WHEN PLAN BECOMES MARKET

- A company’s successful change. The case of Krenholm, Estonia

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When plan becomes market - A successful company’s change. The case of Krenholm, Estonia

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Context: The challenges in going from a system of planned economy
to a free market system are without a doubt enormous both for countries and individual companies. One company that has been in this situation is Krenholm. Krenholm is an Estonian textile company. When Estonia gained its independence in 1991, Krenholm faced a completely different environment with no customers and market economy. After four very difficult years, Krenholm was bought by a Swedish company, Borås Wäfveri AB in 1995. At this point Krenholm was a state owned company in absolute chaos. A leap forward from that point in time brings us to the year of 2000. In this year Krenholm shows a profit of 21 Million SEK.

Purpose: The purpose with this study is to investigate how a company can successfully change from operating in a planned economy to operate with profit in a market economy.

Scope: The major time focus in this thesis is 1995 – 2002 and on a micro level of changes at Krenholm. The years from 1944 to 1995 provide a macro level background of the Soviet Union period and the transition of Estonia towards market economy. These periods are only analyzed in short. When analyzing Krenholm in the areas of managerial resources, strategy and structure, we will focus on top level management and exclude the more operational management conducted by managers on lower levels. In the same way we will solely research strategy on a high level and exclude the more detailed strategic planning on the operational level. Organizational culture will no be considered.

Method: To be able to fulfill our purpose we committed a case study of Krenholm, Narva. In our view Krenholm is a very suitable object of study, as an industrial company that has succeeded in adapting itself from being a company in a planned economy to being a profitable company in a market economy.

We started of by acquiring an excellent preunderstanding. The most important step in doing so was an initial trip a trip to Krenholm. When our focus and frame of references were ready we went back to Krenholm and collected our primary data through interviews with key personnel. In total, 11 interviews were conducted at Krenholm; these included all the directing managers at Krenholm. We also conducted
one mail interview with Narva Business Center and had an interesting meeting in Narva with a consultant at Krenholm from Borås Wäfveri. When we returned to Sweden from Estonia our empirical findings were analyzed with the help of our frame of references and we reached our conclusions.

Conclusions: We conclude that the characteristics of the industry that Krenholm was developed in many respects helped the company to succeed in its successful adaptation to the market economy environment. The single most important factor in Krenholms successful adaptation was however the privatization of the company. We also conclude that in the transition it is vital to develop the managerial resource base immediately in order to be able to survive and also later to develop competitive strategies for the future. On a micro level we found that it seems to be of vital importance who guides a company in the times off difficult and revolutionary change.

**Nyckelord**
Keyword
Textile industry, Plan economy, market economy, Krenholm, Narva, Estonia, transition, change, Jörgen Ljung
We dedicate this thesis to PhD. Jörgen Ljung, the people of Krenholm and to everyone whose life has been affected by a transition from a planned economy to a market economy.
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1 Introduction

In an era of E-business and internet companies of rapid and sometimes frightening technological development a case study on a company in the textile industry might seem dull and boring. This view on the textile industry was also ours until our tutor Ph.D. Jörgen Ljung provided us with our first real insight into the textile industry and the Swedish owned Estonian textile company Krenholm. A study of a mere textile company may not be very interesting but the unique reality shaped by history in which Krenholm exists and, according to some, thrives, makes it an extremely interesting object of study.

Krenholm is situated in Narva, a real paradise for everyone with a passion for history. This city and has been occupied by a number of different nations. Sweden, Russia, Germany and the Soviet Union have all been in possession of the city at least once. The reader might recall the battle at Narova (Narva) in 1700 when a Swedish army led by Karl XII, then only 18 years old, defeated an in sheer numbers superior Russian force. However interesting this period and other periods in the history of Narva may be, the period that left the most visible imprint on Narva and Krenholm is without a doubt the Soviet Union era. During the 1940s and the 1950s a substantial number of people were deported not only from Estonia, but from all the Baltic states. At the same time these countries were forced to accept large numbers of Russian nationals. The situation in Narva however was extreme. More or less all Estonian nationals were deported or fled in the face of Stalin’s cruelty. Today, in 2002, there are only about 4 – 5 % Estonian nationals in the Narva region, 95 – 96 % are former Russian citizens. The common history between Estonia and Russia/Soviet Union, an often brutal such, has led to a very tense situation.
Another dimension that adds to the complexity of the situation but accelerates the potential value of a case study on Krenholm is the differing economic systems that have been present. When Estonia became independent in 1991 it had spent almost 50 years in a planned economy. Suddenly with the collapse of the Soviet Union and the independence of Estonia, this was no more.

A fact that only heightens the interest of this object of study is the fact that textile industry can be seen as a dynamic and turbulent industry of sorts. The trend has been and is that the textile industry moves from country to country in search of lowest possible labor costs. In Sweden, for instance, the textile industry has almost disappeared. England, which must be seen as the cradle of the modern textile industry, has seen a similar development. Furthermore, the textile industry is enormous and employs millions of people all around the world. Our everyday lives are surrounded by products from this industry. We get up in the morning from our beds covered by sheets, take a shower and use a towel to get dry. We then get dressed. These are but a few examples and there are many, many more.

All these factors are factors that play a part of Krenholm’s everyday life. As the reader now might understand, Krenholm is not only a textile company but an object of study with extremely interesting dimensions.
2 Problem formulation and purpose

2.1 Problem Formulation

In 1991 Estonia gained its independence after, from an Estonian perspective, half a decade of occupation by the Soviet Union. A time of happiness, one would think but of course these were also hard times for the country that now faced the beginning of a difficult transition process. The challenges in going from a system of planned economy to a free market system are without a doubt enormous. This is true both for a country as a whole we have seen in the transition process of all the former Soviet and COMECON states but maybe even more so for a single company which unlike a state faces the risk to become bankrupt and simply shut down. One major problem for companies that suddenly find themselves operating on market economy terms is the fact that the two different economical systems have a totally different impact on management, structure and strategy.

One company that has been in this situation is Krenholm. Krenholm is an Estonian company in the textile industry with a fascinating history. When Estonia gained its independence, Krenholm faced a completely different environment with no customers and market economy. In a sense, Krenholm at the time of the independence, like many other companies in the same situation, was like an organism that was still adapted to live in the water but was thrown up on dry land by a wave. This is a quite unpleasant thing to experience when there has been no long term evolution and the organism still uses gill breathing. In practice Krenholm lost all of its market since 90% of its products were sold to the Soviet Union in 1990.
After four very difficult years, Krenholm was bought by a Swedish company, Borås Wäfveri AB in 1995. At this point Krenholm was struggling to find new customers, was lacking a developed marketing organization and was short of working capital. A leap forward from that point in time brings us to the year of 2000. In this year Krenholm shows a profit of 21 Million SEK.

In our view Krenholm is a very suitable object of study, as an industrial company that has succeeded in adapting itself from being a company in a planned economy to being a profitable company in a market economy.

We are looking to Chandler for guidance by using his model as a frame in our quest towards an understanding of why and how Krenholm successfully managed to adapt to the new situation. Chandler’s model states that the evolvement of the environment and resources of an organization influence the evolvement of the chosen strategy which in turn determines the outlook and changes in the structure.

We will in accordance with Chandler’s model focus on four areas of interest: Strategy, structure, environment and resources. We will put our emphasis on one of the most important resources available to a company; the managerial resource base. With these areas of interest in mind we have made the following problem formulation:

*What major encompassing changes have been made in Krenholm in order to turn the company into a profitable international company in a market economy environment?*
In order to be able to answer this question we have also formulated three sub questions:

- How has the dynamic relationship between the managerial resource base and other resources, strategy, environment and structure influenced the development of Krenholm over time?

- In more detail, how has the development of management as a resource for Krenholm proceeded? What role has this development played in the company’s adaptation to market conditions?

- What major specific changes, internal as well as external have been identifiable during the period 1995 to 2002?

### 2.2 Purpose and scope

#### 2.2.1 Purpose

The purpose with this study is to investigate how a company can successfully change from operating in a planned economy to operate with profit in a market economy.

#### 2.2.2 Scope

The major time focus in this thesis is 1995 – 2002 since this was the time when Borås Wäfveri became the owner of Krenholm. It was at this time that the really encompassing and thorough changes were initiated that would turn Krenholm into a western market economy company.
The need for revolutionary changes into a market economy during the time period 1995 – 2002 was a result of a historical lack of evolutionary changes as well as a hard time of Estonian transition after the countries’ independence from the Soviet Union. The period from 1944 to 1991 provides the background with the planned economy system that had a deep impact on the way business and production was conducted. This also includes the period of 1987 to 1991 when some liberalization was taking place in the planned economy system.

The period of 1991 to 1995 was a time of transition for the independent Estonia during which Krenholm more or less struggled for its survival while the owner, the Estonian state, planned for its privatization. With this in mind we believe that in order to get an understanding of the changes, the history that has created the need for changes must also be taken into account. Furthermore, the interplay between the areas of interest that we are going to study is of a kind that needs to be studied during a long period. For instance Chandler’s study on which his model of this interrelation is based was conducted during 53 years.

Figure 1 provides an overview of the timeframe that we are interested in. Our focus of interest is, as mentioned, on the period of 1995 to 2002 and on a micro level of changes at Krenholm. The earlier year provide a macro level background of the Soviet Union period and the transition of Estonia towards market economy and these periods including Krenholm situation regarding our areas of interest are only analyzed in short.
The areas of managerial resources, strategy and structure are extremely broad. Since we are interested in the general transition process and major changes of the company as a whole we will focus on top level management and exclude the more operational management conducted by managers on lower levels. In the same way we will solely research strategy on a high level and exclude the more detailed strategic planning on the operational level.

A very large part of the structure, when defined in a broad sense, is made up by the organizational culture.\textsuperscript{1} Though the organizational culture of Krenholm would be extremely interesting to research, this is not possible for us since an understanding of an organizational culture demands very deep research with a long time of presence at the company.\textsuperscript{2}

\textsuperscript{1} Chandler, A 1962
\textsuperscript{2} Jacobsen & Thorsvik, 1998
2.3 Readers Guide for the areas of interest

In order to help the reader to get orientated in the extensive material that
our master thesis comprises we provide below a roadmap to the areas of
interest. That is, in which chapters they appear and in which form.

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FIGURE 2: ROADMAP.
3 Methodology

In this chapter we will explain how we have decided to construct the thesis in order to reach our conclusions. We will start by explaining what sort of approach we have chosen. This chapter also presents some scientific perspectives on which the researcher must focus when investigating a specific problem area. In fact, in order to write a research paper, a method that allows the researcher to reach the objective of the study, must be designed and explained. Such an explanation is important for the researcher both in order to be clear on what method to select and also to provide an explanation of the research process for the reader. Equally important is that it enables the reader to understand how the results of the study have been attained.

3.1 The Nature of Our Thesis – a Case Study Approach

A case study is a study in which one or a small number of objects are investigated in many different aspects. In investigations with a statistic research method it is often the other way around, a few aspects are investigated, but on a large number of objects. Given the main nature of our task, to investigate the Krenholm Company from our economic perspective, it was clear to us from the beginning that this master thesis is clearly a case study. We are interested in and will investigate mainly one object; the Krenholm Company, deeply and thoroughly, that is considering a large number of intertwined as well as independent factors. That a case

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study is appropriate in this report is further underlined by the fact that the data collection will provide us with qualitative data, hence a statistic research method would be of little use. Merriam notes that a majority of the research community shares the view that a case study is logically derived from the perspective of the qualitative methods, in which the primary intention is to understand a certain phenomenon.\textsuperscript{4} We believe that in order to really understand a complex object like a fellow human being or a textile company you have to get really close to it and that is in a sense what a case study offers: a scientific way of getting close to a subject. With this in mind we would like to quote Merriam; “The depth and detail of qualitative data can be obtained only by getting close, physically and psychologically, to the phenomenon under study.”\textsuperscript{5}

Three special traits of case studies according to Eriksson and Wiedersheim-Paul are that they: \textsuperscript{6}

- Emphasize the role of the actor
- Study historical processes
- Have a good ability to communicate with the reality that is “the map becomes rather similar to the reality”.

We are convinced that all three of these traits are important for the purpose of this investigation. How can we understand the Krenholm Company if we do not understand its actors? In many aspects this paper is also interested in historical processes in which manner has the adoption to market economy and western practices proceeded in Krenholm, what more or less visible changes have there been since Lindahl and Olsson investigated the

\textsuperscript{4} Merriam, 1998
\textsuperscript{5} Ibid
company in 1995.\textsuperscript{7} Furthermore it is an absolutely necessity for us that our picture of the company gets as accurate as possible, of what use would it otherwise be?

Eriksson and Wiedersheim – Paul states that case studies are an excellent research method in action research and change processes such as organizational development.\textsuperscript{8} However, the possibilities of making comparisons and generalizations in accordance with a case study can be debated.\textsuperscript{9} Can we really make any valuable generalizations in connection to the Krenholm Company after a case study of twenty weeks, with only one week of data collection at the company/factory? Well, first of all there already exist several case studies regarding Krenholm and its surroundings, done by students from the University of Linköping. These studies open up very good opportunities for comparisons on our behalf. When it comes to generalizations we believe that such may not be of critical importance to this work. It is often argued that investigation and research in many cases in fact is aimed at understanding specific situations and not at providing any generalizations.\textsuperscript{10} This does not mean however that this report is irrelevant for every other object but Krenholm. Krenholm has adapted to a market economy environment from being a classical heavy industrial company of the Soviet Union. This has been done through surviving great difficulties. Our hope is that this report will provide some insights and conclusions that hypothetically can be of use for other organizations than Krenholm. Such organizations could for instance be other companies in Estonia, other companies that have the same background within a planned

\textsuperscript{6} Eriksson, L,T & Wiedersheim-Paul, F,1991
\textsuperscript{7} Lindahl, C & Olsson, J, 1995
\textsuperscript{8} Eriksson, L,T & Wiedersheim-Paul, F,1991
\textsuperscript{9} Ibid
\textsuperscript{10} Ibid
economy and companies trying to adapt western management on a Russian workforce

When conducting a case study, the researcher must have, and we quote “an enormous tolerance for *ambiguity*”.\(^\text{11}\) Throughout the case study process, from designing the study, to data collection, to data analysis, there are no set procedures to be followed step by step. There are guidelines and of course the experience of others to help, but one must be able to recognize that the “correct” way to proceed will not always be obvious. According to Merriam, the very lack of structure is what makes this type of research appealing to many, especially for us, for it allows the researcher to adapt to unforeseen events and change directions in pursuit of meaning.\(^\text{12}\) Hence, the investigator’s role in qualitative research has often been compared to that of a detective.\(^\text{13}\) A similar analogue was told to us in the initial phase of the study by our tutor. We were told to imagine that a murder case has occurred and our mission was to solve it. In order to do that, one must enjoy searching for pieces to the puzzle and tolerate uncertainty for a period of time. These procedures are far from routine. Case study research thus places the investigator in a largely unexplored ocean. In accordance to Merriam, for some it becomes an adventure full of promise for discovery; for others, it can be a disorienting and unproductive experience. For us this study has been an adventure full of surprises.

*Sensitivity* is the second important feature demanded by this type of research.\(^\text{14}\) The researcher must be sensitive to the context and all variables within it including the physical setting, the people and the non-verbal

\(^{11}\) Merriam, 1988  
\(^{12}\) Ibid  
\(^{13}\) Ibid  
\(^{14}\) Merriam, 1988
behavior. One also needs to be sensitive to the information being gathered. What does it tell us? How can it direct us to the next piece of data? How well does it reflect what is happening? Finally, Merriam indicates that one must be aware of one’s personal biases and how they may influence the investigation.

With the help of our access to earlier case studies at Krenholm and its surroundings as well as the extensive knowledge and connections in the area that our tutor Ph.D. Jörgen Ljung is able to provide us with, we have good hope to avoid some common pitfalls of case studies. These pitfalls mainly consist of so-called access problems. An investigator that does not have great experience in an area, for instance an organization, which he/she is going to investigate, has a difficult time knowing for example: 15

- Which data that is important and which data that is not?
- How shall the data be collected?
- What person possesses important information?
- How shall the gathered data be interpreted?

3.2 Interviews

Merriam discusses two types of interviews: structured, where the questions are designed beforehand and in a logical order, and unstructured, where the interview is more like a discussion. We have in this study conducted both structured and unstructured interviews. In some interviews, we chose to use discussion points rather than questions. This was to create a less structured way of getting information and to let the respondent choose his or her own focus of importance. Unstructured interviews are useful when the

researcher does not know enough about a phenomenon to ask relevant
questions.\textsuperscript{16} One of the goals of the unstructured interview according to
Merriam is, in fact, to learn enough about a situation to formulate questions
for later interviews. The unstructured interview is often used in
combination with observation in the early stages of a case study.

Merriam discusses that interviewing is necessary when we cannot observe
behavior, feelings or how people interpret the world around them. This is
also highly interesting when we, in accordance to our scope, are interested
in past events that are impossible to replicate.

According to Merriam, collecting data through interviews involves first of
all determining whom to interview.\textsuperscript{17} For qualitative case studies, such as
our case study, the answer depends on what the investigator wants to know
and from whose perspective. We have chosen to collect our primary data
through interviews with key personnel. In total, 11 interviews were
conducted at Krenholm; all the directing managers at Krenholm, with the
Chief Executive Officer and the former Chief Executive Officer at
Krenholm, the Financial Director and the Personnel Director. In order to
obtain regional and local information regarding Narva and Krenholm we
also conducted one mail interview with Narva Business Center. The
selections of interview respondents were highly affected by our first visit to
Narva and this is referred by Merriam an “On-site observations”.\textsuperscript{18} We had,
thanks to our tutor the occasion to meet most of the respondents in
advance. We also had an interesting meeting in Narva with a consultant at
Krenholm from Borås Wäfveri.

\textsuperscript{16} Merriam, 1988
\textsuperscript{17} Merriam, 1988
\textsuperscript{18} Merriam, 1988
Unlike the survey research where the number and representativeness of the samples are major considerations, in this type of research the crucial factor is not the number of respondents but rather the potential of each person to contribute to insight and understanding of the phenomenon.\textsuperscript{19}

Other ways to collect primary data are questionnaires or telephone interviews, but since our study is a case study where it is important with closeness to the object of study we chose interviews as our method. Considering the language and cultural differences as well as the qualitative depth we aimed for, interviews were the only realistic choice.

Interviews do not take a lot of time to do and it is also possible to achieve a controlled interview situation. For our study the most important aspect of interviews was the possibility to ask rather complicated questions. This advantage is further enhanced by the fact that the interviewees can get the questions in advance which enables the respondent to reflect over the questions more deeply. Another very important aspect compared to questionnaires is the possibility to follow up questions when needed. When conducting an interview it is possible and even likely that questions that may be sensitive can be answered which would not be the case with other methods. But it may sometimes be difficult for the person in charge of the interview to ask sensitive questions why these questions may not be answered. It is a very real possibility that the person in charge of an interview may ask leading questions and in different ways help the interviewee to answer the questions by for example offering possible answers. The intention with our interviews was to generate a dialogue with the respondents to gain knowledge about facts as well as subjective values.

