

# Developments In Business Simulation & Experiential Exercises, Volume 20, 1993

## CONTENT OR PROCESS? -- CONTENT AND PROCESS! SOME OBSERVATIONS AND REFLECTIONS ABOUT MANAGEMENT EDUCATION IN CENTRAL EUROPE

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### ABSTRACT

Management education in Central Europe by western experts faces unique challenges in that, besides the lack of familiarity with basic management tools, learners have limited knowledge about the context within which these tools are applied. Students' reactions to material presented needs to be related to their experience. The paper discusses observations gathered in Hungary, which are explained by the situation in Hungary and the implications for effective instruction.

### INTRODUCTION

Imagine having the task to teach a group of people how to ride and work with an elephant so that sitting on top of the animal they can log lumber in the jungles of Assam. These people have never seen an elephant, they have heard stories about this huge animal, some of them describing it as a ferocious beast, others as a powerful but gentle creature. There is one catch: You have no elephant at your disposal for your task.

This metaphor tries to capture the situation many western instructors face who travel to Central Europe and to the CIS in an attempt to teach basic management know-how to the men and women who have been propelled into leadership positions in new enterprises, state-controlled firms, cooperatives and government agencies. They try to the best of their abilities and experience to steer the organization through the shocks accompanying the transition to a new system. These managers are forced to learn a foreign language, the language of 20th century market capitalism. This system which so few of them had the opportunity to observe and study in situ has been described to them in stark contrasts. Until recently, capitalism was officially declared a doomed system based on the exploitation of the masses by the few. Unofficially, capitalism was a wondrous engine which promised abundant goods and freedom of choice to everyone.

This paper does not pretend to be the result of a rigorous scientific effort. Rather it conveys impressions and experiences gathered during four 10-day visits over a 9-month period in late 1991 and the first half of 1992 in two

medium-sized Hungarian cities. The purpose of these visits was twofold: to conduct seminars on strategic management for medium and upper level business executives, and work as a consultant to the leaders of the local government and to the business community in one of the two cities as part of a larger project to assist them in the transition to the a western-style market economy.

### HUNGARY: A SPECIAL CASE

Unlike other Central European countries and the former Soviet Union, Hungary has a long tradition in economic liberalization which goes back to the late 1960s and continued until the demise of the communist regime (Bauer, 1991; Kornai, 1986). This is evident in the reduced economic role the state plays in Hungary compared to other Central European countries which, however, is far more significant than in western countries (Table 1).

TABLE 1  
SHARE OF STATE SECTOR OF TOTAL OUTPUT

Czechoslovakia (1984)	97.0%
East Germany (1982)	96.5
Soviet Union (1985)	96.0
Poland (1985)	81.7
Hungary (1984)	65.2
West Germany (1982)	16.7
United States (1983)	1.3

Source: Audretsch (1991)

Reforms began when, in 1968, state-owned firms were declared autonomous to formulate their short-term plans; the authority to set long-term plans remained, however, with the central planning authority. In the 1980s, the pace of the reform accelerated beginning with the divestiture of large supply monopolies. In 1982, the legal basis for certain forms of small businesses was created. 1985 marked a major step forward towards liberalizing the economy. A privatization program was started which led to the creation of over 10,000 new enterprises. These businesses formed the bulk of a newly established private sector whose function remained restricted to a secondary role (Bauer, 1991). New regulations mandated the election of top managers in state-owned firms by the employees instead of being appointed by the higher

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authority. The state monopoly on foreign trade was gradually reduced which increased the number of businesses with the right to trade in foreign currencies from 150 to over 2,000. A year later, bankruptcy legislation was enacted. In the same year, a first step was taken towards reforming the banking sector. A two-tiered banking system was created by spinning off the national bank's commercial business into three new major commercial banks and creating a central bank (Neue Zürcher Zeitung no. 67). The reform also allowed the creation of new banks with foreign participation. In 1988, a new company law legalized private enterprises with up to 500 employees. In the same year, a comprehensive tax reform introduced a value-added and personal income tax and a corporate tax for private and public firms, which aligned Hungary more closely with its West European neighbors.

