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# From socialism to capitalism: the effects of Hungarian human resources practices

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## Executive Overview

***What are the human resources management practices within communist and formerly communist companies? Many of the managers from capitalist countries forming joint ventures with state-owned enterprises in communist and formerly communist countries have only superficial ideas about these enterprises' human resources management practices and their effects. The more lurid dysfunctional practices of these organizations are well known, and foreigners often (mistakenly) assume that these result from incompetence. However, such practices have evolved within complex systems of organizational behavior which were largely successful in achieving their real objectives: political control and production quantity.***

***This article presents a detailed analysis of four human resource management practices in Hungarian companies: (1) the weak performance pressures, (2) substantial pay-at-risk compensation systems, (3) promotion-through-connections, and (4) ambiguous responsibilities. These practices result in numerous dysfunctions: excessive bargaining between supervisors and subordinates, pervasive distrust, the de-legitimation of managers, and responsibility avoidance. Unfortunately, these practices are changing slowly, at best, under economic reform. The article concludes with suggestions for both local and foreign managers.***

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## In My View

Executives from capitalist countries are rushing to form joint ventures with enterprises in the former communist countries of Central and Eastern Europe. Yet, what do these executives really know about the management practices and working relationships in these enterprises? While numerous newsletters and professional newswweeklies can provide detailed analyses of the political and legal environment for business, they provide only partial, but vivid, anecdotes about what happens inside these enterprises. Into this analytic vacuum have come untested assumptions, such as, "Employees do not work hard because they have no financial incentive."

Joint-ventures in reforming communist and formerly communist countries are fraught with difficulty under the best of circumstances. Unfortunately, they are made more difficult by a lack of understanding of the human resources management systems and resultant workplace behavior in these societies. Foreign managers eventually do learn to understand the terrain, but for many it is after a long and frustrating "trial by fire." Unfortunately, some expatriate managers grow so frustrated that their own anger interferes with their ability to build an effective organization. This report is intended to help managers from capitalist systems anticipate and manage in these rapidly changing environments. It describes the actual human resource management practices and analyzes some of their effects in the formerly communist country that has been most successful in attracting foreign investment.

This work also is written for local managers, consultants, and policy makers—those who face a historically unprecedented struggle to transform ineffective enterprises into successful competitors in international (and newly opened domestic) markets. It is actually much easier for the foreign managers: if they stay around long enough, they can build effective organizations, because they have their own “models” of how organizations should work. For the local managers, the perspective of a foreigner (speaking openly as a friend rather than politely as a guest) is particularly valuable now.

### **Why Hungary?**

Hungary has probably come farther than the other Eastern bloc economies in the reorganization of its economic life toward market-driven enterprises. It began significant reform to encourage privately owned enterprises in 1968. Currently foreigners and locals have complete freedom to establish private, profit-making companies. It has nascent stock and bond markets and a vigorous political debate over ways to privatize the state-owned enterprises which still dominate the economy.

Hungary has also established, with Western partners, the first private graduate management school in an Eastern Bloc country, the International Management Center. The purposes of this school are to assist Hungarian managers in more effective management of their newly independent enterprises and to foster the development of private enterprise through entrepreneurship and the facilitation of joint ventures with foreign partners. In 1989, I spent a semester at this center located in Budapest training managers, and this article is based on my experiences of learning how to assist these managers to change their organizations.

Of course, Second World organizations differ in many significant ways from capitalist ones. The situation becomes even more complex as particular countries make radical legal and economic changes, while others have not. Even within Hungary there are wide variations—the executives of some state-owned enterprises aggressively move into new markets and streamline their operations, others attempt novel reorganizations (the actual effects of which no one can accurately forecast), and others nervously wait. One short article could not possibly do justice to all of the variety of management practice and employee behavior in these reforming countries, or even in Hungary’s industrial sector. Choices had to be made. Human resources management features were selected that met two criteria: (1) They were focused on managerial practices in “economic enterprises” (what would be for-profit businesses in a capitalist economy), since these are the likely joint-venture partners for western companies; (2) They were practices that appeared to have their origin in the now-defunct communist system of political control, but which seem to have taken on a continuing life independent of their communist origins. This article is intended to be useful to both potential partners and local managers by openly describing some of the less attractive management practices and their effects on employees in a country that has overthrown communist political control. This analysis is not intended as a balanced representation of all aspects of management practice in formerly communist countries. Hungary has more than its share of successful organizations heroically transformed from bankruptcy to rapid growth and profitability in its state-owned as well as in its growing private sector. There is ample material for both the business-press hagiographers and the academic critics.