\textsuperscript{18} Ibid
\textsuperscript{19} Ibid
The respondent was told the purpose of both the interview and the case study in order to reduce the risks of speculation and other problems. In doing so we feel that we avoided the risk of respondents being suspicious or even hostile. We started the interviews with general questions and then moved on to more specific questions. When designing our interview questions we carefully and critically studied each question in accordance with our theoretical framework. This was done in order to avoid asking the wrong questions.

3.3 Scientific Approach

One important goal in science is to obtain total objectivity in order to create theories that give maximum predictability whenever the theory is used. To obtain total objectivity is, in our opinion, never possible. No matter what we do, there will always exist some kind of driving force that is based on our own interests and opinions. This means that no matter how objective we try to be, every action we perform is founded in a subjective interpretation of reality and knowledge. Having this in mind, we find it necessary to define and explain our views and standpoints on research and knowledge in order to help the reader to a better understanding of our interpretations of the thesis.

3.4 The view of science

Science is a difficult notion to explain or define. It can be defined as the gathering of information on specific activities and the process to get knowledge from it. A scientific approach is also a process of building theories through definite rules and methods. Scientific research can therefore be stated as the systematic, controlled, empirical and critical
investigation of a specific problem emerging from basic assumption and hypotheses.\textsuperscript{20}

There are two traditional scientific approaches: \textit{positivism} and \textit{hermeneutics}.\textsuperscript{21} These trends are often considered as contradictory. These two orientations will serve as guideline for our choice of methodology and will be discussed in the following sections, with a greater focus on the hermeneutic approach, since this is the approach that most closely resembles the way we have chosen to work in this thesis. With the following sections we will use positivism and hermeneutics in order to scientifically position our thesis.

3.4.1 Positivism

Positivism has its roots in the traditional school of natural science.\textsuperscript{22} Positivists are generally considered to be empiricists, in that they feel that scientific knowledge is such that it can be verified by means of empirical testing. The requirement for scientific knowledge to be tested and proven true has been one of the main arguments for natural scientists throughout the years. The positivist is hence more interested in studying and explaining human behavior than interpreting individuals’ thoughts and feelings.\textsuperscript{23}

Another characteristic associated with positivists is that the knowledge that is derived can be repeated through further experimentation. The research should also be conducted according to the same methodology. This

\textsuperscript{20} Kerlinger, 1973
\textsuperscript{21} Lundahl and Skärvad, 1992
\textsuperscript{22} Gummesson, 1991
\textsuperscript{23} Alvesson and Sköldberg, 1994
requirement for repetitive experimentation further supports the notion that the existing knowledge is “true” knowledge; i.e. that the knowledge regarding phenomena is objective and should be interpreted by all researchers without deviation if the same methods are used. To ensure that the knowledge is objective, distinctions between facts and evaluations must be made.24

Generally, positivistic research begins with the observation of a phenomenon that appears to follow a seemingly consistent pattern. Material is then gathered with the purpose of testing whether or not the phenomenon’s pattern is consistent. The collected data is then analyzed and a theory that explains the phenomena is developed. Predictions are then made, tested and the differences between the observations and predictions are then identified so as to either verify or falsify the developed theory. Finally, and along the lines of traditional scientific experiments, it should be possible to apply the results of positivistic research generally; i.e. independent of time or place.25

3.4.2 Hermeneutics

Hermeneutics, coming from the humanistic school, is generally presented as the opposite to positivism.26 The hermeneutic research process is a bit less ‘fact-oriented’ than the positivistic approach. As opposed to positivism, the hermeneutic researcher strives to gain a deeper understanding of a specific phenomenon.27 To achieve this, the researcher often has to try and understand other people and how they define their worlds, their experiences and reactions. The “deeper understanding” that

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24 Lundahl and Skärvad, 1992
25 Ibid
26 Gummesson, 1991
27 Lundahl and Skärvad, 1992
the researcher strives to achieve implies that a great deal of interpretation takes place when the researcher analyzes collected data. Central to this interpretation process is the concept of pre-understanding (see below).\textsuperscript{28} A researcher’s pre-understanding is dependent of two circles: \textit{cognitive} and \textit{normative}\textsuperscript{29}. The cognitive circle contains the knowledge that the researcher possesses before carrying out his/her investigation. This knowledge may have been acquired for instance through education or prior experience. The normative circle consists of the researcher’s prejudgments towards the phenomenon before the actual investigation takes place. These two circles contain elements that influence the researcher’s investigative process and make up the basis for the deeper understanding that the researcher is to gain regarding the phenomenon. During the research, the normative circle will be challenged as the cognitive circle increases.\textsuperscript{30} The key difference here, as opposed to in positivism, is that the researcher’s attitudes towards a phenomenon may be a deciding factor in the outcome of the research. Lundahl and Skärvd have also noted that one of the difficulties that the hermeneutic researcher faces is the problem of separating facts from feelings.\textsuperscript{31} The reason for this is that the researcher has the task of interpreting his/her subjects’ data, which implies that a certain degree of subjectivism may occur, when the researcher attempts to understand those involved in the investigation process.

\textsuperscript{28} Gummesson, 1991
\textsuperscript{29} Jacobsen and Thorsvik, 1998
\textsuperscript{30} Jacobsen and Thorsvik, 1998
\textsuperscript{31} Lundahl and Skärvd, 1992
3.5 Induction and Deduction

Induction and deduction are two different ways that a researcher can use when contributing to scientific knowledge. The positivistic or hermeneutic researcher may elect to use either one or a mixture of these two methods. Both positivistic and hermeneutic researchers collect empirical data in their investigative work. Also all scientific researchers relate to theories, models and/or previous information when conducting research.\(^32\)

The deductive researcher starts with a theory and then searches for appropriate data. The deductive researcher is often engaged in testing a theory via relevant data; hence, deductive research is commonly associated with positivism. Data, on the other hand, that is first collected and then compared to a researcher’s pre-understanding, or theory, is known as inductive research. The inductive researcher builds up an understanding of a phenomenon and it is such research that may lead to the creation of a new theory; hence, inductive research is commonly associated with hermeneutics.\(^33\)

Both hermeneutic and positivistic researchers’ may make a contribution to knowledge in the building up of theories. The difference with the hermeneutic researcher is that even if the researcher has ambitions of developing total (general) theories, they often have their limitations; i.e. theories are often more applicable to specific circumstances and are consequently dependent upon time and place. The hermeneutic researcher does not need to have such an ambition, and the researcher’s goal can be to

\(^{32}\) Gummesson, 1991
\(^{33}\) Patel and Tebelius, 1987
create new meanings, increase the researcher’s own knowledge regarding a phenomenon or to confirm a suspected notion.\textsuperscript{34}

Holmberg points out that in reality, quite often the researcher does not have a clear picture of reality or sufficient knowledge of a problem and therefore does not consciously work in either an inductive or deductive manner from the start. Instead, the researcher studies reality, talks with others and studies theories simultaneously in order to help build up a base of knowledge for the research to be carried out. Afterwards, the proper direction (inductive or deductive research) is chosen.\textsuperscript{35}

In this study, we have essentially gone about learning in an inductive manner. The reason for this is that our starting point for the research was to gather as much information about the phenomenon as possible before looking into theories.

\textbf{3.6 Qualitative and Quantitative Methodology}

As positivistic and hermeneutic researchers take on different types of problems, as well as seek different answers for their research, their research requires different methods. Research methodology is often divided into two main categories: qualitative and quantitative research.\textsuperscript{36}

The method chosen is dependent upon the types of research questions that are to be answered and the nature of the information to be gathered.\textsuperscript{37} For

\begin{itemize}
\item \textsuperscript{34} Brunsson, 1981
\item \textsuperscript{35} Patel and Tebelius, 1987
\item \textsuperscript{36} Jacobsen & Thorsvik, 1998
\item \textsuperscript{37} Rudestam & Newton, 1992
\end{itemize}
example, qualitative researchers tend to seek answers to questions such as “how” and “why”, and gather data in the form of words and other non-quantifiable material such as feelings, attitudes and values. Quantitative researchers on the other hand, tend to be geared towards questions such as “how many…” and “which of the following…” which are easily processed in the form of numbers (quantifiable data).

The aim of a quantitative approach is to explain a phenomenon and to identify connections between different units.\textsuperscript{38} Data is collected mainly through tests and inquires. The qualitative method, on the other hand refers to people’s own written or spoken words and observable behavior. According to this the researcher tries to understand the respondent from his or her own frame of references. The qualitative approach hence focuses on empirical findings and is aimed at obtaining a deeper knowledge about the problem area compared with the quantitative approach. According to Rudestam and Svensson qualitative methodology is best suited for the hermeneutic researcher as it allows him/her to form a holistic view of the research phenomena; i.e. to understand the persons involved and the situation studied in its whole.\textsuperscript{39} They argue that an understanding of the situation is necessary in order to understand the problem and as a logical consequence the qualitative approach is more appropriate. Quantitative studies, on the other hand, are often associated with positivistic research because of the objectivity requirement that normally accompanies quantitative data; i.e. ‘numbers speak for themselves’. According to them the absolute truth can best be found by using the quantitative approach.\textsuperscript{40}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{38} Starring & Svensson, 1994
\item \textsuperscript{39} Rudestam & Newton, 1992
\item \textsuperscript{40} Ibid
\end{itemize}
\end{footnotesize}
It is possible to distinguish the qualitative and quantitative method from each other by saying that the quantitative method is greatly standardized while the qualitative is not. What is also important is that the qualitative method proceeds from the perspective of the object of study, while the quantitative method proceeds from the researcher’s perspective.\textsuperscript{41}

It would be problematic for us to use the quantitative method because the questions that are used in this method should be standardized to such an extent that a personal meeting would not have to be necessary. The qualitative method, however, appeals to us due to the fact that the method is characterized by lower extent of formalization and by closeness to the source of information, which is the Krenholm factory. The problem of getting valid information is in fact much smaller in qualitative surveys than in quantitative ones, because of, as mentioned earlier, the closeness to the object of study.\textsuperscript{42} We assume that the closeness to our object of study is highly important because otherwise it would be very difficult for us to understand the situation in Krenholm. In qualitative methods it is the researchers understanding or interpretation of information that is important. Hence, the method used in this thesis can be characterized as inductive and qualitative.

### 3.7 Our view of science

In our view a company like Krenholm is by nature a phenomena which is very complex by itself. Furthermore, because it is by necessity intertwined with its external environment in a unique way we find that it is next to impossible to make an overall research of a company universal as

\textsuperscript{41} Alvesson, & Köldberg, 1994  
\textsuperscript{42} Ibid
positivism strives for. What we find interesting in the transition process of Krenholm and what relationship and forces behind change that we find is highly subjective and thus not an absolute truth. We are well aware of the degree of subjectivity that can accompany hermeneutic research, and we have therefore tried to be as clear as possible as to which assumptions are and are not ours throughout the thesis. Our approach is therefore a hermeneutic one. Another reason that we have adopted a hermeneutic perspective is that we are in agreement that research results are dependent upon the researcher, as well as his/her pre-understanding of a phenomenon.

3.8 Pre-understanding

There is no understanding without pre-understanding. The pre-understanding or pre-knowledge is the knowledge and experiences we take with us as we try to understand and interpret new things.\(^{43}\) Our former pre-understanding can be edified by our personal experiences (such as type of school education) but also by our Beliefs and ideas and language and concepts stemming from our family and more generally from the society in which we are evolving. In fact it is composed by all the previous experience we have collected through our life. We thus believe the awareness of the pre-understanding to be of great importance in research since the awareness makes it possible to separate already existing knowledge from the discoveries made during the research.

In order to make a successful case study and come close to the object of study a high degree of pre-understanding is necessary. Pre-understanding helps the researcher to become more focused. In our case it was also a way

\(^{43}\) Gilje and Grimen, 1992
to see what aspects of our object of study that would be most interesting to focus on.

Krenholm is situated in a completely different environment from what we are used to, with a remarkable different history and an industry, which none of us had any knowledge about prior to the study. Therefore, we think that our work to gain a pre-understanding was of outmost importance in order to gain this knowledge we were lacking. This was in a great extent achieved by such pre-understanding that originated from experiences of others. Such information sources were Internet, books, reports etc. First we focused on three broad areas that would provide us with necessary knowledge. These three areas were Russian management, the cotton/textile industry and the economy of Estonia. Then we gathered and studied information about both Borås Wäfveri and Krenholm. This also involved a day trip to Kungsfors that is a Swedish textile company situated in Skene. There we received great information and experiences regarding the maintaining of textile fibers and the production process of spinning and weaving. An extraordinary pre-understanding was developed through access to earlier master theses in business administration about Estonia itself and also about Krenholm. We also received specific first hand experience through a trip to Estonia and Narva with Ph.D. Jörgen Ljung. This trip to Estonia and Narva enabled us to gain an understanding about the area, the company and the environment that otherwise would be impossible. During this trip we were given the opportunity to go through the entire plant at Krenholm and also have short informal conversations with most of the managers at the different divisions. This did not only lead to a greater understanding but also gave us vital information about when to go back and conduct interviews. As it turns out a board meeting was scheduled on the same week we initially had planned to go back. We were
given the advice to try to come back either two weeks before or the week after since this was a very busy week. We are convinced that gaining this pre-understanding has been of great importance for the overall result of this study.

3.9 Collection of Data

Regardless of whether the research is a qualitative or quantitative one, it requires a collection of data. This data can be obtained from a number of different sources. These sources are classified into primary and secondary data. Secondary data consists of previously collected material that will be used to carry out the research. We have used several forms of secondary data. These include newspaper and Internet articles, financial literature regarding Krenholm, literature handbooks, course literature and earlier theses. These gatherings of information have helped us to gain a deeper understanding of the presented research problem.

Primary research data consists of new material gathered by the researcher. According to Jacobsen and Thorsvik there are four principal ways in which to collect primary data: questionnaires, experiments, ethnographical studies and case studies. We have chosen to carry out our research by means of a case study. In a case study research, some and occasionally all of the data is collected through interviews.

The interviews were made with the use of a tape recorder. These were then listened through and written down as closely to what was said on the tapes

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44 Jacobsen & Thorsvik, 1998
46 Merriam, 1988
as possible. This was however difficult or even impossible in some parts of the interviews due to poor tape quality or language problems. The written down interviews was then used in our analysis.

### 3.10 Validity and reliability

The credibility of our scientific thesis is dependent on how the theoretical and empirical data were gathered and treated. Here the notions of reliability and validity appear. Within the frames of research there are always discussions on the two concepts of validity and reliability. Validity means that it is important that the work of the researcher is focused on the topic the researcher wanted to study. Reliability emphasizes the importance of evaluating the trustworthiness of the study.\(^{47}\) In accordance to Merriam there are two different kinds of validity, internal and external.\(^{48}\) The internal validity is about how well the result of the study concurs with reality. Does the researcher examine what she/he believes her/himself to examine? In our case the problem is how to generalize about how a company can successfully adapt to a market economy from existing in a planned economy environment. We believe that such a generalization is possible however, but this must be done with caution since one situation may be very different from another. Here, any researcher can learn from our findings and try to use them in empirical studies. There are six basic strategies of how a researcher can secure the internal validity according to Merriam. Two of these strategies are triangulation that is that there are more than one researcher, more than one source of information and methods, and finally that people not included in the research give their opinions about the research performed. We believe both requirements to be

\(^{47}\) Patel and Davidson, 1994
\(^{48}\) Merriam, 1998
mostly fulfilled in this thesis. We believe this because there are three researchers working on this thesis. We also have close contacts with fellow students and teachers who continuously give feedback on our thesis.

3.11 Methodological limitations

One of the critical points is the choice of literature and how to interpret it. There are many possible sources of errors: for instance the literature could be too old or not relevant to our study. Secondly, much of the literature was in English, which is not our native language. When reading a book or article, and when interviewing managers, there was a risk of misinterpretation of what the authors/respondents wanted to say. The problem is further worsened by the fact that English is not of course the respondents’ first language either. There has in some cases been another linguistic dimension since some interviews have been conducted through interpreters. This means that the risk of misinterpretation has increased. The reason for this is that the interpreters may misunderstand or be unable to translate correctly the respondent’s answer. Then there is also a risk that we may, in our turn, misunderstand or misinterpret the interpreter. This risk has been decreased by sending the questions prior to the interviews. This enables the respondents to translate and also ponder the questions before the actual interview. After consideration, we think that it has not made the conclusions less valid as we have been working in English in such topics for several years.

As already noted in this chapter, we had to; conduct our interviews earlier than anticipated. This was because there was a board meeting scheduled that we had no previous knowledge about. This caused a problem with the
depth in the prepared interview questions. The lack of time may in some cases have caused a lack of depth, which we regrettably have to admit.

While interviewing key personnel at Krenholm we noted a tendency towards a glorification of the company and a denial of threats and problems. In many cases problems were played down. This could be a major complication when analyzing the gathered empirical material. Since we are aware of this problem we will also take this into account in order to minimize its possible negative impact on our analysis. There was also a tendency from the respondents to avoid or even ignore certain sensitive questions such as how the relationship between Russian-Estonians and Estonians were.

According to Patel and Davidsson it is necessary to keep a critical attitude towards facts and experiences in order to make a proper evaluation.\textsuperscript{49} During the research process we have been striving towards a critical attitude, towards ourselves, towards the empirical findings and towards the selected literature. We feel that we successfully have taken all limitations in consideration in order to minimize possible errors in the analysis.

\textsuperscript{49} Patel and Davidsson,1994
4 Krenholm and its environment

This chapter consists of three different parts; a LoNGPEST analysis, a description of the textile industry and finally a company description of Krenholm. These parts will enable a deeper understanding about our case company and its environment. We have chosen to describe important parts of Krenholm and its environment since this is vital for a deeper understanding of the specific challenges and possibilities a company such as Krenholm face.

4.1 PEST and LoNGPEST

The LoNGPEST analysis will help the reader as well as the authors towards an understanding of the specific environment that Krenholm operates in. We all live in an increasingly complex and dynamic world and for Krenholm this has been more than true with the revolutionary changes in the local and economic environment coupled with extensive changes in the industry as such. The purpose of this part is to present theories which can function as a tool for organizations in order to make sense of this challenging world and also take appropriate management and business decisions. In order to understand the complexity in the outside world, organizations need to analyze their external environment. This can be done at a broad general level by the use of PEST and LoNGPEST analyses.50

The figure down below illustrates the PEST and the LoNGPEST analyses. The traditional PEST analysis is a short one-dimensional view of the external environment. This two-dimensional analysis will be referred to as
a LoNG (Local, National and Global) PEST analysis.\textsuperscript{51} It represents the view that these external influential elements, whether political, economical, socio-cultural or technological, all exist at local, national and global levels of the environment. We will, however, exclude two dimensions on the global level; the technological and socio-cultural, since these two do not contribute information interesting for this thesis.