As a result of these reforms which put it well ahead of the other former command economies, Hungary's economy displayed a mixture of command economy elements and market features. Kornai (1986) concluded that "the reformed system is a specific combination... of bureaucratic and market coordination." (p. 1699) However, the degree of bureaucratic intervention was much higher than in West European or North American economies, "there are millions of microinterventions in all facets of economic life; bureaucratic microregulation has continued to prevail [in the former state sector, A.A.U.]" (Kornai, p. 1700) These interventions had a significant impact on the firms' goal functions. For instance, while officially the firms were expected to act as profit maximizers, state mandated prices were still widespread. Also, whether or not a company received credit from the state bank was not correlated with its past or expected profitability or credit worthiness. In addition to the official private sector an "informal" private sector similar to the underground economy in capitalist economies was an important factor in the economy. Kornai concluded that "there is somewhat less bureaucratic intervention and somewhat stronger influence of market forces [in the private sector, A.A.U.] than in the state sector" (pp. 1703-4).

Since the demise of the command economy in 1989-90, Hungary has continued to move towards a market economy. The process is now labeled "transformation" instead of "reform". In 1989, the new law on foreign investment unleashed a wave of joint ventures with foreign partners which in 1991 reached 5,652, more than twice than in the previous year (Tomlinson, 1992). In the same year, import controls were relaxed (Angell/VanSant, 1990; Neue Zürcher Zeitung no. 67). In 1991, a second banking reform regulated ownership and tightened the regulations concerning reserves and capital structure to bring them in line with the recommendations of the Bank for International Settlements. Finally, a set of three laws solved the all important ownership problem by establishing a process to compensate

individuals for loss of property experienced during the communist era (Neue Zürcher Zeitung no. 112). In spite of the large number of state-owned enterprises which have been transformed into limited share structures, the influence of the state remains high, since only about 10 percent of the companies formerly in state ownership are now privately owned, primarily by foreign investors (Neue Zürcher Zeitung no. 58). The "active privatization process", i.e. the transfer of entire companies into private ownership, has proceeded slower than anticipated.

### EXTERNAL DETERMINANTS OF INDIVIDUAL BEHAVIOR

A basic tenet of this paper is that previous experiences shape participants' reactions to stimuli. Managerial behavior is strongly influenced by the environment in which decision-makers operate. The entire system of managerial incentives is based on the presumption that managers react to stimuli in their environment. Granick's classic work describing the "red executive" (Granick, 1960) gives a vivid account of the environment within which the communist executive operated. By the same token, the Hungarian system of "indirect bureaucratic control" (Kornai, 1986) and the recent changes in the system have paramount consequences for managerial behavior (Melxner, 1991 and Pearce, 1991). Kornai (1986, p.1698):

"Because of the thousands of bureaucratic interventions, the manager does not have full responsibility for performance. In case of failure he can argue, perhaps with good reason, that he made all crucial decisions only after consulting superiors. Furthermore, many of the problems are consequences of central interventions, arbitrarily set prices, and so on. Under such circumstances, the bureaucracy feels obliged to shelter the loss makers."

We posit that Hungarian managers' responses in courses on management topics will be conditioned by their lifetime experience. This implies that western instructors/consultants are likely to encounter behaviors by their students/clients who can only be understood in the context of Hungary's history and which otherwise seem puzzling if not irrational.

The setting within which the subsequent observations were made involved a weeklong course on strategic management. The course consisted of two parts. First, participants were acquainted with key concepts of strategy in a seminar style context. The second part consisted of a simulation exercise for which a Hungarian translation of Smith's Manager (Smith, 1988) was used. Admission to the seminar was restricted to practicing managers at medium and upper levels with sufficient knowledge about basic management concepts (accounting, marketing, human resource management, etc.). Manager is a simple total manage

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ment simulation which in the United States is primarily used in undergraduate introductory management courses. For each decision, 12 variables need to be considered encompassing marketing (price, marketing effort, product R&D, market research), production (amount produced, process engineering, plant addition), finance (dividends, bank loans, stock, misc. expenses), and a social issue incident. Participants were grouped into small teams of 3-4 persons, which operated as a small company. All teams started of f in an identical position. Throughout the entire seminar an interpreter provided simultaneous translation.