### **Human Resources Management Practices**

Four features of human resources management practice are examined. First is the lack of focused attention to motivating individuals. While the problem originates in old government policies, the labor scarcities worsened by economic reform contribute to continuing weak performance pressures. The second feature,

contrary to what many outsiders assume, is the fact that Hungarian employees and managers have a large proportion of their pay "at risk"—a yearly bonus that can range from zero to 200 percent of base pay. Surprisingly, despite the assumption in the compensation literature that such contingent pay would result in positive outcomes, the actual behavioral and attitudinal effects are quite dysfunctional. Third, promotional policies traditionally were not based on performance assessment and procedural justice, which resulted in resentment among managers. Finally, ambiguity in accountability is widespread, exacerbating distrust and often leading to frustration and miscommunication.

***Thus, a rapid pace of change may be an inevitable ingredient of the conversion from state-directed to market-driven economies, and this abruptness, itself, precipitates management challenges.***

No doubt some of the observations presented here are more "Hungarian" than they are "reform-communist" and so may not apply in other formerly communist countries. Each country has its own unique culture, history, and comparative economic resources. Yet it is my belief that many of the experiences of these pioneering Hungarian organizations may prove useful in understanding management dilemmas in managing employees in other organizations emerging from command economies.

In addition, the economic structures in Hungary are changing rapidly (although some argue that they are not changing rapidly enough!), and some of the employee behavior described here may be influenced by the confusion generated from this rapid change. However, it may be that such a comprehensive economic reform cannot be managed and confined to a more orderly progression. Rather, it may inevitably reach a point, as it has in Hungary, at which there is a sudden avalanche of change. When enough people believe that economic reform will not go back, as in Hungary, there is a stampede to position oneself favorably for the new economic order. Thus, a rapid pace of change may be an inevitable ingredient of the conversion from state-directed to market-driven economies, and this abruptness, itself, precipitates management challenges.

#### **The Economic Context**

Before describing the four human resources management practices and their attitudinal effects, it is important to describe very briefly the economic context to establish the background for the changes that are occurring. Although Hungary has not had a true command economy for many years, for complex reasons<sup>1</sup>, managers in its state-controlled enterprises have been facing an environment more similar to their command economy than to their capitalist neighbors. Even today, while Hungarian managers struggle to make their products more attractive to customers, for a great many state-controlled enterprises, change is coming slowly. Therefore, it is best to see the following description of the economic context as a description of the recent past that is no longer pertinent for many companies (especially private companies) but still is relevant for some (especially in the state sector).

***Under conditions of government domination, managers' strategic attention is focused, not on markets, but on both supplies and "responsibilities."***

There are important differences in the economic context of market-driven and state-controlled economies. These differences are most apparent in the "corporate strategies" that executives must adopt but are also relevant for understanding the pressures on individuals within the workplace.

#### ***A Seller's Market***

The most important fundamental to understand is that state-dominated economies are "scarcity economies." This means that all components of organized activity are difficult to obtain—raw materials, labor, replacement parts, capital, . . . everything. In practice, it means that managers' major operational objective is to secure reliable supplies of needed credits, material, and labor. Since the governmental planning apparatus directs where managers' output should go and how much revenue they are to receive, markets as a revenue source simply do not receive the managerial attention paid them in market-driven companies.

Under conditions of government domination, managers' strategic attention is focused, not on markets, but on both supplies and "responsibilities."

*Most Companies are Monopolies*

In a fully planned economy, one of the theoretical efficiencies is that the planners dedicate one (or a few) suppliers of a certain product to avoid the "waste" of duplicative competing products. Many enterprises thus become the only supplier of their product to the receiving enterprise and, therefore, have a responsibility to them. Since the producing enterprises often face shortages and other problems, it is difficult for them to be reliable in meeting their responsibilities. This sets the stage for the endless rounds of "bargaining" that characterize managing directors' lives: bargaining with suppliers, bargaining with "customers," and, as will be detailed later, bargaining with employees.

*Executives Focus on Bargaining*

In spite of their expanded autonomy under the reforms, Hungarian managing directors still must expend significant energy bargaining. In the now-defunct pure command economy, paying a higher price for the product was illegal; today it is entirely legal to use this "market solution." However, many impoverished state-owned enterprises do not have the foreign currency reserves to make expensive purchases on the western markets.

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***Forty years of a state-controlled economy have left an infrastructure of delivery contracts at artificial prices that make it virtually impossible for many state-owned enterprises to take advantage of their new market opportunities. Many managers are pursuing newly available markets but find that in the short term they are still trapped in a web of monopoly relationships that require perennial bargaining.***

With what can these managers bargain? Sometimes they control something valued by the partner. Until the recent destabilizing changes, the most effective negotiating position had been to have "good connections" or influence with those on whom the partner depended. In Hungary, there is a common joke of a poor man who could not provide much financial support for his son. However, he did enroll his son in one school for a year, and then the next year enrolled him in another school for a year, and so on for his entire school career. Thus, the son always was able to find "an old school chum" who had friends in the right places or who had access to supplies, and the father provided an inheritance for his son that was worth much more than any sum of money. Unfortunately, under scarcity conditions, the threat is usually more viable than the promise, which leads to what one market-research company manager called "ugly, brutal, blood-running-under-the-door bargaining."