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\textbf{FIGURE 3: LoNGPEST}\textsuperscript{52}

\textsuperscript{50} Claire Capone, 2000

\textsuperscript{51} Ibid

\textsuperscript{52} Claire Capone, 2000
4.2 The LoNGPEST analysis

4.2.1 Local

4.2.1.1 Political

Krenholm is situated in the town of Narva located at the Estonian border to Russia. The city is made up mainly by people with Russian ancestry, who make up approximately 90% of the population. There are only 4% Estonians living in Narva. This is due to the history of Narva with Stalin’s mass-deportation of Estonians from Narva and the subsequent movement of Russian settlers to the area. Considering the history it is not surprising that there seems to be some tensions between the Estonian and the Estonian-Russian. In particular, during private informal discussions with Estonians in Tallinn we sensed a feeling of resentment towards Russian-Estonians.

In order to become an Estonian citizen it is required that the person is able to use the national language. This demand that is particularly aimed at the Russian-Estonian population may breed resentment towards Estonians that may even further complicate the relationship between the different ethnical segments.

Thus one might conclude that since Narva consists mainly of Russian-Estonians there may be a potential problem between the local and national government. There may even be problems between the local government and the citizens of Narva depending on the ethnical affiliation the government has. There can of course be risks involved in conducting a business in a politically unstable area. However this does not seem to

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53 Narva Business Advisory Services Foundation
54 Ibid
concern the managing director or anybody else at Krenholm. No doubt, this is a very sensitive question and perhaps therefore it is avoided, denied and/or de-dramatized by the respondents.

The CEO at Krenholm is a member of the board of the Estonian employer’s organization.\textsuperscript{56} As an agreement with the Estonian government every new law and regulation will go under the inspection of the Estonian employer’s organization before it goes to the parliament. This means that the board is given the opportunity to give their opinion on the matter. It also gives Krenholm a very good insight into the politics and a possibility to take action when new proposals are presented.

\textit{“We are 15 persons in the board and we are from all the main sectors of our economy. I represent textile. We are powerful because we are very active.”}\textsuperscript{57}

4.2.1.2 \textbf{Economical}

Narva’s economy is currently based on textile industry and power engineering. The largest employers in town are the two local power stations- the Baltic Power Station and the Eesti Power Station and the textile company Krenholm Holding. Traditional fields of activity according to the business center of Narva\textsuperscript{58} also include clothing manufacture, metal-work and wood-work, as well as the production of furniture, building materials, control and measurement of machinery, medical equipment. Narva is one of the major exporting towns and is responsible for nearly 10\% of Estonian exports. Major exports from Narva are textiles, metal

\textsuperscript{55} Ibid
\textsuperscript{56} CEO, Krenholm
\textsuperscript{57} CEO, Krenholm
\textsuperscript{58} CEO, Krenholm
products, timber and furniture, electronics, wood products, leather and construction materials.\textsuperscript{59}

In reality, though, Krenholm represents an outstanding majority of the job opportunities given in Narva as well as the exports originating from the town. Thus Narva depends heavily on the textile industry and Krenholm, which gives the company an extremely important position in the area. In the words of the managing director of Krenholm:\textsuperscript{60}

“…here lives somewhere around 75 000 people and we have 5000 people employed so I think around 15 – 20 000 people in Narva are getting incomes via Krenholm today, unemployment is pretty high and it is even higher for men so this means often that an employed lady of Krenholm has one or two kids and an unemployed husband to take care of plus a percentage to the city budget. So if we look at service sector in Narva at least 20\% of the funds are from people from Krenholm. We are critical to the region.”

A major obstacle to the further development of Narva’s economy today is the current infrastructure. This is something the authors had a chance to experience first hand. The only way to get to Narva by public transportation is by bus. This on road that is in an extremely bad condition, providing the car or bus passenger with an extremely bumpy ride to Narva. There is no airport and no trains that service individuals, only freight trains.

\textsuperscript{58} Narva Business Advisory Services Foundation
\textsuperscript{59} Ibid
\textsuperscript{60} Managing Director of Krenholm-
This lack of infrastructure is very bad for the business according to the managing director of Krenholm. 61

"We need better roads and an airport in Narva. The current infrastructure is not good PR for Krenholm and Narva. Your singer Sahlene traveled around the country for two days and she said “I like your country a lot, but my ass is sick from these roads”. This gives the entire country a bad image! Very important businessmen on their first visit to Estonia and Narva and their first impression is this bloody road. Businessmen who come to Tallinn and understand that they have to travel for so long by car to Krenholm Narva may decide not to go. If the go they are given a first bad impression by the road. The international road from Tallinn to Narva and St Petersburg should be a priority especially in the future. Maybe it is so that the road between Tarttu and Tallinn is so good because so many in the government live in Tarttu. In the future funds from the EU might help to boost the development."

As noted earlier Narva lies on the border to Russia and not far from the large Russian city of St. Peters burg. The trade between Russia and Estonia is currently not very active as a result of their common history. This closeness to Russia and St. Petersburg may however prove to be important in the future as relations between Estonia and Russia improve. The managing director of Krenholm finds this closeness to such a large potential new market to be a very good opportunity for Krenholm in the future. 62

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61 CEO, Krenholm
62 Managing Director of Krenholm
The overall number of enterprises in Narva is steadily growing. There are about 2000 companies registered in Narva.\textsuperscript{63} The banking system is modern and efficient. Banks have a network of correspondent accounts in European countries, Russia and the US, and provide both domestic and international services.\textsuperscript{64}

4.2.1.3 Socio-cultural

By population, Narva is the third largest town in Estonia after Tallinn and Tartu. Narva is suffering from a high unemployment rate; the official figure is 14.3%. Actual figures according to a consultant in Narva Business advisory Services Foundation are as high as about 20%. The unemployed are mainly made up of young unskilled males.\textsuperscript{65}

Unemployment creates certain problems for a society. One effect may be an increase in alcoholism, drug abuse and crime. One person working for the Narva Business Advisory Services (BAS), which is responsible for assisting development of business and local government, said that the situation regarding alcohol and drug abuse is serious.\textsuperscript{66} On the other hand, the high unemployment rate can be argued to be a positive factor in the sense that labor is cheap and therefore can attract new employers to the region. The problem is that the majority of the unemployed are unskilled which makes it hard for companies to find personnel with the necessary competence.

Narva also has a large problem with HIV which is a result of an epidemic among young drug users. According to the Swedish newspaper Aftonbladet

\textsuperscript{63}Narva Business Advisory Services Foundation
\textsuperscript{64}Ibid
\textsuperscript{65}Ibid
\textsuperscript{66}Ibid
the number of HIV cases increased in Estonia with 450% in 2001 and this increase can mainly be traced to Narva.67

4.2.1.4 Technology

If you go for a walk in any western European city you are likely to encounter a large number of people using cellular phones, this is also true in Tallinn. In Narva this is not the case. This can be interpreted as a lack of technology in Narva. This lack of technology may very well depend on the fact that the local economy is strained due to the fact that the unemployment rate is very high. The necessary financial means are not available in order to buy this kind of merchandise.

4.2.2 National

4.2.2.1 Political

As previously stated the managing director of Krenholm is a member of the employment organization in Estonia which has the right to comment on every new piece of legislation concerning employment matters. Since there are only 15 members in this organization it means that Krenholm has a chance to influence policies actively.

“I’m also a member of the board of the Estonian employers organization and by an agreement with the government every new law and regulation before it will go to the parliament this will go under the inspection of this association, so we will give our opinion and we have been to stop some not so good suggestions.” 68

66 Narva Business Advisory Services Foundation
67 www.aftonbladet.se/vss/nyheter/story/0,2789,129595,00.html
68 CEO, Krenholm
According to the CEO at Krenholm a good relationship seems to exist between the Management at Krenholm and the Union.

“I think we have pretty good relations, when we sit down and speak they understand for example next year we cut down 10% of the staff in spinning. My job is to make the proposal eatable. No one likes to fire people I hate it. I have to look first to the company and then to the people and the trade union the other way around.”\textsuperscript{69}

However we must emphasize that we have not talked to the trade union so we can not conclude that there in fact is a good relationship between the two parties.

4.2.2.2 Economical

Since the re-establishment of independence in 1991 and an economic slowdown after that Estonia has experienced positive growth since 1995. The success of Estonia’s economy has been based on stable currency, liberal foreign trade regime, liberalization of prices and fast privatization. As a result, Estonia has advanced fast in terms of stabilizing and restructuring the economy and been rewarded with high levels of foreign direct investment.\textsuperscript{70} Thanks to its brave approach to liberalization and structural reforms, Estonia has received significant inflows of foreign capital. In 2000, the overall capital inflows amounted to 9 percent of total GPD.\textsuperscript{71}

\textsuperscript{69} Managing Director, Krenholm
\textsuperscript{70} www.eia.ee
\textsuperscript{71} Ibid
Estonia has a very favorable economical climate and the country has been ranked as number four on the list over countries with the most favorable economical climate by The Heritage and The Wall Street Journal.\textsuperscript{72} One explanation to the good result they achieved in the ranking can be found in the fact that Estonia does not have any export or import taxes.

Estonia has no exchange controls or restrictions on foreign investment. The amount of foreign capital invested in Estonia Business enterprise is unlimited and companies can be in full foreign ownership. Foreign companies enjoy equal rights with local ones, including the right to own a land.\textsuperscript{73}

Estonia suffers from a high inflation rate compared to western European countries. This rate is about 5\%.\textsuperscript{74} This high rate of inflation stems from the high economical growth that Estonia has been experiencing the last couple of years. The GNP growth has been around 5\% the last couple of years and this is very high compared to most European countries\textsuperscript{75}. The inflation rate is also something that concerns the CEO at Krenholm but he feels that this is improving.

“...inflation is also going in the right direction if you compare in 1995 it was 28\% and in last year 4-5 \%.”\textsuperscript{76}

\textsuperscript{72} www.boraswafveri.se
\textsuperscript{73} www.stat.ee
\textsuperscript{74} Ibid
\textsuperscript{75} Ibid
\textsuperscript{76} CEO, Krenholm
4.2.2.3 Socio-cultural

Estonia has some problems with well educated people moving to other countries where there are better and better paid jobs. This is especially true for the Narva region, since the jobs offered in Narva are not very well paid, they will move to a place where there are. In accordance with this many are also leaving for Tallinn.\textsuperscript{77}

The Estonian labor market has experienced significant change in the 1990’s. The reason, on the one hand, has been economic restructuring which created new types of employment, but also unemployment. On the other hand there have been changes in the demographic structure of the population. Compared to 1999, the employment levels have decreased most in the agricultural, fishery, forestry and wholesale and retail trade sectors, and increased in manufacturing, real estate, hotels and restaurants sector.\textsuperscript{78}

Despite the strong emergence of the private sector, unemployment has been gradually increasing over the last years. By the end of year 2000 the unemployment rate had risen to 13.7 percent. There are wide regional differences in the unemployment rate, with the capital Tallinn faring the best and the industrial Northeast and agricultural Southeast the worst.\textsuperscript{79}

EU is neither an opportunity nor a threat considering trade, since Estonia already has a free trade agreement with the EU. But free movement of workers may cause a problem. Since there is already a problem with this a membership in the EU may further complicate this problem and Estonia and Narva may loose a lot of sharp and entrepreneurial minds as well as needed unskilled labor.

\textsuperscript{77} Narva Business Advisory Services Foundation
\textsuperscript{78} www.stat.ee
4.2.2.4 Technology

A problem that is very obvious for most of the old eastern countries and Soviet republics is that those countries in comparison to the western world have older machine parks. This leads to the point that there are major investment needs concerning infrastructure. The positive thing is that relatively great investments are constantly done by EU countries. During year 2001, the actual figure was 280 million Euros. Older machine parks make it difficult to compete with west European companies on the same conditions. Yet, Estonia and older Eastern countries have an advantage due to the relatively low salary level. 80

4.2.3 Global

4.2.3.1 Political

In November 1999 Estonia became a member of the World Trade Organization (WTO). 81 This was of course an important step for Estonia in its progress. Membership in the WTO facilitates the accession negotiations with the EU, promotes foreign investments to Estonia as well as increases the security of both foreign and Estonian entrepreneurs by creating a reliable framework for implementing national economic and trade policies. 82

In addition to the economic benefits and possibilities that can be achieved by a membership in EU it might be a positive force in improving the relationship between Russian-Estonians and Estonians since discrimination

79 www.eia.ee
80 www.stat.ee
81 Ibid
is not tolerated by the EU. This is obviously promising for Narva and Krenholm.

In the year 2005, the process of world trade liberalization which started in 1995 (with the signing of the WTO), the “Agreement on Textiles and Clothing”- ATC, will be completed. This will bring about what has been called “a new world order in textiles trade”\textsuperscript{83}, since large textile nations like China, India or Indonesia no longer will be confronted with quantitative restrictions when exporting to the EU or the US.\textsuperscript{84} What this means for the development of the textile industry remains to be seen but there is a threat of a general movement of the textile production to these countries. We will return to this issue in our empirical findings and analysis.

4.2.3.2 Economical

Russia's trading partners, including the US and the European Union, are seeking better access to Russian markets as a precondition for their entry into the WTO. After years of infrequent talks, President Vladimir Putin last year ordered officials to accelerate Russia's entry negotiations. While no deadlines have been set, Russian officials say that the country could join the WTO by late next year - as long as talks go well.\textsuperscript{85} According to Mr. Putin a membership in the WTO can bring great benefits. These benefits include increased foreign investment and a greater diversification in the economy. Furthermore, there is likelihood that this will bring an end to discriminatory trade measures against Russian exports. An integration of

\textsuperscript{82} Ibid
\textsuperscript{83} W. Steng, 2001
\textsuperscript{84} Ibid
\textsuperscript{85} Financial Times; Apr 15, 2002, By STEFAN WAGSTYL
the Russian market into the WTO would act to create many opportunities for the company. Currently there are many high trade barriers and customs for entering the Russian market. Today Krenholm has sales to the Russian market, but only in small amounts. Krenholm will be increasing its revenue by 10% if the Russian market is available on the same conditions as the other external markets.86

There are also global influences that have affected Krenholm lately. The CEO pointed out that examples of such threats were the terrorist attack that took place on September 11th last year and the bankruptcy of K-mart in the US in the beginning of January this year. Krenholm is of course highly vulnerable for these kinds of elements and other economic collapses that are not expected, since Krenholm is working on a global basis. Because of the bankruptcy and collapse of many K-mart stores Krenholm lost a major customer and a lot of efforts were put in to find an alternative customer to K-mart. Due to the crisis in Asia 1999, Krenholm lost 30 percent of the revenue in that year. As said by the CEO,

"after this crisis all the prices went very much down and we took here the very important decision that we don’t want to play on this unstable market and we don’t sell our products with so low prices and we just stopped partly our production, we produced less and we fired a lot of people".87

The company had been very badly affected by the crisis and many changes were made to make Krenholm stronger.88

86 Managing director of Krenholm
87 Ibid
4.3 The textile and clothing industry

The textile and clothing industry is a very diverse and heterogeneous industry, with its products being used by almost everybody. Its activities reach from the production of raw materials, i.e. natural as well as artificial fibers (see below) to the manufacture of a wide variety of semi-finished and finished products. Being one of the oldest sectors in the history of industrial development, the textile and clothing industry is often referred to as a “traditional industry”, as a sector belonging to the so-called ‘old economy’. This view on the textile industry and industries in general as belonging to the old economy and thus unattractive has made it difficult to attract talented managerial labor, as the managing director of Krenholm puts it:

“I have met managers from many different countries. I saw so many textile mills in the US and Europe and if I compare managers then I am satisfied. In Estonia it is really difficult to get a really good guy to run an industry I know it is the same situation in Sweden for example.”

The textile and clothing sector is an important part of the European manufacturing industry, providing with more than 2 million people employment. Its importance for social and economic issues is increased by the fact that it is dominated by a large number of small and medium-sized enterprises, which are often concentrated in particular regions, contributing

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88 Ibid
89 W. Steng, 2001
90 Managing director of Krenholm
greatly to their wealth and cultural heritage. Narva illustrates such a situation perfectly with its dependence of Krenholm.

Like many other sectors, the textile and clothing industry has been affected by the phenomenon of globalization. Europe and the United States are not only important producers of textile and clothing products, they are also the most attractive outlets for the so-called exporting countries, many of which are situated in south-east Asia. It should be noted that many developing countries, and indeed also least developed countries, have become very competitive in textiles and clothing, as they combine low wage costs with high-quality textile equipment and know-how imported from more industrialized countries. As Borås Wäfveri’s purchase of Krenholm was in much a way to get lower wage costs by moving the production from Sweden to Estonia one might wonder if the future is that this production will get further moved to Asia.

In year 2005, as mentioned earlier in the LoNGPEST analysis, the “Agreement on Textiles and Clothing” (ATC) will be completed. This will have great impact on the world textiles trade, since large textile nations like China, India or Indonesia will no longer be confronted with quantitative restrictions when exporting to the EU or the US.

Whether European industry will be able to remain a global player also in the new Millennium, will, according to Steng, depend on its ability to constantly improve its competitiveness through innovation, the increased use of information and communication technologies, and clear focus on products with high quality and/or fashion content.

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91 W. Steng, 2001
92 Ibid
4.3.1 Definition of the textile industry

The textile industry as such is a gigantic industry with a very broad spectrum of products. Therefore we might in general have a very diffuse picture of what the textile industry really is comprised of. According to the European Union the textile and clothing industry ("T/C industry") comprises:\[^{93}\]

- **The treatment of raw materials**, i.e. the preparation or production of various textiles *fibers*, and/or the manufacture of *yarns* (e.g. through *spinning*).
  - "Natural" fibers include cotton, wool, silk, flax, etc.
  - "Man-made" fibers include *cellulose* fibers, *synthetic* fibers (i.e. organic fibers based on petrochemicals such as polyester, nylon/polyamide, acrylic, polypropylene, etc), and fibers from *inorganic* materials (e.g. glass, metal, carbon or ceramic).