### OBSERVATIONS

#### Capacity Equal Demand

Many teams initially equated production capacity with demand. Thus, they assumed that they would sell all they produce, or, rather, that constraints existed at the supply end and not on the demand side. While this mistake also occasionally occurs in management courses taught at U.S. universities, it was harder to convey the difference to the Hungarians. Command economies are scarcity economies where all inputs into the production process are hard to secure. Since the plan directs the allocation of outputs, managers need not to be concerned about marketing.<sup>1</sup> Also, since plans are notoriously poor in assessing consumer demand and have traditionally neglected consumer goods in favor of industrial products, the market usually is cleared no matter how poor the quality. These circumstances also explain the observation that teams usually hoarded supplies without regard for the costs incurred, in spite of the fact that they had no reason to assume that supply was threatened in any way. Only after several decisions did inventory turnover approach more reasonable levels.

#### Fear of Debt

All firms started with \$300,000 long term-debt with real annual interest at 16% and \$786,000 in net worth. Initially, the environment was set to be quite favorable with growing market demand and low price sensitivity. This allowed the less efficient firms to pass on their cost to the consumer. The firms had 7,000 shares outstanding with the option to raise this number to 12,000. In most instances, players quickly seized upon this opportunity to repay long-term debt by issuing additional stock without regard to the Implications on earnings per share and

stock price. Discussions with the teams revealed that the decision to repay the loan was not based on cost-benefit calculations but a reflection of the prevailing environment in Hungary with interest rates ranging between 35 and 40%. In some instances, the relationship between earnings per share and stock price was not adequately understood<sup>2</sup>. This is hardly surprising given the nascent status of the Hungarian equities market. Furthermore, almost all participants revealed little confidence in the "sanity" of the simulated environment and expected sudden, unannounced jolts such as administrative decrees, supply shortages, rate and tax hikes, etc. Because of this, they felt it to be a wise move to avoid any long-term obligations almost at any cost.

#### Cash Hoarding

The simulation provides limited opportunities to invest excess cash. A successful firm may run into a situation where production engineering and marketing expenses can be covered with operating income. Thus the team is in a situation where substantial profits are being generated quarter after quarter unless it decides to expand production capacity in order to gain market share which could be costly when overall demand is stagnant. After paying of f their long-term debt, Hungarian teams did not select the options of increasing dividends and buying back stock in order to raise the value of their company. Instead, cash was hoarded at zero interest. During the debriefing sessions with the teams it became clear that this behavior was related to three factors. First, insufficient understanding of the parameters influencing the value of a security played an important role. Second, the responsibility of the managers towards the owners of the company was not fully appreciated. And third, all participants felt it was important to have cash stashed away in case of an emergency.

The argument that in such a case a short-term bank loan could be less expensive was met with skepticism. This reflected the current situation in Hungary in that participants mentioned that it was very difficult to obtain business loans and if so only at a very steep price.

#### Value of Information

The simulation allows teams to purchase market research such as an overall economic forecast, last quarter's sales in the entire industry as well as important competitor intelligence (product price by company, average marketing, R&D, and engineering budgets). In the simulation this information is significantly underpriced with the most expensive market research variant costing less than one percent of quarterly sales. Additional information

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<sup>1</sup> A correlate to this is the finding that in October 1991, 800 students were enrolled in production/operations and only 25 in marketing in the management program of a Rumanian university.

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<sup>2</sup> In the original second version of the simulation, EPS does not affect stock price. The version used by the author was changed in this regard

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was provided at the end of each year in that the teams had to compile an annual report comprised of an annual income statement, balance sheet and a brief letter to shareholders outlining major accomplishments and plans for the future. The annual reports of all teams were made available to everyone.

