should consider the risk of changes, but also risk of the lack of changes" (Czerwińska-Wojtasik, 2000: 27).

As a rule, the workers team decided to establish the employee company basing on the assets of the wound-up enterprise that was in a good condition, had suitable technical background and whose products were demanded for. Thus, that privatization path was selected by enterprises related to food and machinery processing (423 plants by the end of 2004). That method was also selected by staff of construction plants (361 by the end of 2004), retail and wholesale trade (249 by the end of 2004), an transport and warehouse management (91), real estate offices, services (190) and other (65) (Report 2004, 2005: 26).

Considering the above remarks, the entrepreneurship of staff was based on their practical approach towards the ownership transformation ongoing in Poland. It is possible that by observing the reality the employees knew that if their plant was to survive in the free market conditions and become a partner of other entities operating at that market, the effectiveness had to be increased. The way to achieve the goal was to undergo ownership transformation and introduce common ownership, as factors motivating entrepreneurship. Additional argument for the practical approach of staff towards establishing the employee company was, as it was noted by professor M. Bałtowski and professor P. Kozarzewski, the fear of the plant being taken over by external investor, either domestic or foreign (Bałtowski and Kozarzewski, 2014: 227). The said fear was compounded by the fact that the external investor could dismiss the old managerial staff, change strategy of the company, reduce number of employees and increase workers-related requirements.

Our search for reasons of popularity of liquidation privatization in Poland, realized by formation of employee company and, as a result passing the enterprise property to payable use of employee, brings us to another argument. Such path of privatization was a response to popular in Poland ideals of participation of staff in managing the enterprise and participation of employees in enterprise's property. That was "one of methods to create the human face of capitalism- softer, just, protecting employees' dignity better". Moreover, this was a method to create system somewhere between socialism and capitalism (Surdykowska, 1997: 129).

However, the employee companies, propagating ownership forms, were not free from flaws. In these entities in one person the conflict arouse on the line employee-owner and worker-employee. Conflict of interests arouse between managers who prepared particular development paths for the plant and wanted to have it restructured, and employees-owners who might hamper the plans expecting just the rise of remuneration. Mixture of the purposes resulted in the situation where most employee companies, over 60%, increased employees' remunerations even 5 times within 1990-1994, whilst at the same time 40% did not generate net profit and other 37% observed decrease of

profitability. It was noted that only 12% of employee companies decided to carry out investments in order to modernize the company and only 16% extended its products offer (Surdykowska, 1997: 130). In the above analysis we must also consider the fact that employees perceived the fact of obtaining the employee company from the State Treasury for payable use as a chance to gain significant financial benefits, to generate fast profit. They were convinced that such form of privatization would allow them to maintain the workplace and give them the sense of social security.

However, the liquidation privatization that gave plants in the payable use of employees, was not perfect. Companies established in that manner did not have proper capital necessary to carry out investments. In addition, their economic condition was weakened by the fact that they had to pay so-called leasing installments (repay part of the generated profit to the State Treasury).

### **Empirical analysis**

Empirical analysis of phenomenon of employee companies, considered by experts to be the form of employees' participation in managing the enterprise and a significant form of propagation of ownership concept, does not always confirm effectiveness of that form of privatization as regards effectiveness of management and fair division of property rights.

Research conducted in 1990-1991, so within the period of the highest intensification of formation of employee companies, proved that at the moment of formation of company 27.2% of shares were purchased by the managing staff, 26.8% by workers, 13.8% by administration staff and 13.8% by pensioners. With the time of operation the share of managing staff was increasing, on average up to 47.4%. This happened to the detriment of workers and administration and office personnel from whom the shares were purchased. Thus, the controlling stake was moving into the hands of the managing staff (Surdykowska, 1997: 132). The researchers point out that in 1999 approx. 40% of employee companies lost their specific character and after 2000 the tendency of "secondary privatization of employee companies" strengthened. One could observe that in the plants the ownership transformations took place for the second time (Bałtowski and Miszewski, 2006: 235). Reasons of such course of events were complex. First of all, it was difficult for some companies to survive on the market. Employee companies usually experienced shortages of investment capital and that is why secondary privatization was related to sale of shares to new investors with the purpose to recapitalize the company. From the perspective of effective management and decision related to company development- such flow of shares was favorable. But it contradicted the concept of common ownership.