- **The production of knitted and woven fabrics** (i.e. *knitting* and *weaving*);

- **Finishing activities** – aimed at giving fabrics the visual and physical properties which consumers demand – such as bleaching, printing, dyeing, impregnating, coating, plasticizing, etc;

- **The transformation** of those fabrics into products such as:
  - *Garments*, knitted or woven (= the so-called "clothing" industry);
  - *Carpets* and other textile floor covering;

[^93]: http://europa.eu.int
- home textiles (such as bed linen, table linen, toilet linen, kitchen linen, curtains, etc);

- Technical, or ‘industrial’, textiles

4.3.2 Economic and social importance of the textiles and clothing industry

The textile and clothing industry is, as mentioned earlier, one of the most global industries in the world, and constitutes an important source of income and employment for many countries in the world, in particular for many developing countries. It accounts for 5.7% of the production value of world manufacturing output, 8.3% of the value of manufactured goods traded in the world, and more than 14% of world employment.94

In the EU, some 120,000 textiles and clothing companies employed more than 2 million people in the year of 2001, thus accounting for 7.6% of total employment of EU manufacturing industry. Production and employment are characterized by a considerable degree of regional concentration within the community. Also, a large proportion of the workforce is female.95

We will further describe some general characteristics of the European textile and clothing industry:96

- Globalization and liberalization. EU industry is exposed to hard and increasing competition from a large number of low-labor cost countries, especially from Asia. Despite the huge labor cost

94 http://europa.eu.int
95 Ibid
96 Ibid
differential between those countries and Europe, EU industry still remains competitive due to higher productivity, and competitive strengths such as innovation, quality, creativity, design or fashion. The future may however, with the liberalization to come, cause great shifts in the textile production.

- **Permanent restructuring and modernization.** The sector adopts new technologies constantly, with regard to both Information and Communication Technologies, and new production techniques. EU industry also has a leading role in the development of new products, such as in the areas of artificial textile fibers or technical textiles.

- **Large number of small and medium-sized enterprises.** The average company is family owned, and employs 20 people. **Subcontracting** accounts for a considerable part of economic activity varying from 10 to 60%. These subcontracting activities are spread between a web of thousands of small businesses, often taking the form of cottage industries, which play an essential role as a source of employment and income, and which are often highly concentrated in particular regions. The building of Krenholm’s new sewing plant opened in the year 2000 and this was an action taken in order to avoid dependency on a numerous amounts of subcontractors in the Narva region with a question mark concerning quality.

- **Outsourcing; outward processing transactions.** Many companies outsource more labor-intensive operations to countries such as the agreement candidate countries and countries of the Mediterranean Rim. Due to the geographical closeness of those countries, EU manufacturers are still able to respond quickly to changing market
demands, and they can more easily maintain control over the management and quality of the outsourced operation.

In terms of company size, Europe has few global players. While there are six European companies among the world’s 36 biggest textiles companies, the biggest European group ranks as low as number 18.97

Producers in Europe are faced with a higher cost structure than many of its most important competitors on world markets. This is due to higher social standards (wages, social security payments, etc.), but also to higher requirements with regard to health, safety or the environment. In order to remain internationally competitive, those higher costs have to be compensated by factors such as higher productivity levels, more efficient institutions and markets, and/or superior product quality.98

European industry is still engaged in all production stages, from raw materials (the production of man-made fibers), to semi-processed products (spinning, weaving, knitting, and finishing activities), to the final products (e.g. home textiles, carpets, technical textiles, garments).99

The increasing flow of capital, know-how and technology continues to toughen competition, not least for manufacturers in the high cost areas of the world. Further, as mentioned earlier, liberalization of the international textile trade will make it even harder, particularly regarding consumer goods, over the next few years. The global demand for textile is gradually shifting from natural to man made fiber products.100 On most west

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97 W. Steng, 2001
98 Ibid
99 W. Steng, 2001
100 Borås Wäfveris annual report, 2001
European markets structural changes are visible in the distributive consumer goods trade. Large and multi-store companies strengthen their positions and strive to reposition themselves in the value adding and distributing chain, focusing harder on establishing their own brands and integrating into the design and product development functions.\textsuperscript{101} For manufacturers, these developments require strategic choices.

4.3.3 The textile and clothing sector in Estonia

Textiles and clothing industry is the second largest industrial sector in Estonia, with a total production value of over 2 billion dollars.\textsuperscript{102} The importance of the industry is easy to understand from the fact that Krenholm, the largest textile actor, is the largest industrial company and exporter in Estonia. Almost 60% of the Estonian clothing and textile sector's total turnover is accounted for by the eight largest companies and some 14,000 employees work in this industry. Estonia's Clothing and Textile industry accounts for 9% of industrial output and has traditionally been an important exporter.\textsuperscript{103} The industry is increasing its market share in Western Europe. Cheap labor and plant and an established reputation make Estonia an attractive option for foreign investors.

The level of technology has improved significantly in recent years, especially after the privatization of the companies in the early 1990s, with the larger clothing manufacturers acquiring modern equipment and machinery, mainly coming from EU countries such as Germany and France. The leading Estonian sewing companies have reduced their

\textsuperscript{101} Borås Wäfveris annual report, 2001
\textsuperscript{102} www.swedishtrade.se
\textsuperscript{103} Ibid
traditional dependence on subcontracting, developing instead their own original designs and collections suitable for international markets. Another interesting pattern is that the clothing industry in Estonia is becoming increasingly integrated with its Finnish and Swedish counterparts.

There are many clothing and textile companies in Estonia, from large factory-based manufacturers to individual designers. The major companies in Estonia's clothing and textile sector including the largest actor, Krenholm, are: 104 The companies below are not ranked in any way.

- **Krenholm Group**: Bleached, dyed, printed and finished cotton fabrics, bed linen, tablecloths, napkins, curtains, towels.
- **Baltika Ltd**: Men's and women's jackets, blazers, suits and trousers.
- **Klementi Ltd**: Ladies jackets, skirts, dresses, blouses, coats, trousers.
- **Marat Ltd**: Underwear and outerwear of knitted fabrics for men, women and children.
- **Ilves-Extra Ltd**: Short overcoats, alpine ski suits, ski overalls, jackets, shirts, trousers, coats for women.
- **Virulane Ltd**: Outdoor garments for men and women.
- **Baltex 2000**: Production of cotton fabrics for clothing and household linen.

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104 Ibid
4.4 Krenholm

The Krenholm Group was established in Narva, (situated on the border between Estonia and Russia), in 1857 by the German Baron Ludwig Knoop. The company was later re-privatized from Soviet-era state ownership in 1995 when the Swedish textile company Borås Wäfveri became the single owner.105

During the Soviet era Krenholm was only a production company that received centralized plans from Moscow and there was never any problem to sell the products during that time. They received the orders telling them how much they were to produce and for whom. Krenholm had about 1200 very stable customers in different places all over the Soviet Union and was the biggest company in Narva and in Estonia, with about 11 000 employees.106

World War I and the Russian revolution were hard times for Krenholm and some of the battles were fought on its grounds. With the independence of Estonia in 1918, the Russian market was lost. Krenholm Manufaktuur decreased its production and the company was forced to search for a new market in West, a situation which was very similar to the one that occurred after the independence in 1991 (see below).107 After World War II, Krenholm was nationalized by the government of the Soviet Union. At that time Krenholm was in ruins and people all over the former Soviet Union were forced to go to Narva and help rebuild Krenholm, and also to work there. In fact, Estonians were deported by Stalin and Soviet Union nationals

105 www.krenholm.com
107 Luihto, 1999
were re-allocated to the Narva region. Stalin and his reign were behind the rapid growth of Krenholm which at the end of the Soviet era employed over 11,000 people.

Krenholm was like a large family during the Soviet era. The organization took care of its workers and they saw themselves as a part of the organization. Before the independence in 1991 the government in the former Soviet Union provided Krenholm with raw material mainly from central Asia, which offered cotton for low prices. According to one manager at Krenholm who was working at Krenholm during the Soviet Union era, times were easier then:

“If you look at the history of Krenholm, before privatization it was a planning system. It was much easier to operate because it was more or less stable prices, more or less stable production capacity etc.”

“People never had to care about production cost and sales. It was not a problem to sale our products in the Soviet Union, in the planned system. Therefore year by year people only wanted to ask we need money for this we need money for that. But nobody thought of were the money will come from”

The company was the most famous and the most profitable textile mill in the Soviet Union. Krenholm did not perceive any threat from other textile companies and all the goods produced were sold.

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108 A managing director during the Soviet era
109 A managing director during the Soviet era
The period from 1986 to 1991 was a very interesting and important period at Krenholm. This period in the history of Krenholm may at first glance seem rather insignificant; after all it was not until 1991 that Estonia became an independent state and owner of Krenholm. However, there was a change in the degree of freedom for Krenholm in 1986, to a very limited extent, but the company got a certain insight into what a market environment entails and demand. This development was to a large extent the work of one man, the incumbent President Michael Gorbachov and his Perestroika. The greater general freedom of Perestroika also included more liberal programs implemented in 1986 and 1989.

For Krenholm this led to an opportunity to export their goods in an independent way. Moreover the company received the freedom to decide of its own investments. The company no longer had to get an approval from the textile ministry in Moscow.110

“Krenholm fortunately started to export products several years before the collapse of the Soviet Union. Thanks to the power of the minister of light industry Estonia got a special privilege from the Soviet Union. It was called self finance, currency finance. We got the right to sell our products or export. Not through export companies of the Soviet Union but direct.”111

Another important development was that Krenholm could use some of the earned western currencies to purchase equipment from Western countries:

110 Lindahl, C, Olsson, J
111 A managing director during the Soviet era
“We got the right to buy necessary equipment with hard currency we got from export from products.”

“…We got this right 1986 and in 1989 and 1990 we invested in equipment in about 5 million USD every year from our exports. Therefore we got some equipment which we could use in order to produce export quality products”

After the independence in September 1991, Krenholm became owned by the Estonian state. The stable environment that Krenholm had lived in for such a long time, disappeared. It had lost the Russian market, its suppliers and also a large amount of money. Krenholm had to find new customers and suppliers and looked to the Western market. The word of the managing director of Krenholm during the Soviet era shows how bad the situation really was:

“It was extremely tough, extremely” ......” I don’t want to remember”

The first year after the independence there was a lack of cotton due to the fact that cotton from Iraq and Iran was transported through the former Soviet Union, from where the cotton deliveries had been stopped. Another problem was the increase in price. Krenholm could not afford to buy all the cotton it needed. This was very difficult times for Krenholm and the company had to start from the beginning. They experienced a constant lack of raw cotton and had to sell their products at greatly reduced prices.
Krenholm was often involved in something that clearly resembles barter trade at this time. The Estonian state, which became owners of Krenholm after independence, used Krenholm’s products in barter trade with other nations.

During this time the number of employees decreased to 5600. Until today Krenholm has very modest possibilities to turn back to the Russian market. The border tariff is approximately 65 % of the product cost, which makes Krenholm less able to compete on the Russian market.

The Swedish owner Borås Wäfveri AB and the Estonian State formed in January 1995 a new company, Krenholm Holding Ltd. The former company, Krenholmi Manufaktuur was at the time of the take-over in 1995, on the edge of collapse. The company had in the beginning of that year almost no raw material, no cash flow and further no marketing organization. The Krenholm organization was hierarchically built in accordance to the Soviet model and the operation was in accordance to this very production oriented.

In order to change the former production orientated company into one market orientated, Krenholm was divided, in 1995, into one parent company and six subsidiaries, a Holding company. These six subsidiaries were supposed to act as independent companies both externally as well as internally, in accordance with market conditions. The Holding company made the strategies for the organization and was responsible for financing and controlling the company’s six subsidiaries. The subsidiaries were

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116 www.boraswafveri.se
117 Ibid
118 Ibid
responsible for their own objectives and plans. The main idea according to Borås Wäfveri was to force top- and middle management to absorb the ideas and principles of a market economy. Hence the Swedish owner Borås Wäfveri changed the former structure and replaced some of the management. In 2001 the holding structure was changed into a divisional structure. One reason was that Krenholm had been negotiating with IFC-the International Finance Corporation for some years in order to get a substantial loan. One of the demands from the IFC was that Krenholm would become a divisional structure instead of a holding structure. The reason for this was that it was difficult to see who was taking the loan in a holding structured organization. Another reason was that the internal pricing system associated with the holding structure sometimes produced disadvantageous results and sub optimizations. Also in order to make all the managers in these six subsidiaries to focus on the Krenholm Group result and not just on their own.

Krenholm has generally handled the transition from public to private ownership and from total dependence on the former Soviet market to competitive western markets well. Over the past four years, Krenholm has increased capacity utilization, introduced new products, accessed new markets, and managed profitability by shifting away from low margin products such as yarn and gray fabric, to high-quality fabrics, higher value designed fabrics, bed linens, and towels.

Krenholm is a vertically integrated producer of cotton-based textiles, including bed sheets, towels, fabrics, garments, and furnishings. With annual sales of about $71.2 million and approximately 5 000 employees,
Krenholm is the largest industrial company and exporter in Estonia with more than 80 percent of sales exported, primarily to Western Europe and the US. The company’s revenue has increased greatly the last three years and now stands for approximately 45 percent of Borås Wäfveri’s total sales. Krenholm Company is also highly employee-intensive (see above) and accounts for 85 percent of Borås Wäfveri’s total business employment. Concerning the production volume, Krenholm delivers approximately 5-6 million textile meters per month.

At the end of the year 2000 a long term financing agreement was reached, lead by International Finance Corporation (IFC). Of the total credit facility of 25, 8 million Euros, 19, 8 million was intended for investments. Most of the 15 investment projects included have been initiated during 2001. The investment program is expected to strengthen Krenholm’s competitiveness by shifting its product range towards higher value-added products, to cut production costs, and optimize the machinery and infrastructure use. The investment period that is now proceeding will be crucial for Krenholm Groups continuous competitive advantage and for the development of Estonia, hence regarding to a future membership in the EU. As a result, substantial cost reductions and improvements in productivity and quality are expected planned for coming years. The Krenholm Group constantly strives to increase its market shares in Western Europe and the added value of its products. In line with these ambitions a new sewing plant was opened during the year and a sales subsidiary was established on the UK market.

120 Managing director of Krenholm
121 www.boraswafveri.se
122 Ibid
123 Borås Wäfveri financial report, 2000
During year 2001, substantial work has been done in order to achieve an ISO 9001 certification, for the entire organization. During 1998 and 1999 the revenue for the Krenholm Group decreased due to the crisis in Asian, but turned in year 2000, and an increase in 23 % were noticed. The operating profit for the Krenholm Group amounted in 2001 to 44, 5 million SEK, and sales revenue of 731 million SEK.\footnote{Borås Wäfveri’s annual report, 2001}

Today, except for the extensive the IFC- program, further investments are being made for developing the IT- system and also a wide educational program for initiating the English language in the Krenholm Group.\footnote{www.boraswafveri.se} There exists at the company, despite threats from low wage countries, an optimistic view of the future. This is clearly visible both in the interviews and also in the substantial investments that are being made.

\footnotesize{\textsuperscript{124} www.boraswafveri.se \textsuperscript{125} Borås Wäfveri’s annual report, 2001}
5 Frame of references

In this chapter we will describe theories that are relevant in relation to our case study and thus have chosen to use in our studies. We will begin with a general discussion about the interconnection between the different theoretic fields and their relevance in relation to our case study.

We find Chandler’s investigation into the historical relationship between strategy and structure in American companies very useful as a tool for analyzing the development of Krenholm. Mostly this is due to his famous model where the evolvement of the environment and resources of an organization influence the evolvement of the chosen strategy which in turn determines the outlook and changes in the structure. Thus in our belief this model is an excellent frame for trying to grasp and understand the general overall development of a company both over longer time spans and during more specific transition processes. This is also how we will use it.

Furthermore we will include more specific theories about strategy and structure in order to gain a depth that Chandler’s investigation and model in some aspects does not provide.

One of the most important resources for a company is according to Chandler managerial skills; therefore we also include some interesting theories of management in our frame of references. In addition to this we are of the belief that management can not be separated from strategy and structure and that management has most certainly had a critical role in the transition process.

\[126\] Ibid
With our purpose and the history of Krenholm in mind, we also find it necessary to include theories of organizational change.

5.1 Links between strategy, structure and management

5.1.1 Chandlers dynamic model of strategy and structure

The historically most widely held view on the relationship between strategy and structure is that structure follows strategy.\textsuperscript{127} The work on the relationship between strategy and structure as well as the opinion that structure follows strategy, was first started by Chandler.\textsuperscript{128} In his research of the historical development of American corporation, he proposed a dynamic model of strategy and structure as illustrated in figure 4.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{chandlers_dynamics.png}
\caption{Chandlers Dynamic relationships between strategy and structure.\textsuperscript{129}}
\end{figure}

\textsuperscript{127} Hall, D.J & Saias, M.A, 1980
\textsuperscript{128} A.D, Chandler, 1962
\textsuperscript{129} A.D, Chandler, 1962

The nature of the environment (Et1) and the resources (Rt1) of the organization influence according to the figure above the strategy (St1) chosen at time t1, and this in turn determines the organizational structure (STt1). Then further the evolution of the environment and or of the resources of the organization brings about a new strategy (St2) and a new structure (STt2).\(^{130}\)

Chandler concluded that a company’s strategy in time determined its structure and that the common denominator of structure and strategy has been the application of the enterprises resources to market demand. Structure has according to Chandler been the design for integrating the enterprises existing resources to market demand and strategy has been the plan for the allocation of resources to anticipated demand.\(^ {131}\)

It must be noticed that the evolution of the environment and the resource base of a firm in general goes hand in hand according to Chandler. The environment influences the resources and the application of these resources to the market demand of the environment can in turn influence the environment. The activities of the firm in turn channel the application of resources in strategy and structure.\(^ {132}\) By this we can see that all of the variables in Chandler’s model: environment, resources, strategy and structure are linked to each other in the dynamic evolution of a company.

\(^{130}\) Hall, D.J & Saia, M.A, 1980
\(^{131}\) A.D, Chandler, 1962
Chandler’s investigation into the changing strategy and structure of the large industrial enterprise in the United States was truly a massive one. The investigation was done partly by primary data such as surveys and interviews but mainly it was based on historic secondary data as correspondence, memoranda, annual reports, articles etc. The investigation spanned over 53 years, from 1909 to 1962. It included at most 70 companies with focus on the pioneers in modern American business administration – Du Pont, General Motors, Standard Oil Company and Sears Roebuck & Company. A common denominator between these companies is that they can be characterized as Industrial enterprises; Chandler defines an industrial enterprise as:

“A large profit oriented business firm involved in the handling of goods in some or all of the successive industrial processes from the procurement of the raw material to the sale to the ultimate customer”

Despite the huge scope of his investigation Chandler notes that his investigation provided much, but certainly still insufficient information on which to generalize about the growth and management of the great industrial enterprise in the United States.