Of course, under the previous political system, the most important scarce supplies (such as investment credits and apartments at low rents) were controlled by members of the ruling communist party (in Hungary called the Hungarian Socialist Worker's Party). Good relations with key party members became necessary to cope with the primary strategic difficulty of securing credits and supplies faced by enterprise managers. Party membership was a virtual prerequisite for top managerial positions, and most executive careers moved up through the party apparatus, then over to executive positions in enterprises.

Note that this form of party influence over managers was not obtained through brute force and differed only in degree from the relationships many capitalist-economy executives must maintain—with bankers, for example. Today in Hungary, the party has disintegrated and no longer has a monopoly over all

sources of supply, but its former members do retain important positions and their collegial connections throughout the system. One of the ambiguities of the economic transformation is what happens when the individuals occupying key positions and their personal connections with one another have not changed but they are no longer "organized" through one (party) institution. At present, good connections are still vitally important in many aspects of managers' lives, whether they be state-owned enterprise managing directors, entrepreneurs, or foreign joint-venture partners.

For example, currently the Hungarian government is under severe financial pressure from the International Monetary Fund because the country is running a budget deficit, while trying to repay its large foreign debt. So the government has reached an agreement with the International Monetary Fund in which it is significantly reducing the supply of money to the economy. With such a large proportion of the economy state-owned and the banking system still dominated by state-owned companies, this monetary restriction has had a powerful effect on all enterprises. That is, short-term credit has been restricted and payments delayed, so large state enterprises have no cash to pay their suppliers, who then have no cash to pay their suppliers, and so on—resulting in a domino-effect cash squeeze throughout the economy. Yet when an enterprise finally does receive cash, who among their many creditors do they decide to pay first? Although they often are constrained by contractual obligations, it does happen that managers sometimes pay first those with whom they have "the best relations." Anyway, believing in this possibility, many suppliers consider it necessary to maintain continuous good relations with customers to protect their own enterprises.

As these examples illustrate, although Hungary has not been a fully command economy for more than twenty years, some aspects of the scarcity economy remain for many of its organizations. The government still owns nearly eighty-five percent of the country's capital stock. Privatization is proceeding slowly in all of the former communist countries. At present many enterprises are still tied to the contracts and relationships developed in the communist era, and many managers and employees firmly believe that cultivating good connections is the most effective use of their time.

#### **Human Resource Practice #1: Weak Performance Pressure**

The attention given to individual levels of employee and managerial performance are rooted in the former economic structure but, interestingly, have not changed notably in this early period of reform.

The lack of incentives and pressures for high levels of product quality and efficiency in state-owned monopolies is widely known. However, the manner by which these enterprise-level processes are translated into individual job performance expectations is more complex than many assume. While it is true that the lack of performance pressure at the top of the organization is reflected in weaker performance pressures on subordinates, the situation has been intensified by labor scarcity, and labor scarcity is becoming worse under reform.

#### *Labor scarcity*

Under the previous political system, necessities (food, schools, health care) were provided at nominal costs and wages were kept low as a matter of public policy—to prevent individuals from accumulating capital which might foster the rebirth of capitalism. This situation cannot change quickly for the state-owned enterprises, since there is no "market test" of employees' value. Therefore, for decades, wages and salaries in Hungary have been set at very low levels (particularly for professional and managerial workers) in comparison to western levels. In addition, Hungary was essentially a one-employer monopsony market for labor, which will force wages down.

To make matters worse, Hungarian state-owned enterprises developed a strong demand for (low-wage) employees, like state-owned bureaucracies everywhere that are not known for their excessive zeal to shrink the sizes of their organizations. Thus, under the previous system, many state-owned enterprises found that they had more jobs than employees willing to work for artificially low wages, leaving them with a labor scarcity, just as they faced a scarcity of material and capital when prices were set at low levels.

Under economic reform, the labor scarcity problem is worse. State enterprises' wages still are very low (partly because of legal restrictions and partly because many of these organizations face severe financial constraints as they seek to adapt to market conditions with constrained credit). Now, however, employees are able to leave for higher paying jobs in the burgeoning private sector; thus many state-owned enterprises are finding it difficult to attract and retain high quality labor. Similarly, the private companies are also encountering a shortage of labor, particularly of trained managers who speak foreign languages. The supply of Hungarians skilled in capitalist management practices, technical specialties, and languages lags well behind the rapidly growing demand.

Under these circumstances there was—and continues to be—weak pressure for high levels of individual performance. This is a result both of labor scarcity and of the fact that state-owned enterprises themselves do not receive significant pressure to produce at optimum levels of performance. Further, in this early period of reform, many of the private firms lack sufficiently meaningful competition which would motivate them to strive for internal efficiency or high levels of quality performance.