It soon became clear that the value of information is not well appreciated. Teams routinely under-invested in market research and made little use of it. Also, whereas in the U.S. participants would immediately pour over their competitors' annual reports, their Hungarian counterparts barely touched them. This observation can be explained by the fact that even under Hungary's relatively enlightened central planning regime the need for market re-search and competitive intelligence was relatively minor. In many sectors competition is still weak resulting in a reduced need for this type of information. A third factor could be that just like her sister countries in the region Hungary has a tradition of unreliable if not intentionally falsified statistical information (Hinteregger, 1992). A tradition of administered prices, a habit of keeping crucial information secret and of manipulating data when reporting to higher authorities has left its imprint on peoples' minds not to trust publicly available information. Because annual reports are in the public domain, these data could not possibly be correct and thus be safely disregarded. The alternate interpretation that the participants did not know how to use the data could be ruled out since the teams were given instructions and forms for condensing and interpreting the financial data. Also, by the time the first annual reports were available each team had had the opportunity to analyze and interpret four of their own quarterly reports and market research purchased.

The lack of understanding concerning the value of information was corroborated by the second sample of local government officials and leaders of local business organizations involved in local development. While these individuals repeatedly deplored the lack of reliable data for their work and were constantly searching for new data bases, they seemed to have very little use for whatever data they had available. One small business entrepreneur involved in computerized data collection and management had helped city hall in collecting data on the community. When made aware of the fact most likely the same need existed in other communities and that his expertise could be expanded into a profitable business, he did not understand. Only after a 2-month visit to the United States did he comprehend the importance of up-to-date, accurate information for decision making.

### Erratic Pricing

The Hungarian teams' marketing strategy seemed less coherent than that of U.S. teams. Most importantly, there seemed to be little consistency between the amount of resources invested in product R&D resulting in a

differentiation advantage and the price charged to wholesalers. Furthermore, changes in prices were not clearly related to market share position, strategy and/or the business cycle. In one instance, a team which had invested heavily into developing a highly differentiated product and, following textbook wisdom, priced its product at the higher end, dropped its price dramatically from one quarter to the next without a clear reason. When the author inquired about the thinking behind this change in strategy and pointed out that this move might negatively affect the product's image with final customers, the team members answered that they did not anticipate that the wholesalers would pass on any of the savings to the customers. Therefore, the high quality image of the product would not suffer. The intention was to endear the firm with its distributors via high profit margins.

### Static View of the Competitive Process

More so than their American counterparts, participants had a hard time understanding the dynamic features of competition. The notion that a differentiation advantage could disappear and that consumer preferences may change thereby reducing sales from one quarter to the next needed to be learned during the simulation. Related to this was a lack of understanding of the entrepreneurial risk. Participants had difficulties accepting an environment of incomplete information where key relationships such as price, marketing or innovation elasticity were unknown and had to be determined via trial and error. Again, this is a reflection of Hungary's recent past and of the fact that all participants were employees of (former) state-owned enterprises and industrial cooperatives.

### Compartmentalized View of Competition as a Mechanism of Allocation

The Hungarians involved in economic development at the local level displayed a somewhat compartmentalized view of the prevalence of competition, which they perceived as being restricted to rivalry among firms. The notion that communities are in competition, too, for attracting businesses, was less obvious to them. In the past, competition has been downplayed in Hungary. Although since the reform of 1968 certain sectors have been opened to competition, the influence of the bureaucracy has remained very strong. Typically, localities were not involved in location decisions for large plants, and the state took care of economic development to ensure adequate levels of employment. Therefore, there was no need for localities to actively search for new investment.

### Social Responsiveness

The simulation contained one social responsiveness variable. In each decision the teams were confronted with an incident dealing with issues such as charitable

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donations, pollution control, supplier relationships, kickbacks, truthfulness in advertising and several options from which to select one. In order to ensure relevance, these incidents were adapted to the Hungarian situation. It was interesting to see that the teams had difficulties dealing with these questions on a fundamental level. Many of them had a hard time understanding why companies should be concerned with charity. In their view, this was the state's responsibility. Thus, coming from the opposite end of the spectrum in terms of their own experience where state-owned enterprises were deeply involved in the distribution of good such as housing, food, support of sports teams, their views were more of the Friedman type (Friedman, 1962).

### IMPLICATIONS FOR PEDAGOGY

The declared purpose of much of the teaching and consulting activity conducted by Westerners in Central Europe is to upgrade the skills of managers and public decision makers. Since the late 1980s, a stream of Westerners has descended upon these countries emerging from communism marketing and selling its skills. Indeed, cynical comments regarding the help of some forms of Western assistance can be heard in many places. A manager of a Big Six accounting firm: "When you are trying to shed a few people back in London, Budapest is an ideal place to send them" (Copeland, 1992).