It is interesting to note that Chandler discovers that the performance of the companies in the study suggest that a self generating force for the growth of the industrial enterprise within a market economy like that of the United States has been the drive to keep resources effectively employed. Historically then the role of administration and the function of the administrator in the large American enterprises have been to plan and direct

132 Ibid
133 A,D, Chandler, 1962
the use of resources to meet the short term and long term fluctuations and developments in the market. Of these resources, trained personnel with manufacturing, marketing, engineering, scientific and managerial skills often became even more valuable than warehouses, plants, offices and other physical facilities.\footnote{Ibid}

In the course to these conclusions given above and in the model, Chandler found four phases in the history of the large American industrial enterprise:\footnote{Ibid} The initial expansion and accumulation of resources; the rationalization of the use of resources; the expansion into new markets and lines to help assure the continuing full use of resources and finally the development of a new structure to make possible continuing effective mobilization of resources to meet both changing short term market demands and long term market trends. These stages can be summarized as follows:

5.1.1.1 Accumulating Resources

With the buildings of the railroad and rapid urban growth gave work to what Chandler calls unskilled labor. This working force did not only provide labor to the growing industrial enterprises but also increased the demands for their products. To meet these opportunities, industrial enterprises began to enlarge their productive facilities, labor force and trained supervisory personnel. Often the new resources were self generated. The firm’s profits provided the funds for further expansion, while the skills of its personnel were developed as the latter carried out their daily tasks.

\footnote{Ibid}
\footnote{Ibid}
\footnote{Ibid}
Consolidation allowed the lowering of unit costs through high volume production for the large market. Consolidation and with it the formation of a marketing department, was usually followed or accompanied by forming purchasing departments and often by obtaining control of raw materials. So in many key American industries after the 1880s a few great enterprises took over the several different stages of the industrial process that, up to that time, had always been operated by separate, relatively small wholesalers, manufacturers, transporters, and raw materials producers.

5.1.1.2 **Rationalizing the use of resources.**

The successors of the men that built the huge American industrial enterprises had to start to think of administration and not only accumulation of resources.\(^{137}\) That is they had to develop methods for managing rationally the large amount of men, money and materials. Often in their eagerness to meet the new market, the empire builders in one industry had collected more facilities and personnel than were really necessary to meet the existing demand. Now two tasks was ahead, first to reduce unit costs by rationalizing the several functional activities and second, these functional activities had to be closely coordinated to market fluctuations. The first task led to the definition of lines of authority and communication within a single functional department; the second brought a structure for the enterprise as a whole.\(^{138}\)

To be able to deliver on time goods made to a confusing variety of specifications and at the same time to keep large plants operating fairly steadily necessitated scheduling of a high order of skill. Also the designing of new or improved products to meet customer needs and to counter the

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\(^{137}\) A.D, Chandler, 1962

\(^{138}\) Ibid
offerings of competitors, demanded the close cooperation of the marketing, manufacturing and engineering departments.

The need to apply resources effectively to changes in short-term demand brought the creation of a centralized, functionally departmentalized administrative structure. The functional activities were departmentalized in order to assure effective and rational coordination, evaluation and planning in each. The central office in turn, had to make certain the coordination of these different activities in relation to the market. The resulting structure provided a communication network that linked all the facilities involved with the customers demand.

5.1.1.3 Continued growth
As other firms followed the innovators in developing more efficient purchasing, production, distribution and above all administrative methods, cost differentials between companies lessened and profit margins dropped. As the market became more saturated and the opportunities to cut costs through more rational techniques lessened, enterprises began to search for other markets or to develop other businesses that might profitably employ some of their partially utilized resources or even make a more profitable application of those still being fully employed. Diversification thus became the keyword. In enterprises whose products and processing were based on a highly complex technology, both skills and facilities were most easily transferred to new lines of goods.

5.1.1.4 Rationalizing the use of expanding resources.
It became increasingly difficult to coordinate through the existing structure the different functional activities to needs of several quite different

139 Ibid
markets. Expansion, primarily through diversification, enlarged the range number and complexity of the entrepreneurial activities required of the senior executives. The long term allocation of resources now involved deciding between the expansion, maintenance and contraction of personnel, plant and equipment in several different, large scales, widespread businesses. The appraisal of existing performance as well as the planning of future uses of resources called for a general office in which the executives were given the time, the information and the encouragement to develop a broad view, all so necessary for the handling of new and more complex problems. The multi divisional structure met both the short term and long term requirements for the profitable application of resources to the changing markets. This model was created by Du Pont, General Motors, Jersey standard and Sears Roebuck and its availability encouraged and helped many more companies to embark on a strategy of diversification.140

5.1.2 Other views on the relationship between strategy and structure

We have to admit that the dynamic model in Figure 1 is very appealing. It seems logical and efficient that the evolution of the environment and the organizations capabilities influence the strategy of the firm. More important, it seems like an optimal situation that a new structure follows a new strategy so that the firm operates efficiently. As Chandler states;141

“Unless structure follows strategy, inefficiency results. This certainly appears to be the lesson to be learned from the experience of our four companies”.

140 A.D, Chandler, 1962
141 Ibid
The question is, however, in which degree the model illustrates the reality. A common accepted truth in organizational theory is that organizational changes concerning both structure and culture are hard with many difficulties and different forces against change. Sociologist has for a long time debated over in which degrees the individual as well as companies are free to act. This corresponds with the degree that these actors are bound by the structure. From the viewpoint of the firm this structure could be both external as well as internal, that is the environment and the organizational structure.

Hall and Sias claim that structure partly determines strategy. The structure can in their viewpoint “alter and stand in the way of strategic planning”. This is among other variables due to the fact that in practice the effort required to draft the first and subsequent strategic plans are so heavy that there is little chance of them being spontaneous. If strategic planning is to succeed and grow, a constant pressure is required. This requirement is only fulfilled if both the organizational structure and the attitude of top management are favorable.

How then can basic organizational structure-traits like decentralization, centralization and bureaucracy affect the strategic planning?

When there is a high degree of decentralization in the company, for example with rather autonomous divisions, the initiative for the launch and revision of a plan will not come from top management and probably not

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142 Jacobsen & Thorsvik, 1998
143 Layder, D, 1997
144 Hall, D,J & Sias, M,A, 1980
145 Ibid
from the divisions either.  

Even if the divisions do feel the need to initiate the process, the probability of reaching a satisfactory conclusion remains low because of the complex audits that an overall plan would demand. This kind of firm is generally to be found with a series of divisional plans which when added together in more or less ordered fashion, serve as the overall strategic plan. Proactive strategy leading to a defensive attitude for the total organization is often suppressed; strategy no longer exists as a coherent and integrated whole.  

An excess of centralization can in the same way be self destructive. In this case every important decision is made by top management and little room for maneuver is left to their subordinates. Those who have the best knowledge about the environment cannot decide or act, many errors are inevitably made, and this leads first to a lack of confidence in the plan and then later to its abandonment.  

Meyer and Rowan note that bureaucratic structures often hold a culture which is unfavorable to the birth and development of strategic planning. In this kind of structure a very formal system of planning is most frequently chosen. Those in charge attach more weight to form than substance. They fill out long and useless forms and devote themselves to calculations of little interest or real value. They forget that the essential merit of strategic planning is to think about the future in a creative way. Where top management is not fundamentally attached to the planning process, and where division heads enjoy a certain degree of autonomy, the plan is frequently abandoned. If on the other hand autonomy in the divisions is

\[\text{\textsuperscript{146 Ibid}}\]
\[\text{\textsuperscript{147 Ibid}}\]
\[\text{\textsuperscript{148 Ibid}}\]
\[\text{\textsuperscript{149 Ibid}}\]
slight or top management cherishes the planning process, then the plan itself may generate internal conflicts. Here too strategic planning will probably be abandoned in order to resolve or reduce these conflicts.\textsuperscript{150}

Can structure influence strategy on a higher level than the one of strategic planning? Hall and Sias note that an organization decides and acts in accordance with its perception of changes in the environment or in its own capabilities.\textsuperscript{151} In accordance with this the structure can make an organization more or less short-sighted and blind. With Miles, Snow and Pfeffers words: \textsuperscript{152}

“\textit{The organization whose managerial talent is fully employed in the operation of the existing technology and process is unlikely to perceive new environmental threats or opportunities}”

Miles, Snow and Pfeffer thus conclude that structural characteristics act like filters and limit what the organization can see. This view is depicted in figure 2.

\textsuperscript{150} Hall,D,J & Sias,M,A, 1980
\textsuperscript{151} Hall,D,J & Sias,M,A, 1980
\textsuperscript{152} Hall,D,J & Sias,M,A, 1980
So how does the relationship between strategy and structure really look? Does structure follow strategy or is it the other way around? Well Chandler states that structure follows strategy. Hall and Sias do not believe that this is never the case but notes that the relationship indeed is very complex and that,  

“One can in fact accept that structure follows strategy but equally that strategy follows structure. It is therefore reasonable to understand Chandler’s position “unless structure follows strategy inefficiency results as meaning “unless structure matches strategy inefficiency results”
5.1.3 Management, strategy and structure

Without a doubt there are strong links and overlaps between management, strategy and structure. Both structure and strategy are in practice set by managers.\textsuperscript{155} The strategy of the firm as well as the structure in turn affects the managerial practice in a company. As we noted earlier Miles, Snow and Pfeffers state that the organization whose managerial talent is fully employed in the operation of the existing technology and process is unlikely to perceive new environmental threats or opportunities.\textsuperscript{156} Thus we believe that when structural characteristics act like filters and limit what the organization can see in fact it is what the managers can see that is affected.

The managerial perceptions of external situation are therefore affected by the structure. How the managers perceive the external situations in turn affect the strategy of the firm.

5.2 Strategy

As an economist you often find yourself working in diffuse and complex fields of studies. Strategy is one of those fields where there seems to be no common accepted truths, in fact there is not even a common accepted definition of the concept as such. A popular definition of strategy however is the one provided by Chandler. He defines strategy as:\textsuperscript{157}

\textsuperscript{154} Ibid
\textsuperscript{155} Steers, R & Stewart Black, J, 1994
\textsuperscript{156} Hall, DJ & Saias, M,A, 1980
\textsuperscript{157} A,D, Chandler, 1962
“The determination of the basic long-term goals and objectives of an enterprise, and adoption of courses of action and the allocation of resources necessary for carrying out these goals”

This definition gives a good guidance to what the concept of strategy is all about.

5.2.1 Typology of Strategies

What different types of broad strategies can be found in the organizational world? In our view a theoretical typology can never catch the complexity of the “real” organizational world. However we believe that typologies can be a good tool for analyzing the same. In this purpose we find Herbert and Deresky's typology of strategies very interesting and useful. 158

5.2.1.1 Develop strategies

Herbert and Deresky explain that these strategies are common to young business and center on exploiting new product and market opportunities. R and D are important both for products and innovations to production. The marketing strategy emphasizes search of market share and high risk taking. The financial orientation in this case is longer term with less concern with absolute cost efficiency.

5.2.1.2 Stabilize strategies

According to these strategies the firm seeks to hold its competitive position. This may be both through niche strategies and across the industry, and will be backed by strong brands and/or product specialization, with emphasize on high utilization. And also as stated by the authors’

158 Herbert, T. Deresky, H, 1987
continuous capital investment is highly necessary here to sustain high efficiency according to the authors.

5.2.1.3 Turnaround
Involves survival or rebuild. Typically, it requires tightened controls strategies to limit negative cash flows, rationalization of product lines and production capacity in the first hand. This may be according to Herbert and Deresky followed by new products, merger and acquisition or sell-offs, and perhaps new investment.

5.2.1.4 Harvest
Herbert and Deresky point out that this is a standard fix strategy with two subtypes:
Deliberate harvest which is a planned and longer term divestment in an orderly fashion. Here investment is kept to minimum necessary to sustain adequate returns. Market share is in favor of profits.
The emergent harvest, in contrast, results from unintended consequences such as failed turnaround or rapid environmental change such as product obsolescence and has to be executed

5.3 Competitive Strategy

Michael Porter provided a framework that explains an industry as being influenced by five forces. The strategic business manager seeking to develop a competitive advantage over rival firms can use this model to better understand the industry context in which the firm operates.159

159 www.quickmba.com/strategy
In any industry, whether it is domestic or international or produces a product or a service, the rules of competition are embodied in five competitive forces: the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among the existing competitors.\textsuperscript{160}

The strength of these five competitive forces together determines the ability of firms in an industry to earn, on average, rates on investment in excess of the cost of capital. The five forces determine industry profitability because they influence the prices, costs, and required investment of firms in an industry. Buyer power influences the prices that firms can charge, for example, as does the threat of substitution. The power of buyers can also influence cost and investment, because powerful buyers demand costly service. The bargaining power of suppliers determines the costs of raw materials and other inputs. The intensity of rivalry influences prices as well as the costs of competing in areas such as plant, product development, advertising and sales force. The threat of entry places a limit on prices and shapes the investment required to prevent entrants.\textsuperscript{161} The strength of each of the five competitive forces is a function of industry structure. Industry structure is relatively stable, but change over time as an industry evolves. According to Porter, firms through their strategies can influence the five forces.

\textsuperscript{160} DeWitt & Meyer, 1998
\textsuperscript{161} DeWitt & Meyer, 1998
5.4 Porter’s Generic Strategies

If the primary determinant of a firm’s profitability is the attractiveness of the industry in which it operates according to above, an important secondary determinant is its position within that industry.\textsuperscript{162} A firm positions itself by leveraging its strengths. Even though an industry may have below-average profitability, a firm that is very well positioned can generate great returns. Michael Porter has argued that a firm’s strengths fall into one of two headings: \textit{cost advantage} and \textit{differentiation}. By applying these strengths in either a broad or narrow scope, three generic strategies result: \textit{cost leadership}, \textit{differentiation} and \textit{focus}. The following table illustrates Porter’s generic strategies.\textsuperscript{163}

5.4.1 Cost Leadership Strategy

This cost leadership strategy stands for being the low cost producer in an industry for a given level of quality. The firm sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain market share. The cost leadership strategy usually targets a broad market. Some of the ways that firms acquire cost advantages are by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and vertical integration decisions.\textsuperscript{164}
If competing firms are unable to lower their costs, the firm may be able to sustain a competitive advantage based on cost leadership. Firms that succeed in cost leadership often have the following internal strengths:165

Access to the capital required to make a significant investment in production assets.
Skill in designing products for efficient manufacturing.
High level of expertise in manufacturing process engineering.
Efficient distribution channels.

5.4.2 Differentiation Strategy

The differentiation strategy calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition. The value added by the uniqueness of the product may allow the firm to charge a premium price for it. The firm hopes that the higher price will more than cover the extra costs incurred in offering the unique product.166

According to Porter, firms that succeed in a differentiation strategy often have the following internal strengths:167

- Access to leading scientific research.
- Highly skilled and creative product development team.

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165 Ibid
166 DeWitt & Meyer, 1998
167 www.quickmba.com/strategy
• Strong sales team with the ability to successfully communicate the perceived strengths of the product.
• Corporate reputation for quality and innovation.

5.4.3 Focus Strategy

The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation. The idea is that the needs of the group can be better serviced by focusing entirely on it. A firm using a focus strategy often enjoys a high degree of customer loyalty.

Because of their narrow market focus, firms pursuing a focus strategy have lower volumes and therefore less bargaining power with their suppliers. Firms that succeed in a focus strategy are able to tailor a broad range of product development strengths to a relatively narrow market segment that they know very well. 168

5.5 A Combination of Generic Strategies

It is important to notice that these generic strategies that we have presented are not necessarily compatible with one another. If a firm attempts to according to Porter, achieve an advantage on all fronts, it may achieve no advantage at all. 169 For example, if a firm differentiates itself by supplying very high quality products, it risks undermining that quality if it seeks to become a cost leader. For this reason Porter argued that to be successful over the long-term, a firm must select only one of these three generic

168 DeWitt & Meyer, 1998
strategies. Otherwise, with more than one single generic strategy the firm will be "stuck in the middle" and will not achieve a competitive advantage. There have been cases in which high quality producers faithfully followed a single strategy and then suffered greatly when another firm entered the market with a lower-quality product that better met the overall needs of the customers.\textsuperscript{170}

5.6 Organizational structures

There are numerous definitions for the term organizational structure and we have chosen to stress Hall and Sias description of it. According to the authors the structure is "\textit{the formal distribution of roles, the administrative mechanism which facilitate the control and at the same time the integration of the different activities.}\"\textsuperscript{171} While trying to tackle with the term organizational structure it is also important to understand that structure whether formal or informally defined has two aspects. It includes first, the lines of authority and communication between the different administrative offices and officers and second, the information and data that flow through these lines of communication and authority.\textsuperscript{172} As there are numerous definitions for structure there are also different types of structures in organizational context. The structures that organizations adopt are usually aligned to one of the five generic organizational structures. These structures are the \textit{simple structure, the functional structure, the divisional structure, the holding company structure and the matrix structure}.\textsuperscript{173}

\textsuperscript{169}www.quickmba.com/strategy
\textsuperscript{170}www.quickmba.com/strategy
\textsuperscript{171}Hall, D & Sias, M, 1980
\textsuperscript{172}A.D, Chandler, 1962
\textsuperscript{173}Clair Capone, 2000
The simple and functional organizational structures are described according to Claire Capone as centralized structures where all the important and long-term decisions are taken by top management. This means that top management will determine the rules and procedures that closely control and direct the jobs and tasks of managers further down the organization, which are responsible for the departments, products/services and markets on a day-to-day basis.\(^{174}\) However, the divisional, the holding and the matrix organizational structures are decentralized, having divisions/subsidiaries/project teams that have a significant amount of decision-making power and responsibility of their own.\(^{175}\) This states that cooperation and co-ordination between the divisions/subsidiaries/project teams and the board of directors are crucial if the spreading of power and responsibility throughout the structure is to work for the organization as a whole.

The more the organizations are growing, the more decentralized they seem to be.\(^{176}\) In large organizations it becomes impossible for management to have an overlook on everything that is going on. Decisions must be brought down to a lower level. Some have maintained that this perhaps is not directly caused by the size but rather by the formalization.\(^{177}\) Hence large organizations are more formalized than the small ones, and the formalization increases the possibility to delegate decisions.\(^{178}\)

The machine bureaucratic is characterized by centralized decision power and high degree of formalization because one manages and coordinates a

\(^{174}\) Clair Capone, 2000
\(^{175}\) Ibid
\(^{176}\) Hall, 1972
\(^{177}\) Ibid
\(^{178}\) Ibid
big part of the organization with written rules and procedures.\textsuperscript{179} To that, the machine bureaucratic organizations are often functionally specialized. The advantages with the machine bureaucratic are; clear responsibilities, predictability and a standardization that promote efficiency. The disadvantages are that the bureaucratic organization structure makes the organization rigid and makes it difficult to change.\textsuperscript{180}

A bureaucratic structure could have been correctly adapted for certain of time, but when the environment has changed and the structure is still maintained; it can become an obstacle for continuous growth.\textsuperscript{181} The organizational growth is however inhibited by a certain structure. The environment’s significance for the structure has been studied by Burns and Stalker.\textsuperscript{182} They resulted from the assumption that the environment is stable alternatively continuously changing. In a stable environment, the organization can establish huge amount hierarchical and functional units. The roles are well defined and coordination occurs in a standardized way, were planning and control are characterized by centralization.\textsuperscript{183}

The environment’s effect on an organization is however a function of dependence; a dynamic environment has more influence on structure than does a static one. Complexity and environmental uncertainty are inversely related, and the more complex the environment, the greater the decentralization.\textsuperscript{184}

\begin{itemize}
\item \textsuperscript{179} Jacobsen & Thorsvik, 1998
\item \textsuperscript{180} Ibid
\item \textsuperscript{181} Ibid
\item \textsuperscript{182} Burns & Stalker, 1961
\item \textsuperscript{183} Ibid
\item \textsuperscript{184} Jacobsen & Thorsvik, 1998
\end{itemize}
We will more thoroughly describe divisional and holding structures since these types of structures are the ones that have been officially in use at Krenholm since 1995.