#### *Neglect of Formal Performance Appraisal*

Under these circumstances, the dearth of any systematic formal performance review practices should not be surprising. Some state-owned enterprises have performance appraisal systems, but personnel directors find it very difficult to interest their managerial colleagues in completing the evaluations unless the managing director issues a direct command to do so. Systematic individual performance evaluation simply is not a focus of attention for many managers.

#### *Goal Conflicts in Foreign-local Joint Ventures*

The labor scarcity has two important implications for foreign joint venture partners.

The first is a potential conflict of goals between foreign and local-state company managers planning a joint venture. Private companies and joint-ventures with foreign private companies do not face ceilings on wages and so can usually solve their labor scarcity problem by paying higher wages. Therefore, many managers of state-owned enterprises see the joint venture as an opportunity to raise wages, because they face a ruinous drain of their best employees to the private sector (and, of course, would like to see their own salaries raised). They see the foreign joint venture partner as a source of capital and as providing relief from onerous governmental restrictions. These needs are so pressing that local managers may not fully consider the fundamental changes that will be required in a joint venture.

The second implication is that scarcity in labor of skilled professional and managerial employees (especially those who speak English) will worsen in the next few years as more investment capital pours into these countries. For skilled professionals, wages are rising very rapidly, so investors must stay apprised of current pay rates and plan for significant inflation, especially in the pay of managerial employees.

*Human Resources Practice #2: Substantial "Pay-At-Risk"*

As a result of both debilitating labor shortages and the fact that in these enterprises it used to be virtually impossible to fire workers, a complex monetary bonus system was developed in communist enterprises. Under this system, bonuses may range from zero to 200 percent of an employee's base salary. The largest percentages were usually reserved for managers, but workers at even the lowest wage levels in most Hungarian enterprises have grown to expect yearly bonuses up to forty percent of their base pay. Experienced managers will recognize that this is much more than the usual two to seven percent differentials in capitalist-system merit pay systems. These bonuses are usually given at the sole discretion of the immediate supervisor or of a committee which includes party officials. Because performance pressures are weak, rarely are these large bonuses tied to clearly defined performance objectives. In a society where the average salary is \$200 a month, most families need this additional money just to survive, so these bonuses have become very important to employees.

**As a result of both debilitating labor shortages and the fact that in these enterprises it used to be virtually impossible to fire workers, a complex monetary bonus system was developed in communist enterprises. Under this system, bonuses may range from zero to 200 percent of an employee's base salary.**

*The Communist Personnel Practice Capitalist Executives Love*

Although this "conventional pay system" grew out of the distorted economic conditions of the previous political system, newly established private enterprises have been quick to adopt it. Even the non-governmental educational institution where I worked used it for the Hungarian faculty members (but wisely decided that the foreign faculty probably would not find it attractive). Yet what appears to be a very powerful set of incentives for performance motivation has had the perverse effect of establishing a relationship between supervisors and subordinates characterized by continuous bargaining and distrust.

*Maybe there is a Reason why Companies Don't Really Pay for Performance*

Conventional Hungarian managerial wisdom held that workers get their salaries for just showing up (and sometimes even that was not required), but if their supervisors wanted them to do any work, the supervisor must "pay" for it. As an illustration, a personnel director in a large industrial products company recounted that he wanted to revise one of his company's personnel systems and so convened a task force of his subordinates and representatives of affected departments to draft the new system. No overtime work was required; this would be considered a normal job assignment in the United States. Yet the personnel director said that his subordinate would not agree to work on the task force unless she was given a monetary bonus for this extra assignment. He said this was not an unusual situation but continued to be the normal expectation in all industries. So managers have learned that they must always "hold some of the bonus money back" for unexpected demands, and employees know of this reserve so they continuously strive to gain more through bargaining.

*Continuous Supervisor-subordinate Bargaining*

Managers and their subordinates find that they must continually haggle over job assignments and payments. Subordinates believe that this is the only way to get their "fair shares" of the bonus money, and since many managers spend their reserves in these small contracts, the employees may be right. Managers and subordinates grow to distrust one another, and the acrimonious bargaining reinforces the distrustful relationships. Although this system grew out of economic conditions that are no longer pertinent to most managers and employees, it has become the normatively accepted relationship between boss and subordinate and so continues, functionally autonomous from its origins.

In addition to the inertia rooted in expectations, this disagreeable situation seems also to be reinforced by the absence of concrete *a priori* criteria established for bonus payments. Only very recently have some state-owned enterprises begun tying executives' bonuses to enterprise earnings. Evidence for the importance of clear performance criteria is provided by the experience of a private

Japanese-Hungarian joint venture which also used large bonuses but had clear performance measures (as well as clear minimum standards with termination for any employee who could not reach them); this joint venture did not have the continual employee-supervisor bargaining and distrust described previously. It is ironic that a major supervisory complaint of Hungarian managers (constant haggling with subordinates) apparently could be alleviated by the formal performance appraisal systems that they are too busy to implement.