From the social point of view a very sensitive matter was valuation of state enterprise that was selected for direct privatization. Discrepancies arouse due to application of various valuation methods. The government side proposed to use the book value of company in price negotiations and make it the starting point for further negotiations (Information, 1991). The State Treasury pointed to the fact that, apart from the price suggested by consulting firms, when negotiating the price of a plant with its workers and potential external shareholders of the employee company, one must also take into consideration the use of fixed assets, expenses to restore these assets, pro-eco investments, and collected useless reserves and uncollectible (bad) debts. When determining the price of enterprises it was necessary to gather information on interest of domestic and foreign investors in a particular company. It was also important to calculate

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such a price that would allow the employees "to take up together the small and medium enterprises at a price possible to be paid without declining the inflow to the State Treasury". (Explanations...). In price negotiations it was considered that a new employee company took all responsibilities of the wound-up enterprise, including its loans and liabilities towards the budget, Social Security and suppliers. Not without the influence on the negotiated prices was the fact that the employee company took up all employees of the former state enterprise. Thus, the material factors of prices were discussed, such as value of the machinery stock and ground, company debt and social factors, including the basic one- maintaining social order by providing workplaces and common ownership. Besides, in negotiations one had to take the state budget interest into consideration. Because of that "in view of the rising unemployment the approach towards the discussed price demanded considerable flexibility. In many situations failure to start privatization at the right moment could lead to enterprise dissolution due to economic reasons, which could be followed by considerable loss for creditors and budget" (Explanations...).

Empirical example of the course of price negotiations conducted by the State Treasury with employees may be the Zakłady Piwowarskie (Brewery) in Bydgoszcz. Valuation of that enterprise by the profit-based method allowed to estimate its value at 62,551,000 PLN, and application of the reconstruction method gave the value of 98,680,000 PLN. At determining the final price it was considered that "the enterprise's tangible goods resources are to a certain extent deprived of capital and the company standards do not meet the current requirements on technical level or environmental protection as the brewery is situated in the city center". It was considered that none of the proposed prices reflected the actual value of the company. In the course of negotiations it was assumed that the company value was 80,000,000 PLN and "such amount was included in the agreement for payable use of property concluded with the State Treasury and the lease contract" (Explanations...).

An interesting solution, from perspective of strengthening the employees' motivation for work and emotional engagement in privatization was applied at the Confectionery Plant Jutrzenka SA in Bydgoszcz. The plant was transformed into the employee company on 1st March 1993. It was significant that shares of the enterprise were sold to the employees without any limits. Every person could buy as many shares as he wished. There was no catalogue of privileged individuals. Such solution strengthened staff identification with the company, which was expressed in their resignation from dividend on shares in 1994 (Zielazna, 1994: 9). By courtesy of all shareholders the generated income was allocated to investments (e.g. construction of the plant in a new location).

Process of secondary privatization of the Jutrzenka employee company became a fact when it was to debut at the Warsaw Stock Exchange in order to gather capital for further investments. This was the right decision, considering the future of the Company. Shares of the company were popular at the Stock, and in 1999 the increase in quotation reached 132%. Such result confirmed a strong position of the Company among the Polish brands quoted at the Warsaw Stock Exchange. Taking into account the high value of intangible assets of Jutrzenka, the Colian SA Capital Group purchased its shares.

Observation of participation of employees in managing the employee company Jutrzenka SA Bydgoszcz reveals a rare mechanism of creation of employee's identification with the company after dissemination of ownership. Employees and at the same time shareholders of the company were both co-owners and workers. Such new, double role of an individual at the plant significantly influenced the way of perceiving one's own workplace, responsibility for work and role of the enterprise as the managing institution

whose goal was to generate profit. Workers-shareholders found out that the market success of their company depended on their responsibility and rational attitude. Imposed and accelerated education of employees within the field of free market economy allowed to observe formation of new values. Obviously, quite important was also the company economic success- employees-shareholders of Jutrzenka SA could notice that in their remunerations.

Market success of that employee company followed also from the fact that together with the tangible assets the company took over the priceless intangible asset that was the brand of Jutrzenka, recognizable on the market. That brand was already well-known within the years of the People's Republic of Poland. Its value was extended by the fact that the positive image of the trademark had been shaped before 1990 also in other countries gathered in the Council for Mutual Economic Assistance acting under supervision of the Soviet Union. The positive image of the enterprise acting under the logo of Jutrzenka helped it to organize a distribution network in Poland in the period when the state monopoly in trading was collapsing. That trademark also helped the company to re-introduce its products into the markets of the Eastern Europe. The high value of the intangible assets of the company, as were the logo and the trademark, similarly to Jutrzenka, had been used by the employee company Fabryka Cukiernicza Kopernik (Kopernik Confectionery Company) since the moment of its formation in 1991. The positive image of the company and its identity had been built for some centuries. So the company centuries-long tradition and use of traditional recipes, known for generations, were the main asset of the marketing campaigns. The described successes of the employee companies prove that Poles appreciated much the Polish food trademarks. However, they were not bound to domestic brands from other market segments, such as: electronics, or home appliances.