5.6.1 The holding company structure

The holding company structure is usually found in large industrial corporations with a parent company acting mainly as an investment company acquiring and divesting smaller subsidiary companies. A company operating as a holding company will usually have a small corporate headquarters from which the parent company will conduct business. The subsidiary companies continue to trade under their own names, with the parent company either wholly owning its subsidiaries or acting as a majority shareholder in them. Subsidiary companies will operate independently of the head office, with all decision-making power and responsibility for their own performance resting with their management. Therefore, as the author would like to point out, the industrial corporations adopting the holding company structure are therefore much decentralized. However, the control systems implemented by head office will tend to center on the subsidiary companies meeting tight financial targets with regard to profit forecasts, profit margins and return on assets.\(^{185}\)

The ownership of a large number of subsidiary companies in a variety of different industries spreads the risk and profit for the parent company as a whole. The main potential disadvantage of the holding company structure relates to the subsidiary companies, which may view themselves as continuously up for sale. This type of situation relates to high degree of

\(^{185}\) Clair Capone, 2000
uncertainty and the likelihood of change can be difficult for the subsidiary companies to manage on a permanent basis. The other potentially disadvantage relates to the general fact that diversity is more difficult to co-ordinate and manage overall than simplicity, and so the holding company management face a more complex task.  

![Diagram of Holding Structure](image)

**Figure 6: Holding Structure**

### 5.6.2 Divisional structure

A company that has adopted a divisional structure contains separate divisions based around individual product lines or services. And the divisions can be based on the geographic areas of the markets served. One organization may contain some divisions based on product or service lines and others geographically allocated. However, one single division would not usually be based on both product and location. The divisional structure is as we mentioned above decentralized and as such a company with a

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186 Ibid
187 Ibid
divisional structure usually offers a wide and diverse range of products and services compared to a company operating with the more rigid and centralized functional structure.\textsuperscript{188} According to the author this means that the key benefit of a wide and diverse portfolio is the ability to spread either the general profitability of each division or as the author says ” the burden of the poor performance of one of the divisions by subsidizing it from the profits of the others”.

Management of this diversity requires the divisional managers to have short-term and medium-term decision-making power and responsibility for the division they manage. This however, allows the managing directors to concentrate on long-term planning for the organization as a whole. But there must be good communication and working relationships between the divisional managers and the board of directors, as short-, medium- and long-term decision making must all relate to each other and link together if the whole company is to move forward in the same direction.\textsuperscript{189}

The divisions in a divisionalised company will be cost centers or profit centers having to manage budgets, meet budgetary targets and operate within budgetary constraints. Divisions must also satisfy performance criteria relating to profitability and asset use, with profit margins and return on assets likely to be the key measures applied to individual divisions. The separate divisions within the same organization have an internal structure of their own. The potential difficulties with the divisional structure relate to the allocation of resources, overall co-ordination of activities and the cost of running separate divisions. The existence of competition between separate divisions and a very limited resource base may lead to conflict

\textsuperscript{188} Clair Capone, 2000
\textsuperscript{189} Ibid
between the divisions, as each separate division vies for the best possible allocation of resources.

FIGURE 7: DIVISION STRUCTURE

5.7 Organizational change

Change is basically a new way to think or act, something will be done for the first time or something old will be done in a new way. There are two

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190 Clair Capone, 2000
different ways to implement change according to Jacobsen & Thorsvik. The first is incremental change which has the nature of a more smooth process (evolution). The second is strategic change which is characterized by a more thorough change of the organization (revolution). The major difference between the two methods of change is the time aspect. An incremental approach occurs during a longer period of time, a small step at a time, as opposed to the strategic change which by nature has to happen much faster. A strategic change is necessary when an organization must go through major changes in a relatively short period of time.

Incremental- and Strategic change can be further divided into two categories: Proactive and Reactive (see figure above). If the change is based upon expectations that something will happen externally or internally it can be said to be a “proactive” change or if, on the other hand, the change

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191 Jacobsen & Thorsvik, 1997
192 Nadler & Tushman, 1990
193 Jacobsen & Thorsvik, 1997
is a reaction to circumstances that has already occurred the change is called a “reactive” change.

There are two dimensions of change with the character of incremental change that can occur. As can be seen in the figure above an incremental change that is proactive is called fine tuning and means that the organization based upon expectations, changes minor parts in the organization. An incremental change that happens after the fact so to say or adjustment is minor changes in the organization that is a reaction to something that has already happened.

When the change has character of strategic or revolutionary change there are also two different dimensions. The first is re-orientation that is a proactive response to something that is expected to happen internally or externally and is characterized by major restructuring in the organization. The second dimension is transformation which means that something has already happened which requires major changes in the organization for it to survive. An example for this may be a company in a major crisis.

5.7.1 Resistance to change

Change are often meet by resistance within an organization. In many cases this resistance is based upon the individual trying to defend something he or she believes is right and well known to them. Change may often require that individuals are faced with demands on new knowledge and capabilities. 194 An individual that has worked with the same type of work for some time has naturally developed capabilities tied to the day to day

194 Jacobsen & Thorsvik, 1997
tasks. The higher the degree of special capabilities tied to the tasks the higher the risk for resistance to change. Change also means that individuals must go from a situation that is well known to a situation that is unsure and unknown. This will also contribute to resistance to change.

According to Jacobsen & Thorsvik, implementing change in an organization means that pre-existing patterns of influence and power will also be affected. This means that some people will resist change in order to defend their influence and power that is coupled with the existing structure.195

5.7.2 Qualities needed in a changing organization

According to De Wit & Meyer there are three important qualities an organization needs in order to be able to implement changes.196

All employees within the organization shall strive for continuous improvements. The attitude of the individuals within the organization need to be that everything can be improved.

Individuals need to be motivated to continuous learning. Knowledge and capabilities among the personnel need to be renewed and upgraded constantly.

The third and last quality is that personnel must go through constant adaptations. When change is occurred in the external environment members of the organization must adapt. The structure and system in the organization must be flexible enough to handle this.

195 Ibid
196 De Wit & Meyer, 1998
5.8 Turnaround management

According to Arogyaswamy and Barker a *turnaround* situation can be defined as one where a firm suffers declining economic performance for an extended period of time and the actual level of firm performance is low enough that the survival of the firm would be threatened without performance improvement.\(^\text{197}\)

Turnaround management is usually applied to companies that are in great financial difficulties. In order for these companies to survive some extreme measures are needed and also sometimes taken. Wejke and Arpi compare a person in charge of a company in need of turnaround management to a doctor.\(^\text{198}\) Both professionals need to make a quick diagnosis of the illness and also find a remedy for the illness. The person in charge of the turnaround also needs to ensure that the patient goes through the prescribed treatment. The typical turnaround situation does not depend on an unpredictable and uncontrollable force over which the company has no control. Usually the situation has been developing during several years.

Situations similar to turnaround situations can develop as a result of other factors than mismanagement of a company. A similar situation can be a result of:\(^\text{199}\)

- Acquisition of a smaller company.
- A merger between two larger companies in the same business.
- Privatization of a state owned company with a large bureaucracy.

\(^\text{197}\) Arogyaswamy, K and Barker III, V, 1995
\(^\text{198}\) Arpi and Wejke, 2000
\(^\text{199}\) Arpi & Wejke, 2000
In these cases turnaround management is not the term used. Instead a number of different expressions are used:200

- Restructuring
- Cut downs
- Avoidance of double work
- The realization of extensive synergy effects
- The reducing of over-capacity in the line of business

However, no matter what terminology is used in these cases most of the actual actions taken are similar to typical turnaround cases.201

The present CEO of a company in need of turnaround management can often be blamed for a lot of the problems that exist in the company. Therefore it is very common that the board of a troubled company chooses to replace the CEO with either a new long term CEO or a CEO that is going to be working during the turnaround period.202

A consultant is sometimes placed as a temporary CEO in order to get the turnaround started. It is also very common to have a consultant working side by side with a new CEO in order to focus exclusively on problem areas. This gives the turnaround consultant a chance to:

- Problem analysis. Easier and faster to collect data about the company, its customers, markets and products.

200 Ibid
201 Ibid
202 Ibid
• Create a realistic plan of how the company should look like.

• Make a description of the turnaround plan.

• Help the CEO to create understanding and commitment among top and middle managers who are the people that will carry through the plan.

The turnaround in itself is accomplished when the company returns to a profitable level and is able to hold this level of profitability for a longer time period. Also important is that a satisfactory rate of return needs to be possible for the owners.

5.9 Strategy, structure and management in a Soviet Union context

The reason for the difference in business administration between Russian companies is except for cultural differences, completely to be found in the Soviet Union background with the planned economy system. This background has caused enormous differences in the outlook of Russian management, structure and strategy.

The basic reason for the great differences between management in planned economies and market economies is due to the fact that the plan economy is production oriented while the market economy is consumer oriented. As with so many things in the Soviet union an other planned economies the demand of the customer were theoretically supposed to be met by adjustments in the plans for the need and demand of the customer and so
on. This however was not the case, the plans never succeeded to adjust price levels and direct resources in the effective way that the market does. In this section we will describe management, strategy and structure as it took the shape during the Soviet Union period. Much has changed since then but without a doubt the traces from this time are still living. Maybe most so when it comes to management and lack of strategic thinking. It is very hard to go from a planned economy to a market economy. In the same way it is very difficult for Russian managers to change from being production oriented to being market oriented (consumer oriented). All the old experiences and routines are suddenly worth nothing. It is only natural that this transformation does not take place over night and that there are many obstacles to overcome.

5.9.1 Strategy

The strategy of the companies in the Soviet Union was of a kind that hardly ever can be found in a market economy namely a completely deliberate strategy. The strategy was prepared in detail on a governmental level and implemented at the company level; there was no freedom for the companies that allowed emergent strategies and abandonment of parts of the intended strategy.

The strategic thinking in a planned economy naturally has the character of planning. The closest thing to what we in west name strategy was the long term production plans. In the Soviet Union these production plans were not made by the companies it was made by GOSPLAN, fine tuned by a lower  

203 Hamilton, Isachsen & Gylfason, 1992
204 Ibid
specialized governmental body and implemented by the companies.\textsuperscript{205} The situation for Krenholm was illustrative for the system. GOSPLAN prepared a main plan of the production amounts of different textile goods. The Ministry of Light Industry in Moscow made the plans more detailed and finally the Ministry of Light Industry in Tallinn prepared the final detail figures for the production. The only role Krenholm itself played in this process of developing the strategy or production plan was to calculate what amount of raw materials, electricity, investments and so on that was needed to fulfill the received production plan.\textsuperscript{206}

In conclusion the strategy of the Soviet Era was characterized by deliberateness, long term planning and on the company level there was simply no strategic activity.

\textbf{5.9.2 Management}

In line with the fact that no strategic activity was left to the company, the management of the Soviet Union Company became operational short sighted and production oriented. Since there was hardly any freedom at all the manager became more of an implementer in the words of Lawrence and Vlachoutsicos.\textsuperscript{207}

The most important activity, all categories, for the managers in Soviet was the achievement of their given production plan, \textit{production quota}. The measurement of manager success thus was the fulfillment of the production quota.\textsuperscript{208} A managerial skill that was encouraged by the system was

\textsuperscript{205} Lawrence,P.R & Vlachoutsicos,C,A. 1990
\textsuperscript{206} Andrén,C,
\textsuperscript{207} Ibid
\textsuperscript{208} Lawrence,P.R & Vlachoutsicos,C,A. 1990
operational and technological. As a by-product of the economic system other skills and activities not officially promoted or allowed appeared. Negotiating skills and building of informal relationships deserves to be mentioned.

The Russian leader in fact became an expert on negotiating. The important thing was to get as low production goals as possible for your company. There was no incitements whatsoever for becoming more effective or exceed the production quota, exceeding it only meant that the next years production goal would be set on a higher level which would demand a higher effort but not any increase in the living standard of the employees or managers.209

To be able to get somewhere in the system, climb the latter; a manager had to be skilful in building informal relationships, have the right connections so to speak. The communist party and the union were two actors that the “successful manager” had good connections with.210

The lack of competition was very strong and thus most companies in Soviet was dependent on one single supplier, if this supplier did not deliver according to the plan there was catastrophically consequences for the measure of success: the production. Therefore enormous inventories were built up in Soviet which of course was very ineffective.211

What we have noted of management in a Soviet Union context is summarized well by Liuhto.212 He describes the task of the Soviet manager

209 Ibid
210 Kets De Vries, M, 2000
211 Hamilton
212 Liuhto,K, 1999
as taking place in two cultures. In the official management culture, the manager was a director responsible for the internal production and processes in the factory. In the unofficial management culture, soviet manager’s activities expanded from internal production supervision to struggling against the imperfections of the centrally planned economy.

Even if the management in some extent could be characterized as paternalistic during the Soviet era with duties of social obligations, care for the worker and so on the management in general took on an army like structure with rules and directives as tools for authoritarian managers/leaders. Except for the fact that the structure was of a classic functional bureaucracy this was mostly was due to cultural differences in the variables as power distance, power in general and so on. Cultural differences are however not within the scope of this master thesis.

Liuhto studied the long term organizational and managerial change in Krenholm and divided the managerial development of Krenholm into five phases. These phases and their characteristics are given in the following model:\footnote{Liuhto, 1999}
### Stages of Management Transformation

<table>
<thead>
<tr>
<th>Stage</th>
<th>Key Elements</th>
</tr>
</thead>
</table>
| THIRD STAGE OF REAL MANAGEMENT TRANSFORMATION (Late 1990s - ?) | **Strategic management**  
  - Management ideology – “do right things”  
  - Key issue – organizational effectiveness improvement  
  - Change type – profound type |
| SECOND STAGE OF REAL MANAGEMENT TRANSFORMATION (Middle of the 1990s – late 1990s) | **Operative management**  
  - Management ideology – “do things right”  
  - Key issue – internal efficiency improvement  
  - Change type – active change |
| FIRST STAGE OF REAL MANAGEMENT TRANSFORMATION (Beginning of the 1990s – middle of the 1990s) | **Crisis management**  
  - Management ideology – “a right to do things”  
  - Key issue – survival in market turbulence  
  - Change type – reactive change |
| PRE-MANAGEMENT TRANSFORMATION (Late 1980s – beginning of the 1990s) | **Dual management**  
  - Management ideology – “a restricted right to do things”  
  - Key issue – adaptation between planned and market economy  
  - Change type – ad-hoc change |
| PURE MANAGEMENT SOVIETICUS (Since the beginning of the soviet era – late 1980s) | **Command management**  
  - Management ideology – “no right to do things independently”  
  - Key issue – production plan abeyance  
  - Change type – cosmetic change |

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**Figure 9: The Transformation of Krenholm Manufaktuur.**

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214 Liuhto, 1999
5.9.3 Structure

The organizational structure of the Soviet Union Era was characterized by centralization and bureaucracy. More precisely the regular organizational structure during this period was a classic functional authoritarian bureaucracy. This structure fitted very well into Stalin’s Economic policy. He focused on heavy industry, technology and monopoly. With the building of huge industrial enterprises in combination with the planning system centralization and bureaucracy was according to Kets de Vries necessary.²¹⁵

The role model structure did not change over the years. The companies did not have any power or incitement to make any changes and with the stable planned economy there were not even any real pressures for change.

²¹⁵ Kets De Vries, M, 2000
6 Empirical findings

In this chapter we will present some of the empirical findings which we gathered during our interviews with the managers of Krenholm. Due to the complex diversity of our questions with spontaneous follow up questions, we have chosen to present these findings under three main categories: Structure, strategy and resources (tangible and intangible). We will within these three categories when possible present the major changes in a chronological order.

This must not be interpreted as an attempt to pre-analyze the findings, rather it is a measure taken in order to make the presentation easier for the reader to grasp. Thus the findings will be presented in a strictly objective manner and we will attempt to divide the findings in the three above mentioned categories. However there may be some overlaps since there are strong links between the three categories.

6.1 Strategy

In 1995 Borås Wäfveri became majority owner of Krenholm. In 1996 the CEO of Borås Wäfveri stated that:

“There is reason to see a future production area for the Swedish textile industry consisting of Sweden, Poland the Baltic States and most likely also the western part of Russia. In this area the advanced production and product development is
Since then more and more of the Borås Wäfveri production has been moved to Krenholm in line with the overall development in the textile industry with a movement of the production to countries with low worker salaries. Today Krenholm in turn are threatened by the production and future potential movement of production to Asian low cost countries.

As with marketing and other areas there were a lack of experience and knowledge in the Krenholm organization also about strategy and strategic thinking. This of course was due to the company’s history and the fact that strategy and strategic decisions were something that were enacted and given from above. Only short term production oriented planning was left to the managers at the companies. Therefore the development of strategy has gone hand in hand with the development of management. The first couple of years after 1995 the vital thing was to in practice rearrange the whole company. This empirical section will predominantly consist of the existing strategic thinking on the managerial level at Krenholm.

We will below only present the most interesting answers under different headings. We have chosen to present the empirical findings in this way in order to avoid a premature analysis. The empirical findings will be divided under five headings: Markets, Market segments and brands, Competitive advantage, supply chain and IFC.

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216 Borås Wäfveri’s annual statement
6.1.1 Markets

Krenholm is taking their first steps towards the Baltic States market. The starting point is Latvia and the capital Riga during the second part of 2002. During 2002 there are also plans to expand into the Eastern European markets. The next step according to the managing director at Krenholm is St. Petersburg and surrounding area in 2005. The largest question mark is the Asian market:

“...how to act in Asia after five to six year because we don’t know these markets today but most likely these markets will be very large. The problem is that we have to understand more of these markets and which market to choose to start it, maybe China or India etc. We have to do some research before we start to invest into these markets.”

6.1.2 Market segments, products, brands

Krenholm have chosen to compete in the middle price range segment of the market since this is the fastest growing part. The products they compete with are:

“...are with our Grey cloth on Industrial segment of business markets, mail-order catalogues and whole sellers segment for ready-made product.”