*Management-by-special-favors*

Finally, there is another kind of individual incentive that deserves mention. This is the practice by which managers turn a blind eye to employees' use of organizational resources for their own purposes and to their absenteeism. As is common in market-driven companies, many managers (particularly first-level supervisors) find that they can expand their available incentives by allowing deserving employees to "break the rules." For example, Sayles<sup>2</sup> argued that nothing legitimizes a supervisor more than the ability to "successfully buffer" subordinates from outside demands, a process that may involve "covering up for them." One way in which managers can reward their best employees is by condoning these small illegitimate activities.

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***Although cheating and stealing certainly are familiar to managers in all countries and may be no more prevalent in state-dominated economies than in others, they do carry a different moral tone in countries emerging from communist control. Recall that Hungary had a political regime imposed on people against the popular will, and its totalitarian character meant that enterprises were harnessed for political control as well as the production of goods and services. Under these circumstances, cheating could be a form of heroic resistance. When rules were immoral, rule breaking became a moral act.***

The fact that recent "prisoners" have been elevated to prominent governmental positions in Czechoslovakia and Poland on the basis of their widespread moral authority helps illustrate that rule breaking can have a more ambiguous interpretation in Eastern bloc countries. Of course, much of the cheating and stealing that takes place in Eastern bloc enterprises is done for the same narrow self-serving reasons as anywhere else.

Further ambiguity is introduced by the widespread resentment of the favors formerly extracted by party members and their allies. That is, a large portion of the misused enterprise resources went to party members and their good connections. Previously, fellow employees felt compelled to watch these practices in silence, but no longer. Thus, Hungarian managers and employees are moving out of a climate in which cheating was an acceptable form of resistance against detested bosses and unofficially, yet openly, tolerated for the politically favored.

Interestingly, Hungary's well-developed private economy may have exacerbated the complex emotional reactions many have to small-scale favors. With wages so low, most Hungarians long have held second and even third jobs in the private economy. With some notable exceptions, managers and employees at all levels have jobs on the side. With the widening freedoms for private enterprise, many professionals and managers in state-controlled industries with low barriers to entry (for example, computers) have become entrepreneurs running companies that sometimes directly compete with their first-job employers. (Hungarian entrepreneurs routinely retain their state-sector first-jobs for the job security, access to connections, and resources these jobs provide.) Thus, a resentful subordinate begins to whisper that the department head uses the enterprise vehicles to make deliveries for his pub. Colleagues wonder whether a manager's recommendation reflects his first- or second-job interests.

Even the state-owned enterprises routinely accept "second jobs" (private contract work). This allows them to increase employee compensation (contract work is not considered in wage ceilings) and provides revenue for capital improvements or new ventures. Yet, again, the presence of "state work" and "private work" in the same company creates powerful incentives to misuse state resources. I drove for some kilometers behind a large diesel delivery truck for one of the prominent state-owned enterprises that was towing a small private car—a very unlikely official business activity. Was the driver using the truck for his personal business or fulfilling a private contract for the enterprise?

#### *Should Foreign Managers Cheat Too?*

Some have argued that western joint venture managers must get along by going along with such local customs, no matter how personally repugnant.<sup>3</sup> Yet my observations suggest that this is a very risky practice. This management-by-special-favors and misuse of employer resources (or imagined practice based on the recent past) has a pernicious effect on interpersonal relations. While simultaneously bargaining for their own "favors" or rewards, co-workers resent the apparent special favors colleagues receive. It may be that the manager is simply acting to maintain internal equity for truly performance-justified reasons, but the secrecy in which it occurs breeds suspicion. Sometimes colleagues suspect a special favor when none has been given. When theft is tolerated, it is not clear whether or not this is justified compensation or the actions of a few bad individuals. Because bonuses and favors alike are given privately and are based on personal appeals and bargains, everyone suspects that someone else is getting a better deal, which fuels an escalating spiral of distrust. If managers want to prevent their subordinates from cheating them, they would be wise to become models of scrupulously honest behavior.

There is another reason to avoid these practices. Many observers believe that the overwhelming electoral defeats which have surprised the Communists stem from resentment at these corruptions in the workplace. Since foreign businesses in any country face potential scapegoating from resentful locals, adopting the more offensive practices of local elites may not be prudent.

#### **Human Resources Practice #3: Promotion-through-Connections**

In organizations without strong performance pressures, managerial positions become "awards" for loyalty or for having useful connections. As noted, it was the normal staffing practice to place loyal party members in executive positions. Under reform, this process initially accelerated.

Until very recently, many state-owned enterprises found that they were receiving so-called "parachutists"—party members in purely party or planning jobs who realized that they must secure a position in a company while they still retained some influence. Although this practice may have stopped with the waning of (Communist) party influence, most of these managers still retain their places. They may have the potential to be quite competent, but they have arrived illegitimately (in the eyes of their non-party subordinates and colleagues) and so face self-fulfilling expectations regarding their incompetence.<sup>4</sup> Parachutists' colleagues are further inflamed by their resentment of the damage the party has done to their economy, as well as past political abuses. This is not the sort of climate in which shared goals and mutual problem solving can be expected.