Employee companies, playing an important part in maintaining workplaces, provided for social security of workers. This was the reason, why they could expect aid from the State Treasury if problems arouse. The forms of aid from the State Treasury included mainly direct financial support. It consisted in debt relief. The unpaid liabilities due for the State Treasury were redeemed. In 1995 parts of the postponed payments, due from six employee companies for 1992 and 1993 at the amount 2,312,146 PLN, were redeemed. Significant support from the State Treasury was given to Przedsiębiorstwo Wielobranżowe Centrostal (Multiple Company) Bydgoszcz SA. That employee company was given consent for three-year deferral of payment of a part of liabilities for 1994 following from the leasing contract. The decision was thus explained: "The investment activity carried out by the company allows it to develop and maintain a proper employment policy" (Budget...). Deterioration of the economic condition of Przedsiębiorstwo Przemysłu Drzewnego Sawmill sp. z o.o. (Wood processing company) in Więcbork that had stopped paying the due leasing installments in 1992 made the State Treasury express their consent for prolonging the payments. Payment of debt towards the State Treasury was divided into favorable installments (Budget...). However, not in every case was the State Treasury willing to concede. By the end of 2006 the State Treasury applied the sanction of cancellation of the payable use of the company property with 83 employee companies that had discontinued settling payments of the leasing installments (Krajewski, 2009: 56).

In researches into the field of ownership transformations of the state enterprise, by way of liquidation and giving it to the payable use of workers, one must pay attention to the obstacles hampering the process of making the ownership common, of ownership



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generalization, dissemination. The main obstacle was deficit of capital in many plants. Lack of capital was a consequence of poverty of the Polish society and visible shortage of capital accumulation. The problem was referred to as follows: "for most of the staff it is a problem to gather resources necessary to obtain minimum capital, required upon the Act on privatization of state enterprises to take over the property of privatized entity" (Explanations...). Such obstacle could not be overcome by for instance the Przedsiębiorstwo Transportu Przemysłu Mięsnego (Meat transport company) in Bydgoszcz. In 1992 it employed 311 people. Its privatization by liquidation and formation of the employee company (employee leasing) was hampered, according to the management, by lack of financial reserves at the workers' disposal. It was pointed out that "due to low remunerations the staff was not able to acquire shares at the high price" (Statistical...1994). As a result, the staff was not interested in the employee privatization. Moreover, the company could not be subject to privatization by other method because, for instance, its fleet was technically poor quality. So, the adopted strategy was limited to passive waiting for more convenient, better circumstances that never came. This was not an isolated case. Przedsiębiorstwo Prefabrykacji Mobet (Prefabrication plant) in Mogilno had to face similar troubles. Its employees did not possess sufficient resources to establish the employee company and no external investor was interested in becoming a strategic investor to that company. The above examples again reveal the problem of shaping a positive image and a valuable brand of the company, such important in the free market economy. Those intangible assets of companies for many companies such as the above mentioned Jutrzenka and Kopernik became the valuable heritage. For others, such as the Przedsiębiorstwo Prefabrykacji Mobet (Prefabrication plant) in Mogilno or the Przedsiębiorstwo Transportu Przemysłu Mięsnego (Meat transport company) in Bydgoszcz they became additional burden that, mainly in the closest perspective, hampered the development planning and so making the decision on selecting the privatization path. In my opinion, this problem should be referred to wider in studies over the bankruptcy of enterprises in the period of the economic system transformations. When following empirical examples it comes out that the awareness of the low value of company intangible assets, including its negative image, considerably affected psychical condition of the staff, caused their disbelief in their success as the employee company, especially with the view of increasing competition of private entities that were hungry for success and constructed a new company value basing on the owner's name. The name became the company's brand and was included in its intangible assets.

### **Summary**

According to the legislator's assumptions, passing the enterprise property to payable use of employee company by the State Treasury (so-called "employee leasing") was to constitute the path of ownership transformation reserved for a few companies, difficult to privatize by other methods. Everyday practice proved that such form of ownership transformation, related to dissemination, generalization of ownership, became dominant. To many politicians and economists of those times the employee companies fulfilled the demand of employees' participation in managing the company. They allowed everyone who was employed there become acquainted with the ownership in capitalism. The news said: "According to the theory of economic justice successes of capitalism grow proportionally to the number of owners of productive assets" (Dowżycki, Sobolewski, Tłuchowski, 2003: 139). As a result of dynamic changes taking place in the Polish economy and growing competition of the new economic entities, the employee companies

lost their development pace within the years. They were looking for so-called strategic investors who, in exchange for the purchase of shares in the company, were ready to perform deep restructuring.

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