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217 Managing director of Krenholm
218 A manager at Krenholm
It is impossible for Krenholm to compete with a large production. That is with large quantities. This is considered a real threat by Krenholm management:

“... and I think this is really a threat. And one as they become better, as I have heard western companies build their factories in Asia, they put their western managers there and they have the know-how. Very cheap resources, so the threat can become stronger.”

Out of total produced products about 20 % is made up of Krenholm’s own design. Of total produced and subsequently sold about 5 % carries their own brand.

Krenhom has plans to differentiate their products and sell more of their own brand:

“...differentiation, we must sell more and more of our brand. We must do this kind of product that our competitors can’t do in such an easy way. And to do other products which are not so easily copied, but this everybody can do.”

The managing director is very pleased with the development of their own brand and also with the expansion of sales possibilities abroad for their brand:

219 A manager at Krenholm
220 A manager at Krenholm
“...About the brand, I am very happy about our good sales people in Estonia. This was fantastic how much they been able to develop our brands here and we could see to everybody lets say from top departments stores up to supermarkets, and if to look to home textile there are all the sales our products and so we have now product for sales to the Baltic states we done the first steps in the UK they the best home textile retail store network called British all stars we are selling our first products of our own brand.”

The managers are aware of the problems associated with introducing brands. One manager states that they have many nice products that they cannot sell. One possible reason for this according to the manager is historical reasons. Historically, Krenholm has been considered as a producer of cheap products in large quantities. But they still feel that they have come a long way since it was only a few years ago when they were producing only for capacity.

6.1.3 Competitive advantage

Asia and Asian producers are potentially very dangerous for Krenholm. It is very hard to compete with Asian producers on very simple, cheap products. It is therefore important to find new means of survival:

“...We must try something different, something more value-added, branded goods for example, something that requires good knowledge good developed system of work and of course servicing. At the moment the external buyers of yarn, indicator
of the market, as fast as they need bulk goods where time of delivery is not that important they buy in Pakistan or India you name it.

Krenholm is very aware of that they can’t compete with low price products. But they feel that they have a place on the market with other qualities and services:

As soon as there are needs for better quality, just in time deliveries and what is most important the responsibility of quality, because we are responsible for our quality, if there is something wrong we take claims. We have even paid for some of our customers their losses. As soon as that it is needed they turn to us.”

It is often discussed what good quality really is and the managing director of Krenholm had his own interpretation of that. This interpretation shows a very good customer oriented attitude:

“Agrred quality is our level of quality, let’s say very often people ask me what is your quality and I can only say good quality is agreed quality with the customer. I don’t know who in the world can do better quality then Krenholm, I don’t believe that anyone in the world can do better quality then Krenholm and vice versa.”

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222 A manager at Krenholm
223 Managing director of Krenholm
The managing director also states that high quality is the wrong way to compete in the industry. At least if the term “high quality” only refers to the cotton. A broader definition of high quality entails:

“...very high quality means maybe very good service very good logistics but not the quality of the product it is impossible for someone to make better quality then Krenholm. Cotton is similar if we in spinning process are using the similar best technology the same in weaving we all use the same technology from Switzerland and most of the companies are similar finishing equipment.”

A more extensive clarification of what high quality may mean was given and also an explanation to how Krenholm may survive despite a disadvantage when considering prices:

“Logistics and services all this is more and more important. If to look to the costs we can never compete with Pakistan. This is very clear not today and not tomorrow, in costs, but costs is not all. Lets say if we are a customer, every company in Europe is looking, because life is tougher, how to reduce their inventory our order lots are smaller and smaller and if they buy from Pakistan minimum lot is a container but a container of bed sets for example that is a lot. Container of table cloth is a terrible lot. And they have to give an order three four months before but only God knows what will happen in four months time how successful retailer will be able to sell stock out, if retailer made the wrong choice they will be out of stock or
wrong stock. From us you can order much smaller lots and with much shorter notice for example our largest customer in Finland department store network Anttila, they can call on Monday and say that we need to have next order in our stock in Helsinki at Wednesday two o clock.”

According to the managing director Krenholm has a very attractive quality/price ratio for the middle market niche. Krenholm also have a good flexibility with minimum quantity per order and swift reactions to customer needs:

“...Such criteria as product and service quality, production lead time, after sales service, positive experience of previous co-operation.” reliability etc. is playing quite an important role in building up Krenholm competitive advantage in the market.”

6.1.4 Supply chain

One way of competing with larger producers than Krenholm has been to establish supply chain thinking. This is currently going on in USA, Finland, Sweden, mid Europe. In mid Europe there are also plans to establish warehouses for storing of products. This will enable Krenholm to deliver goods 48 hours from the time the order is placed. This service is seen as very important for Krenholm:

222 Ibid
223 Ibid
226 A manager at Krenholm
“Because from Estonia it will take three to five days, this is too long. This means that on the competitive side this logistics is service in every meaning and service is a very big part of the quality we are giving to the customers. And IT because I also feel that if we don’t go through with this supply chain management very soon companies who are not able to work on IT orders from retails, retails will change the supplier.” 227

There are companies and areas whereas the co-operation is even more developed:

And also I would like to say that for example with Anttila we are developing today so called supply chain, we will have with Anttila agreed assortment with twenty different products that always needs to be in stock. Krenholm will have access to the software of the stock and the user will start to control and if stock is lower then the agreed level we will produce and ship. We are doing the same thing in South Carolina today concerning diapers.” 228

Krenholm have their own retail stores.

“We have retail stores in Estonia, we are planning to establish also in Riga. We have today two stores in Tallinn, two stores in Narva and one store in Tartu.” 229

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227 Managing director of Krenholm
228 Ibid
229
It is however nothing that will expand into a new line of business.

“*We will expand but mostly in the neighborhood since this is part dangerous to compete with our own customers. But in Estonia also shops are very important to sell our stock and it is very expensive to start shops in such a way you have to rent a place, find people etc. But when it comes to the products we only need to move part of the stock.*”

There are some plans to lower the spinning production and instead buy from other producers. This does not entail all types of yarn however:

“...*We will buy simple yarn that we can buy cheap on the world market and we will concentrate more on differentiate quality as fancy yarns. So this means in general to get free from low quality segment and this will start to happen already next year. I am not able to say how much but approximately we will produce 75% of the yarn for Krenholm’s production internally.*”

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229 Ibid
230 Managing director of Krenholm
231 Ibid
232 Ibid
6.1.5 IFC

As were presented in the structure IFC put a lot of other demands in order for Krenholm to receive the loan, financial, strategic and so on in connection to the loan. IFC had therefore had a great influence on the current strategies. Krenholm will also be under regular control in the following years in these financial and strategic matters.

“I would say the very top strategy is to follow everything what we agreed with IFC when we got the loan in December. It is not only a loan there is also a part on how Krenholm needs to develop, which product groups need to be attention next 8 years. We have financial forecast for 10 years now, so it's a huge work plus we are still in the implementation face of the investments of this loan. This is a very top priority.” 233

“In relationship to the loan the strategy and everything was made here, we also used Dutch consultants....” 234

“I think that Krenholm will fulfill its obligations this is the reason why I took the loan.” 235

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233 Ibid
234 Ibid
235 Ibid
6.2 Tangible and intangible resources

6.2.1 Tangible

In the Soviet Union period up until 1985 Krenholm did not enjoy any freedom in making material investments. Krenholm had to send written proposals of investments to the ministry of textile in Tallinn who in turn sent this to the ministry of textile in Moscow. The ministry of textile in Moscow then took the ultimate decisions of investments.\(^{236}\)

In 1986 however, in connection to Krenholm’s opportunity to export on their own, the company received full freedom in investments.

“\textit{Estonia got a special privilege from Soviet Union. It was called self finance, currency finance. We got the right to buy necessary equipment with hard currency we got from exporting our products...... We got this right in 1986 and in 1989 and 1990 we invested in equipment in about 5 million USD every year from our exports. Therefore we got some part of equipment which was able to produce export quality products}”\(^{237}\)

The following tough year from 1991 to 1995 provided no financial room for investments as the Estonian state owned Krenholm struggled for survival.

\(^{236}\) Andrén, C, Öberg, L, 1996
“In the beginning there was no hard currency in Estonia, it was more or less like a barter system. It means that if Estonia needs for example tires for tractors from Belarus we had to deliver our fabric at the same time and Estonia got their tires. We were continuing to deliver our products without any payment.... At that time of course we lost our working capital”\textsuperscript{238}

The serious situation that the companies were in was accelerated by the fact that external actors had no trust in Krenholm.

“The Krenholm company had no trust for example the company was not able to get any loans for working capital because the bank did not know what would happen tomorrow who would be responsible for all lets say obligations and so on same with sales to customer, no customer wanted to bring long term contracts to Krenholm, again no trust.”\textsuperscript{239}

When Borås became majority owner in 1995 the company had no raw material no marketing organization and more important in this context no working capital as stated earlier.

This was a turning point concerning the investments, Borås Wäfveri promised in their contract with the Estonian state that 12 million SEK would be invested in three years. This was outdone by far. As an example: up till the year 2000, 190 million SEK was invested.

\textsuperscript{237} Manager during the Soviet Union Era
\textsuperscript{238} Ibid
In relation to Borås Wäfveri, Krenholm has not enjoyed a total freedom in making investments.

“If to look to the investments we agreed in the beginning that when Krenholm is making investments in high amount that is one million EEK and more. I had to ask approval from the board, so I present these ideas to the board plus explain why the investment is necessary, what this brings to the company, what return we will have from it and how I'm planning to finance it”\textsuperscript{240}

In fact however the board has never so far rejected any proposals.

“Never, because I have to think: why should we? Before I present the proposal”\textsuperscript{241}

After visiting Borås Wäfveri’s spinning mill Kungsfors in Skene, Sweden, we for some reason expected that the equipment in Krenholm finishing would be older and not as sophisticated. In our first visit this belief was demolished when we were guided around the facilities and found that the equipment were at least as modern and more diversified then in Kungsfors. The diverse machine park can be traced to the fact that Krenholm uses both the Open-ended and the-ring ended spinning method. That the machine park was advanced and relatively new also seemed to be more or less the case for all of Krenholm’s factories. In comparison to other mills Krenholm thus does not seem to lag in technology.

\textsuperscript{239} Ibid
\textsuperscript{240} Managing director of Krenholm
“...Very high quality means maybe very good service very good logistics but not the quality of the product it is impossible for someone to make better quality then Krenholm. Cotton is similar. In the spinning process we are using the similar best technology the same in weaving we all use the same technology from Switzerland and most the companies have similar finishing equipment”²⁴²

6.2.1.1 The IFC loan

The investments are not decreasing at the moment. Instead Krenholm is now in the middle of a very large investment program financed with a loan from the IFC (World Bank). This loan of 25, 8 million Euro was granted to Krenholm in the year of 2000 after two years of negotiation, analyses and investigations and 19, 8 million Euro of it was marked for a three year long investment program. The CEO of Krenholm is very happy about this loan and the investments that it has made possible. Krenholm is still in the implementation face of the investments of the loan.

The whole investment plan was thoroughly worked out and that was a demand from the IFC.

” We had 16 investment project altogether with a estimated price for every single equipment, transportation cost to Narva, insurance cost, installation cost and training cost. Preparation, construction how to prepare room, in detail”²⁴³

²⁴¹ Ibid
²⁴² Ibid
²⁴³ Managing director of Krenholm
We have already noted that IFC according to several sources played a vital role in the change to a division structure. IFC put a lot of other demands, financial, strategic and so on in connection to the loan. On the other hand IFC also provide professional advising and knowledge in many areas. Our empirical findings concerning these aspects of the relationship to IFC will be described in the strategy section of this chapter.

The Investment into material resources during the years 1995 - 2002 has had a broad character. Machines, buildings, energy sources etc. The largest investment, which was made possible by the IFC loan, so far is the new sewing plant. The new sewing plant opened in August 1997.

“The most costly investment was the new sewing plant for sure, 57 million EEK. The boiler house (energy source, authors note) was a very big investment, 27 million EEK. We bought from Germany a quit expensive preparation line in the finishing. And we had so many investments only last year we invested altogether 205 million EEK in building, equipment and construction...”244

The new sewing plant was a strategically important investment for Krenholm. Sewing was before this increase in capacity somewhat of a bottleneck, with to low capacity in relation to the demand.

244 Ibid
“This was a bottleneck before, because in our very simple strategy we had to produce more value added products. In the beginning of year 2000 the capacity of our first plant was totally used. Therefore there were some months where we had 26 subcontractors in sewing and this made a lot of troubles. We were not able to control the quality, the delivery terms and we got all the claims from the customer it was these costs that were the reason to build a new plant. Nowadays we have 4-5 subcontractor, it depends.”

In general the managers seem to be very pleased with the material investments that Krenholm has been taken. This is illustrated well by the following first words from the CEO while asked what the opportunities of Krenholm are.

“If to start from the production and markets I am very glad that we been able to invest so much for the future....”

6.2.2 Intangible resources

6.2.2.1 Management

By their research on Krenholm in 1995 Lindahl and Olsson concluded that much of the old way of thinking still remained among the managers. There had thus at that point not been any fundamental change in the way of thinking at Krenholm. A sign of that was that most of the people in the organization at this time talked in figures of production and not in figures of sales or profit. They always talked about how much they produced or

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245 Managing director of Krenholm
246 Ibid
how much they are able to produce, but very little about what they are able to sell.247

At this time in 1995 several measures were taken in order to change the management of Krenholm to a market oriented and more efficient one. Borås Wäfveri changed the managing director and some other managers. The new managing director was Estonian and had received part of his business education in USA. Further on the structure were as we know changed to a holding. Training in the form of courses was also introduced and Mercuri was hired to specifically learn the top managers about the market economy and western business concepts.

6.2.2.2 Training

The Mercuri training program entailed broad business areas as management, marketing, production accounting etc.

“**In the same way as product development has been emphasized all these years so has also training been, already in the middle of 1995 we started real long term training program to all our top managers. I still remember that my first own training was from Mercuri International. It was for six months in Narva and say every second week two days. Management, leadership, marketing and accounting. I don’t think that from August in 1995 until this day we had any day at Krenholm with no training there is always something going on.**”248

The managers seem to be pleased with the result of the Mercuri training program.

247 Lindahl, C, Olsson, J 1995
“I think it was a development for these persons because they had worked in another kind of situation they knew less about the market economy and how to work in it and so on. So this was a possibility to give them knowledge on how to work in this situation…..the training program helped a lot to change the mentality”  

We got the impression that the managers in some extension still uses the Mercuri course material as a help in their work since we saw many Mercuri maps in central positions in the manager’s bookshelves.

Except for the broad management/ business administration training there has been and still is extensive language education.

“We have also spent a lot of money on language training, mainly English and Estonian.”

As is self evident with the management courses the language training has also been focused on the managers.

”The training is for the managers and is quite expensive. To train the worker in languages would be far too expensive and today we don’t have big training program like the Mercuri program. Sure we think about training program of middle
managers and today there are some consultants and one part of the work is also training program."  \(^{251}\)

The language question is also connected to the explanation we get from the managers when asking them why the tendency is that more and more of the top managers are Estonians compared to Russian-Estonians. The explanation is that in order to become a manager of Krenholm one must be able to speak at least three languages English, Estonian and Russian. Estonian –Russians unwillingness and difficulties to learn Estonian and the demand of a passed test in Estonian in order to get an Estonian citizenship is a socio cultural problem that causes tensions in Estonia and not the least in Narva.

“This is a 100% Russian company, 10 Estonians and 5000 Russians. We have some complains from our trade unions. We are not looking at people by their nationalities. We are looking for people who speak English and of course are able to read and understand Estonian. The problem with the Russian people is that they in general don’t speak other languages. They say “let’s get translation and the problem is over” but it is not. These Russian people they don’t qualify. In Narva all the talented, Russian people leave. It is a society problem. It is a quite sensitive and very bad question because it is impossible to import all the managers from Tallinn.”\(^{252}\)

\(^{251}\) A manager at Krenholm  
\(^{252}\) Managing director of Krenholm
The recruitment of managers is mainly from outside of the company even if there is a possibility to “climb the latter” inside Krenholm.

“If we on the inside of the company can find middle managers with capabilities for development the possibility is there. But sometimes we have the problem that it is not possible to find people inside the company and then we start look outside.....Today it is hard to find inside and outside also253.”

It is difficult to recruit new skilled and experienced managers to Krenholm. The main problems when recruiting a manager to Krenholm is languages the mentality of the person and that the person must be willing to move to Narva.

It must be clarified that there is no problems with the internal communication due to language problems. The problems and need for three languages is caused by the external contacts.

“All workers who work here speak Russian and usually also the persons who want to come to work at Krenholm they know that the area is Russian speaking and that mean that they need Russian and they don’t start to be a candidate if they don’t speak Russian. However to communicate inside Estonia with clients suppliers, owners and other foreign contacts that is a problem254.”

253 Personell manager of Krenholm
254 Ibid
6.2.2.3 Transfer of knowledge

The transfer of knowledge from Borås Wäfveri to Krenholm seems to have been rather modest. In managerial and strategic questions Borås Wäfveri have had a guiding role in that the board for example as noted earlier has to give approval to major investments? Krenholm seems to have enjoyed a rather high degree of freedom but valuable knowledge in management and strategic issues might very well been transferred through the board. The managing director wants to use the board as advisors

“If we look to the start this was actually our agreement, that they (Borås Wäfveri), authors note) don’t want to be involved and that I could look to the board as advisors...If we speak about strategy, when I show what I am about to do sometimes in a board we maybe decide a little bit differently what is priority one, two or three so this means I am very glad I always said I want a clever board I want to use the board as advisors” 255

The relationship with the IFC has provided a new source of knowledge with professional consulting opportunities and access to information and knowledge in many areas.

“IFC is much more then a bank, because no matter what kind of advising I need I will get it. The IFC has much easier to get different information. They have access to information channels which are not open for regular companies. For example we have been thinking about building up our own combo-station. We were not sure if this was the right step to do so I wanted
someone to evaluate this project so in January I asked help from the IFC.
In March a professional guy from Washington came for a week and we will have a report in two weeks now.”

The IFC also opened up for knowledge transfer on the operative level.

“…Top guy, his name is Peter he’s a 60 year old textile professional, he knows all the work and technologies. When we got in little bit of problem to get this loan our manager said that “Meelis you have got to sign this agreement this is the only way that Peter will start to visit us regularly.” We needed him so they valued him this highly.”

The transfer of operative knowledge from Borås Wäfveri has mainly consisted of one consultant in retired age that has visited Krenholm frequently since 1995. He has worked on quality programs, for example a bonus system. Planning system in the different factories and so on. There have been some other consultants working with the operative business of Krenholm but not on a regularly basis. When we held our interviews there was an independent consultant from the USA working for one month with improving the salary and personnel system. Some of the managers expressed the view that there was a satisfying transfer of knowledge while other did not think so.

“We have good teachers from Sweden. It is very important that we have persons with big experiences.”