Another effect of this recent practice of promotion-through-connections is reflected in the following incident. At a management training retreat conducted for managers of a state-owned computer services enterprise, it was surprising to see one of the computer center managers toadying to the personnel director who was visiting on the final training day. He hung around the director whenever he could, and his previously aggressive demeanor turned sweet and mild. I had admired

this manager during the week as an aggressive fighter (even if he did step on a few toes). Yet now he followed this director around like a fawning puppy, literally waiting to be the last to see him at the end of the training. What could account for the starkly contrasting demeanors of this manager? Perhaps his first—the aggressive—demeanor was more authentic and he wanted to advance in the organization. However, the environment he perceived himself to be in was not one that rewarded displays of performance prowess, but rather one that rewarded toadying like a courtier. He apparently thought that the best way to get ahead in this computer services company was *not* to be aggressive in building markets for products (at which he might have been better) but rather to smile sweetly and serve as a handmaiden to the high-ranking. It may have been more visible because it has been particularly difficult for managers to demonstrate “loyalty” in these highly centralized organizations—loyalty to the supervisor is insufficient and opportunities to demonstrate loyalty to the truly powerful high-ranking executives are few. This manager’s ingratiating behavior was very open, and so it would be plain to his colleagues and subordinates that he sought promotion by currying favor.

#### *Management Jobs Discredited*

Whether or not this manager had accurately analyzed the promotion criteria in his company, his behavior had the effect of delegitimizing him by suggesting that he only received his managerial position through toadying. Certainly it is possible to imagine that he may be professionally competent as well. What is worse, these actions have the larger systemic effect of delegitimizing all managers. Managerial activities are notoriously invisible to subordinates, and those at the bottom probably see only the most blatant currying—so they generalize that all managers get their jobs this way, which helps to fuel their resentment and distrust.

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#### *Self-blame*

Finally, in full circle, this hostility can be turned on oneself. Lövey<sup>5</sup> has described the deeply ingrained self-blame of some Hungarians. It can be seen as a reverse-image of the positive attributions to successful leaders described by Pfeffer.<sup>6</sup> He argued that we have a bias for seeking explanations for events in the actions and characters of individual people, rather than seeing events as the result of more abstract “structures,” such as selection or reward systems. For example, when everything is going well the leader receives personal adulation, but when problems occur there is a rush to blame him or her personally. Consistent with this framework, some Hungarians attribute their economic problems and the dysfunctions and abuses of the last decades to national character traits. This unfortunate bias is probably exaggerated in a society where informal personal connections and relationships are so important.

#### *Restoring Legitimacy*

Although the political-economic system that led to these resentments has changed, the feelings of individuals change more slowly. The negative assumptions that many make about themselves, managers, and their work continue to be unexamined. Hostility and distrust appear to be the psychological residue of an imposed order in which one could accomplish work and make a decent life only through personal connections, appeals and bargains. Game theorists have argued that the rational response when one has been exploited is to be distrustful in all future exchanges.<sup>7</sup> Distrust breeds future distrust in a stable, self-perpetuating system. That is, even though most state-controlled enterprises are beginning to change their promotion criteria and making incentives contingent on performance, the pre-existing expectations and assumptions slow the acceptance and effectiveness of these new practices.

**Human Resources Practice #4: Ambiguous Responsibilities**

Finally, individual responsibility has been significantly more uncertain in Hungarian enterprises than in their capitalist counterparts. The traditionally hidden character of much of decision making in highly centralized state-controlled enterprises fosters ambiguous responsibilities. Many managers know very little about what their colleagues or bosses do or about others' goals and pressures. Unfortunately, some even feel that it is not their responsibility to understand these things.

*Truncated Lateral and Downward Communication*

In many of these large enterprises, managers have had little opportunity to understand their colleagues' problems, because communication has tended to be predominantly vertical with only informal communication across departments. Lateral problems could only be solved by special appeals to higher level authorities, and frustrated employees could only blame vague "top bosses."

Further, downward communication traditionally has not been open; rather, managers have tried to maintain their highly centralized power by withholding information from subordinates. Even high-ranking managers often did not understand the reasons behind directives from on high. It isn't surprising that insufficient information from higher levels was the universal complaint of Hungarian managers and employees.

*Widespread Avoidance of Responsibility*

Conversely, managers complained that their subordinates "avoid responsibility." I asked one manager who had spent several months working in a company in the United Kingdom what he found "most surprising" about the capitalist workplace. He replied that it was that the employees and managers worked so independently—that they initiated action on their own and yet knew when to ask questions.