Frequently, little emphasis is being placed on what should be learned, what the learners' initial knowledge is and what the most appropriate method of delivery should be. The definition of learning "as a [planned, A.A.U.] change in cognition, attitudes, or behavior" is ambiguous in several respects. Learning can concern declarative knowledge -- concepts, facts and figures which constitute the nodes of an associative network -- or procedural knowledge -- the effective application of knowledge, i.e. the linkages between the nodes (Gentry, Stoltman and Mehlhoff, 1992a). Its is clear that at this point in history the task of teaching management in Central Europe, a heretofore foreign language, encompasses both elements: New concepts need to be learned ranging from basic accounting to marketing. Managers and business people need to have the "cultural literacy" to interact with western counterparts. In addition, they must also be able to apply these concepts within their environment (Gentry, Stoltman & Mehlhoff, 1992b).

In order to clarify the instructional task, Bloom et al. 's (1956) taxonomy is particularly useful for management education given its orientation towards problem solving and decision making. It identifies six different levels of cognitive learning and appropriate assessment procedures for each (Table 2).

Learning Objective	Description of the Learning	Assessment Process
Basic knowledge	Student recalls or recognizes information	Answer direct/ tests
Comprehension	Student changes information into a different symbolic form	Ability to act or process information by restating in his/her own terms
Application	Student discovers relationships, generalizations, and skills	Application of knowledge to simulated problems
Analysis	Students solve problems in light of conscious knowledge of relationships between components and the principle that organizes the system	Identification of critical assumptions, alternatives and constraints in a problem situation

Source: Gentry and Burns (1981)

Table 2 makes clear that in order for teaching to be successful, ex ante clarification of the desired level of learning is critical. In view of the applied nature of management, learning should at least encompass levels 1 to 3. Effectiveness at higher levels is more difficult to achieve, not only because of the amount of practice required relative to the time constraint imposed on these courses, but also because at higher levels consideration of contextual factors gains in importance. This represents a tall challenge to Western consultants. They will have a hard time with regard to providing tailored procedural knowledge since they themselves usually have an incomplete understanding of the existing political, economic and cultural environment in Central Europe.

In addition, since the issue at hand is western assistance to Central Europe, the level of familiarity with fundamental concepts on which the more specialized management knowledge rests should also be determined beforehand. To go back to our metaphor: It is essential to determine how accurate a picture of the elephant the participants have, before we teach them commands and techniques how to control the animal.

A basic tenet of experiential learning is that simulations are suitable tools to address higher levels of learning, especially levels 3 and 4 following a quote attributed to Confucius (Gentry, Stoltman & Mehlhoff, 1992a): I hear and I forget, I see and I remember, I do and I understand. Judging from the participants' reactions and final discussion the simulation did indeed improve procedural knowledge and further the understanding of key concepts and how they should be applied. All of them stated that the simulation helped them better to understand the tools they had learned in the first half of the session. They also noticed that the simulation added a process dimension, which was not fully understood beforehand. Several participants of large combines suggested that their entire middle and upper management should go through the simulation.

One particular issue that received some attention was the question to what degree the simulation should be adapted to the prevailing situation in Hungary. Some participants considered it as a disadvan

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tage that it represented an American situation. Others felt that this was, in fact, an advantage in that it helped them to prepare themselves for the future and for the competitive game, which they are likely to encounter on export markets.

Finally, simulations have a special advantage for instructors operating in a foreign language with which they are not familiar. In practically all cases the English vocabulary required for playing these management games is limited to a terminology the participants need to or want to learn anyway in order to be effective. The key advantage is that the discussions surrounding the decision making process in each team requires limited instructional input and can take place in the native language. The main start-up costs are related to translating the manual and providing initial instruction with the help of an instructor. The participants felt that with regard to the translation problem, the simulation was less cumbersome than the preceding seminar. Therefore, based on impressionistic evidence, simulations are very useful instructional tools to enhance understanding and application of management skills in Central Europe.

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