Again, these problems of ambiguous responsibility are derived from the historical use of enterprises to control. Recall that individuals effectively organized in opposition to the regime in enterprises are a potential potent political threat, as illustrated by the political power of labor strikes in Poland and the Soviet Union. Further, if executives gained their jobs through party connections, not through technical expertise, they were loath to display their ignorance. Finally, when virtually the entire economy of a country is "centrally organized," a large complex bureaucracy is created, making it difficult for middle and lower ranking members to understand who makes which decisions. These historically fostered ambiguities are reflected in four different patterns of workplace interpersonal behavior.

*Feelings of Personal Impotence*

One dysfunction is the routine assumption that only those at higher ranks (than oneself) can take corrective action. For example, on several occasions I observed the following: at meetings complaints were voiced and participants agreed that these were serious issues, yet the meetings broke up without anyone taking responsibility for a next step in addressing the problems. It was not that these meeting participants were prevented from taking responsibility—they worked in a "new" foreign-Hungarian joint venture—it just didn't occur to anyone to do it. So the problems remained and festered. Under these circumstances, foreign managers can easily fall into the position of taking on all the responsibility, to the detriment of their organizations and themselves.

*Credentials as Substitutes for Performance*

Under conditions of ambiguity, even when managers had the best intentions to make performance-based decisions, they often did not have the information to do so. Since state enterprise owners (ministries) traditionally were not interested in

extracting information from their accounting systems regarding which lines of business or products were most profitable, these could not be the basis for decisions. Marketing functions, when they existed, were often handled by a foreign distributor (for export products) or by the executives in their spare time (for domestic products). So these organizations often lacked accurate, detailed information about customer preferences and changing market conditions. In practice, the only form of "individual merit" many managers could use was professional technical qualification, even if this was not particularly relevant to the job at hand. For example, a successful engineer in an oil industry enterprise who spoke English was placed in charge of the entire marketing function in this large organization—despite the fact that he had no experience in marketing. What was worse in the Hungarian context, he did not have the extensive network of personal contacts through which products would be marketed domestically. Several important customers were lost, and this formerly successful engineer left the enterprise.

#### *Pervasive Distrust*

The lack of clearly defined areas of responsibility also increases the distrust noted previously. An illustration of how these processes of personal bargains and ambiguity interact to produce distrust among shop-floor machinists is provided by Haraszti<sup>8</sup>:

*Supplementary wages are our most frequent topic of conversation with the foremen. They have at their disposal a relatively large sum for the adjustment of individual wages. No one knows exactly how much, nor whether all or part of it is used up. The foremen's accounts never mention it, nor can you find any trace of it under either "deficits" or "outgoings" or in the official "bulletin of results." . . . The foremen, setters and inspectors never once mentioned the existence of supplements, and it was only some time after my arrival that I heard about it from old M. . . . Perhaps it is because no one knows anything precise about them. Only one thing is certain: the foremen resist paying supplementary wages. Each worker therefore concludes that if there are too many demands less will be left for him. . . . So each worker treats what he gets as a supplemental wage as a secret. . . . Information I got from other millers slipped out unawares in a moment of anger.*

#### *Imprecise Communication*

An illustration of how these ambiguities are reflected in interpersonal communication practices is "the knowing shrug." The shrug is in response to a vague statement (preferably about the venality or stupidity of others) and communicates the message, "Well, sophisticated people like us know all about this, but what can one do about such things?" This kind of nonverbal communication best captures the widespread ambiguity in communications. For example, I had a great deal of difficulty getting a precise understanding of facts and events in many organizations. The answers were "perhaps," "I'm not sure," "We'll see." A manager said, "No one owns my company." Even presumably straightforward questions, such as, "Did the company council vote to break the regional divisions into limited liability companies at the last meeting?", were answered with a "Perhaps." When I aggressively pressed these managers for an American-style "straight answer," sometimes I received a long complicated story that really was best summarized as a "perhaps," yet other times it was clear that the manager really did not know the answer.

Under these circumstances, the wise individual has learned not to inquire too closely. Sometimes, finding out what is really going on is more exhausting than it is worth (and it used to be dangerous). But everyone wants to seem knowledgeable—so this face-saving shrug has developed in which no actual

**But everyone wants to seem knowledgeable—so this face-saving shrug has developed in which no actual information is exchanged. This adaptation to prior political and practical circumstances is understandable, and it is also characteristic of many ingrown bureaucracies in other countries with their opaque jargon and long managerial apprenticeships.**

information is exchanged. This adaptation to prior political and practical circumstances is understandable, and it is also characteristic of many ingrown bureaucracies in other countries with their opaque jargon and long managerial apprenticeships. However, it leads to two serious practical management problems.

#### *How Can You Manage When You Can't Find Out What's Going On?*

First, two individuals having completely different understandings may never "check their perceptions" with one another and thus may make errant judgments which lead to anger, blame, and poorer performance. Second, since individuals become used to communicating imprecisely, it is difficult to determine who has done what and who is responsible for which decisions. It can become impossible to trace where problems have occurred and to correct them. Rather, the powerful person at the top must assume all blame, all responsibility. When problems become visible, these top managers may be removed, but the structure and behavior patterns that led to the malperformance remain in place.

#### *Early Reform Increases Ambiguity*

Enterprises are revising their information systems and responsibilities will be necessarily clearer in the smaller disaggregations that currently are being formed from large state conglomerates (at least, the highest ranking manager will be more visible in a smaller organization). Yet, some of the early reforms also seem to increase ambiguity. For example, many limited liability companies are being formed from the departments of a state enterprise which still retains ownership of its former departments. How much daily control is retained by the former central office executives? Are the "limiteds" required to use the central services, such as personnel, that are still retained with the former-central-office-now-owner? Opinions differ widely on these questions, and no doubt these fresh opportunities for bargaining will keep Hungarian managers busy. Foreign managers need to understand that when suppliers, customers, and their own managers say "they didn't know," they may, indeed, not know.

#### **The Practical Business of Building More Effective Organizations**

Until relatively recently political conditions in communist countries have not permitted extensive open debate about their organizations. As an illustration, in 1973, Haraszti was tried and sentenced to prison for the work quoted previously. Despite the new political openness, many managerial practices originating under the communist political systems have fostered functionally autonomous assumptions and attitudes that have been slower to change. However, this should not be read to imply that these patterns are immutable. As was noted, many Hungarian enterprises have successfully adapted and are prospering. Rather, an open recognition of such patterns is the initial basis for their change. Once openly acknowledged, dysfunctional behaviors and assumptions can be managed through widely available organizational development techniques.

#### *What Foreign Managers Can Do*

In many respects, this change is much easier for foreign-controlled organizations. Hungarians expect managers from capitalist countries to manage differently. They see the success of these foreign organizations and want to learn from them. However, the dysfunctional assumptions do need to be recognized and addressed. This work was intended to alert expatriate managers and investors to some of the difficulties they will face in reforming communist and former communist countries.

This description has highlighted some of the dysfunctions in state-owned companies. Because patterns of relationships become established and habituated in organizations, it will be more difficult to address these dysfunctions in on-going state-owned enterprises than in newly established organizations. While there may be many good strategic reasons for a foreign company to form a joint venture with a local state-owned company, changing the human resources practices and

patterns of behavior will, by its nature and necessity, be more difficult than establishing those same practices and patterns in a newly created organization. Yet, even in new organizations, foreign managers will want to insure that their local colleagues do not inadvertently replicate familiar dysfunctional practices.

*What Local Managers Can Do*

Acknowledgement of the dysfunctions carried from the past is even more important for local managers in reforming and former communist countries. Because the patterns described here have been the norm in the past, they are less visible to those who have always lived with them. Yet recognition of the dysfunctions inherent in conventional human resources management practices is an important first step in correcting them.

Local managers face an additional serious problem. Because not many of these managers are used to assuming responsibility (since they could not realistically expect it before), some may happily let their foreign bosses assume responsibility. In Hungary today, state-owned companies are aggressively seeking foreign partners. I fear that for many it is not only for the tax and technological advantages but to find a new all-knowing, all-powerful "top boss" who will solve their problems for them. This is not only bad for the long-term development of Hungarian organizations, it is bad for the short-term career prospects of the local managers. Managers from profit-making companies expect all employees (and most especially their managers) to take the initiative and assume responsibility. Those who don't do so are tolerated as long as necessary and removed as soon as possible.

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Endnotes

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<sup>1</sup> Readers interested in learning more about central planned economies should see J. Kornai, *Economics of shortage* (Amsterdam: North Holland, 1980), and J. Kornai, "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature*, 24 (1986), 1687-1737.

<sup>2</sup> L.R. Sayles, *Leadership* (2nd ed.) (New York: McGraw-Hill, 1989).

<sup>3</sup> For example, see J.A. Wall, Jr., "Managers in the People's Republic of China," *The Executive*, IV(2), 1990, 19-32.

<sup>4</sup> R.M. Kanter, *Men and Women in the Corporation* (New York: Basic Books, 1977).

<sup>5</sup> I. Lövey, "The Whole Nation is Complaining," *Mozgo-Vilag, 12, Panaszkodik az Orszag*, 1986.

<sup>6</sup> J. Pfeffer, *Management as Symbolic Action: The Creation and Maintenance of Organizational Paradigms*, in L.L. Cummings and B.M. Staw (Eds.), *Research in Organizational Behavior*, Vol. 3. (Greenwich, CT: JAI Press, 1981).

<sup>7</sup> R. Axelrod, *The Evolution of Cooperation*, (New York: Basic Books, 1984).

<sup>8</sup> M. Haraszti, *A Worker in a Worker's State* (New York: Penguin Books, 1977).

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