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255 Managing director of Krenholm
256 Ibid
257 Ibid
258 A manager at Krenholm
“The Swedish company has very good technology persons and we need them as a helper. It is a good idea to have a connection with Borås Wäfveri.” 259

On the other hand we also received comments like this one:

“The knowledge could be more transferred to Krenholm. The Swedes have very good knowledge... We want to use their know-how, but this is very difficult. You see that is very sensitive.” 260

6.2.2.4 Pressure from the environment and from within

An often expressed during our interviews was that different challenges from the environment and the freedom and own responsibility in the market environment brought with it a positive development of Krenholm.

“Every budget I presented for the next year to the board was always accepted. For us this was “terrible” because we also got an obligation to follow it and there was nobody to blame. We made the budget ourselves and we had to fulfill it.” 261

An intangible resource that immediately was developed in response to the problematic socio-cultural environment in Narva at the time of the takeover was a security system. There were great costs of stealing inside the company and organized crime elements approached Krenholm. The

259 A manager at Krenholm
260 Ibid
261 Managing director of Krenholm
newly appointed managing director received some very unpleasant threats, but decided to stay and fight. He believes that these criminal activities even helped to develop Krenholm.

“This helped a lot to improve the company. We organized very fast a good security system. I believe in 46 month time we were able to stop all the organized stealing that was before, for example. I closed the cash funds in two months because I was afraid of stealing. Before all of the salaries were paid in cash. We went really fast to a situation were all of the cash transactions went via the bank. We were one of the first big companies to do so. In the beginning there were some voices against it but now everybody is satisfied. By agreement with the bank we have this cash automate at the main gate of Krenholm. So these criminal activities helped to develop Krenholm because I was so afraid......So for 46 month it was so hard then it stopped and it has never started again.”

In the same way the managing director believes that the tough period caused by the crisis in Asia was positive for Krenholm in the sense that it developed the company.

“After this crisis all the prices went very much down and we took here the very important decision that we don’t want to play on this unstable market and we will not sell our products at so low prices and we just stopped partly of our production. We produced less and we fired a lot of people. We altogether made
so many changes and as I told made Krenholm much stronger. Sometimes these tough years are very healthy for the company.”

Other parts of the company that has developed as an answer form the pressure of the market economy are product development and sales offices.

“In my opinion up to 1995 there were no marketing activities just traders from other companies came and found Krenholm. Already in 1995 we started to change this policy; we started to make our first investments into product development which today is a continuous process. I can’t imagine that we could not have these costs. I believe that we every year invest around two million Euro. We also started to establish and continuously develop our sales offices abroad. This started in august 1995 when we started a sales office in Sweden for the Scandinavian market. A second sales office followed in 1997 in Hamburg, Germany and today we also have a sales office in London. This year we plan to open a sales office in Holland.”

On the whole we also got the picture that the Krenholm manager is very optimistic about the situation and the future.

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262 Ibid
263 Managing director of Krenholm
264 Ibid
6.2.2.5 Development of the management of Krenholm from 1995 to 2002

If we look at the general picture we get from the overall management of Krenholm it seems to be clear that there has been an enormous change since 1995. This is not surprising since Krenholm at that point where in the beginning of an overarching change to a market oriented company. Forces behind the changes are education as dealt with above. The structural changes and off course a constant pressure from the environment.

A key role in implementing structural as well as overall changes has naturally been played by the managing director of Krenholm. In playing this role he had to work against the common pressures against change that exists in all organization.

“*It was very hard to change because this was a new work area.....I was a strong hand because so many people said why? It has always been like this! I would say mainly 97% no difference between countries don’t like changes.*”

During our time at Krenholm we never heard a single negative or doubtful comment about the managing director personality or capabilities. Rather we got a lot of positive remarks from the managers of Krenholm. Borås Wäfveri is very pleased with him and he seems to be respected by the workers even though he’s not Russian-Estonian.

“The managing director is very social and communicative. He has a good philosophy and is intelligent, he is very attentive and it is easy to work with him. Estonians has other mentality
than Russians has, maybe it’s easier for them to communicate...The result is good when the Estonians and Russians work here in Krenholm.”

The question is to what extent all these different factors and changes in turn have changed the managerial resource base of Krenholm? We have already noted that the managers themselves found the Mercuri training fruitful. It is also clear that the change to the holding structure according to our interviews actually did cause the managers to focus more on profit and result than was the case in the earlier production oriented times. It helped to fast introduce market thinking notwithstanding the problem with sub optimization. In 1995 Krenholm had no real marketing organization whatsoever. This have of course changed and there is presently a well developed marketing division. The effects of the pressures to perform by themselves and by the environment are of course impossible to measure. What then can in more detail be stated about the management of today? Well let’s start with what the managers think themselves and then continue on to a simple comparison we have made in relation to the picture that is given in Lindahl and Olsson’s research from 1995.

Every manager we spoke to seems to be thinking that the management has gone through a very positive adoption towards market thinking and western management practices.

“..Capitalism started in Krenholm in 1995. I think that now everybody in Krenholm thinks about selling, not about

265 Managing director of Krenholm
266 A manager at Krenholm
producing. Before that Krenholm focused on production, now they focus on sales."

On a direct question whether he is confident that the managers can work efficiently in a market economy, the managing director gave us the following answer:

“Yes I think so. I can’t say that I am 100% satisfied but I have meet managers from many different countries. I saw so many textile mills in the US and Europe and if I compare managers then I am satisfied. In Estonia it is really difficult to get a really good guy to run an industry I know it is the same situation in Sweden for example.”

Many of the interviewed noted however that there are some traces of the old mentality left in some cases and that for example a person that has worked for a long period in the planned system even 10 year may not be enough to completely erase the old mentality. In one interview we could note that there were mixed signs of both old and new thinking.

“The explaining for the successful development of Krenholm is that we have a huge capacity and good knowledge of our technical specialists, because we produced some fabrics earlier in Soviet times and we remember what kind of fabrics we can produce.”

267 A manager at Krenholm
268 Managing director of Krenholm
On the other hand the same manager notes that:

“But I am very positive. Because if you see our collection of Krenholm you will understand that when the exhibitions show our collection, (Krenholm won several prices in a textile exhibition in Frankfurt, authors note) I am very proud of it. It is excellent collection. I am sure that we could be in the market.”

Lindahl and Olsson noted that in 1995 the managers seemed to have only a vague understanding of the difference between the concepts of strategies and plans. In order to be able to make a comparison of the understanding and view on these concepts in year 1995 and 2002 we simply asked the respondents if they felt that there was a difference between plan and strategies. The answers in general showed a good understanding of the concepts but in some cases the answers indicated that there are still remains of the old way to think. In other words a certain bias towards short term production oriented planning.

The following answers are some of those that were able to distinguish between the concepts. There is however a risk that some answers were prepared in advance since we distributed the questions to the respondents prior to the interviews. This could mean that one or more managers do not correctly understand the difference even though their answers imply that they do. One manager for example had prepared answers and even had them written down. There is no way for us to determine if this manager or other managers had prepared the answers by themselves.

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260 A manager at Krenholm
270 A manager at Krenholm
“Yes, there is a difference; the plan is what we do every day according to our business plan. Strategy is the development of the company for some period some years, global objectives. Plan is what we have to do and strategy is development.” 271

“My opinion, my personal opinion is that strategy is one part of planning, strategy also has a goal we have to reach, and we want to reach. Maybe there is a part of long term planning I think.” 272

“Yes I see the difference. Strategies this is the idea and the purpose of what we need to receive, but the plan means the specs what we have to do.” 273

“Well the plans should be according to the strategies so there is of course a difference. Strategy is something that is for a longer period and plan is something that you do according to the strategy in order to achieve the goals that you set up for yourself by the strategy and if you look at how does it goes here it is difficult to say. The strategy of Krenholm what is it? The vision of Krenholm, the overall goal, is to be customer oriented and constantly developing European Textile Company in technology, work culture, product development and management.” 274

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271 A manager at Krenholm
272 A manager at Krenholm
273 A manager at Krenholm
274 A manager at Krenholm
The following quote is from a manager that judging from his/her answer does not clearly understand the difference between the concepts.

“For me strategy is also a part of planning, common plan. Plan how to reach goals.”

6.3 Structure

As mentioned earlier in this thesis Estonia gained its independence in 1991 and at this time Krenholm was organized in a centralized, functionalistic, departmentalized and administrative structure that had been the dominant structure in the Soviet Union system. Some internal changes however occurred in the sense that Krenholm in a small extent got in direct contact with external customers in 1986.

“Krenholm fortunately started to export products several years before the collapse of the Soviet Union. Thanks to the power of the minister of light industry Estonia got a special privilege from the Soviet Union. It was called self finance, currency finance.”

At this time Krenholm were allowed to export their products directly and not through export companies in the Soviet Union as had been the case previously. And this was seen as important since this meant a first chance to get in contact with western companies.

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275 A manager at Krenholm
276 A manager during the Soviet Union era
“We got the right to sell our products or export. Not through export companies of the Soviet Union but direct.”

Even though the privilege did not lead to any real changes in the structure of Krenholm it did however give management at Krenholm valuable lessons about exporting and competing with market economy companies.

“I can say it was the best old time for Krenholm this Gorbatjov time because at that time we started to export very fast. Of course we started from zero, because we were absolutely not experienced in this because previous years all sales were organized only through export companies. This means that Krenholm sold to a Soviet export company this company paid by rubles not by hard currency. We never knew who real customer of our products is. That’s why of course we needed time to get some experience but we started to do it very fast.”

However important this was for Krenholm it was not a major change in the overall organizational structure. The first attempt to a major change in the organizational structure was made in 1993. In order to raise the level of efficiency factories were made more independent and given the right to change their own internal structure. Every factory was charged with the responsibility to calculate revenue and cost, a profit responsibility. This attempt proved to be unsuccessful and after nine months the old structure was re-introduced.
"I try to establish more or less the same system, holding system (as in 1995, authors note). Of course it was not holding system but I try to establish systems were every mill will calculate revenue and cost, revenue and cost. It was extremely difficult." 279

In January 1995 Krenholm Holding Ltd was founded by Borås Wäfveri AB and the Estonian state. Borås became the major shareholder with 75.5% and the Estonian state kept 24.5% of the shares. This company took over the operations previously conducted by Kreenholmi Manufaktuur.

6.3.1 The holding structure

Soon the first major organizational change was implemented. At the time of the change in ownership of the company the organization had almost ran out of raw material and capital. Furthermore was there no marketing organization but a classic organization of soviet model. In order to change the production oriented structure that had been pre-dominant into a more market orientated structure the company was divided into a holding company and six subsidiaries. These six subsidiaries were supposed to act as independent companies both externally as well as internally. There seems to be no doubt among the managers that the initiative to this change into a holding structure came from Borås Wäfveri. The newly appointed CEO was charged with the task of implementing the holding structure.

"On lets say my first workday one shareholder came with me, introduced me to the managers, made this organization chart of what he wanted to see and said good luck and left." 280

279 A manager during the Soviet Union era
280 Managing director of Krenholm
The main idea according to Borås Wäfveri was to force top- and middle management to absorb the ideas and principles of a market economy. This explanation can also be found among the managers.

“Main idea of holding structure is the change to market economy thinking.”  

“I think it was a way of teaching people for the changes.”

“During those years the structure was correct, because each company studied how they need to manage of costs, of money, of sales, of planning, because we must receive this information to this knowledge.”

There are however other reasons for the change into a holding structure that doesn’t conflict with the idea of educating managers about principles of the market economy. The organizational structure before 1995 did not support analyses of cost and revenue efficiency simply because it was so large. It was therefore necessary to divide the company in order to give the management a chance to more clearly identify problem areas.

“We started pretty fast to change all this huge organization. This was one big company just different mills so we went from this huge company to a corporation. For me this was also an early way to understand measurements because before we had

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281 A manager at Krenholm
282 A manager at Krenholm
283 A manager at Krenholm
only one management, the Christmas three organization. I did not get anything; I did not understand where we lost money.”

“This was one main reason because also lets say all this spinning, weaving, finishing, sewing these are totally different…”

This view is also shared by the managers.

“I think to get better control. To do about results of the division, because it was so big system and difficult to control it and this way it was better to understand what happened in one place and in another place and also control it.”

According to some managers the structure that Krenholm called a holding structure was not a real holding structure since it lacked some important ingredients.

“You know frankly speaking it was never a real holding structure, it was only intention of our shareholders but in fact holding structure means that every company has their own account and have the power to get the money, sell and spend. In fact of course all money which was coming to Krenholm from different sources, from spinning, from terry, from textile all this were collected at one point by finance department.”

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284 Managing director of Krenholm
285 Ibid
286 Manager at Krenholm
287 Manager at Krenholm
Lindahl & Olsson also states in their master thesis that the changes in the structure in 1995 were most paper changes. The people within the organization did not feel that anything had changed.  

The structural change also brought problems. It is clear when the managers got more independence coupled with a responsibility for profits externally and more important internally they lost sight of the overall goal. For the individual manager it was more important to show good results for their own company rather than Krenholm as a whole. Negotiations about internal prices brought with it relatively large costs. The responses from the managers make it obvious that this was a recognized problem. When asking one manager if the purpose of the holding structure was fulfilled the following answer was given:

“Yes, but every medal has two sides.....Of course this holding structure, how to say, people only see their own target not the general target for the company. And now we also have not only disputes but discussions how to say it not so good connections between mills.”

“Everybody tries to hold the blanket.”

Even if there were problems with the holding structure during this time most managers agree that implementing a holding structure was the right thing to do. Most managers felt that they needed to learn how to operate in
a market economy environment and that this holding structure gave them the chance to learn just that.

“During those years the structure was correct because each company studied how they need to manage of costs, of money, of sales, of planning, because we must receive this information to this knowledge.”

The holding structure was not only a tool for helping the managers to adjust to new conditions but also a way to get a more transparent organization. As previously mentioned the organization was very large and it was hard to identify where problems were. With the holding structure the management was given the chance to more accurately see and act upon problems.

“...It is much easier to find our bottlenecks now. We see where we have to act.”

The holding structure with internal pricing and so on was however not satisfying for CEO Meelis Virkebau. The strong focus on the profit of the individual companies became more and more troublesome. What you measure is what you get was something that the CEO became very aware of.

“Yes, everyone (the managers of the separate companies, authors note) is looking first to their own interest.”

291 A manager at Krenholm
292 A manager at Krenholm
293 A manager at Krenholm
“...I need that all the managers will focus on the group results not their own.”294

6.3.2 The division structure

In 2001 the holding structure was changed into a divisional structure. During the interviews several different reasons for the change emerged. One reason was that Krenholm had been negotiating with IFC for some years in order to get a substantial loan. According to some respondents one of the demands of IFC was that Krenholm would become a divisional structure instead of a holding structure. The reason for this was that it was difficult to see who was taking the loan in a holding structured organization. Was it holding, terry, sewing and so on that would be responsible for paying back?

“It is very easy to explain, maybe you heard that Krenholm got very big loan from IFC. Of course when the negotiations between Krenholm and IFC took place they asked who would be responsible for this credit, who will pay back? Of course Krenholm will pay back. Not Krenholm because you are in different companies.”295

There are however other opinions about why the structural change were made. Another opinion was that the internal pricing system associated with

293 Managing director of Krenholm
294 Ibid
295 A manager at Krenholm
the holding structure sometimes produced counterproductive results and sub optimizations.

“Before this division thing the managers had a possibility to make profit for their own companies. After the restructuring we thought about whole of Krenholm. Sometimes before the restructuring we didn’t produce orders because it was not profitable for us even if it was profitable for whole of Krenholm.”

Yet another opinion in a way was that the change was only a change on the paper and not a real change. There was no difference after the change had been implemented and that problems still remained. According to one manager the only change was employment contracts for the workers and that nothing changed other than that.

“In 2001 they made this change in contracts between worker and office and all contracts were made now as a worker from Krenholm Valdusi instead of weaving, terry, spinning and so on.”

“In 2001 when there was a restructuring of Krenholm they made an explanation that nothing would change in work, just
that the contract was between Krenholm Valdusi and the divisions."²⁹⁸
7 Analysis

7.1 Strategy, structure and change

We find Chandler’s investigation into the historical relationship between strategy and structure in American companies very useful as a tool for analyzing the development of Krenholm. Above all this is thanks to his famous model that depicts that the evolvement of the environment and resources of an organization influence the evolvement of the chosen strategy which in turn determines the outlook and changes in the structure. Thus in our belief this model is an excellent frame for trying to grasp and understand the overall development of a company both over longer time spans and during more specific transition processes. This is also how we will use it.

The companies that Chandler studied were all Industrial enterprises. He defined an Industrial enterprise as:

“A large profit oriented business firm involved in the handling of goods in some or all of the successive industrial processes from the procurement of the raw material to the sale to the ultimate customer.”

With this definition, without doubt, Krenholm is an Industrial enterprise in Chandlers meaning which enhances the usefulness of his investigation four our purpose of analysis. In one important sense though, Krenholm has not until recently fulfilled this criteria; It has for much of its lifetime been “a
large production oriented company”. This leads us to yet another interesting dimension in using Chandler’s investigation as a frame for analyzing Krenholm, namely the development of Krenholm with its background in the Soviet Union compared to the general development of the Industrial enterprise of the United States. Our analysis will follow a chronological pattern where we will deal with some major chapters in Krenholm’s development with a more general analysis of the early years that constitutes a unique background and a deeper one of the years from 1995 to the present time.

7.2 The development of Krenholm in the period of 1944 – 1986

7.2.1 Growth of resources

We start our analysis in the year of 1944. As we noted in the company description Krenholm, at this point was in ruins, after WWII and became owned by the Soviet Union. Krenholm was rebuild as part of Stalin’s economic policy and if we borrow a term from Chandler we can state that money, men and material poured in to the expanding Krenholm, and turned it into a gigantic Industrial enterprise. Unlike the huge companies in the United States the growth was policy driven not profit driven.

In some aspects, the development of Krenholm had much in common with the first chapter of the American Industrial enterprise in the sense that resources were accumulated and unit costs could be lowered through high volume production for the large market. The development of the resource

290 A,D, Chandler, 1962
base of Krenholm however was in many aspects completely different then the one of a growing American enterprise. Tangible resources as machines and buildings should not have differed in any great sense but in the intangible resources of human skills Krenholm developed a much narrower knowledge base.

The managerial resource base as we noted in our frame of references was more of a” implementer resource base” since the management of the Soviet Union Company was operational short sighted and production orientated. Strategy was taken care of by GOSPLAN and even material investments were decided from above. Liuhto labeled the management during these years as “pure management Sovieticus” with no managerial right to do things independently and noted that the organizational changes in these periods were of a cosmetic type.

7.2.2 Organizational structure

The first Industrial enterprises in the United States in fact invented the Centralized functionally departmentalized administrative structure in response to the need to apply resources effectively to changes in short-term demand.

A similar invention of an organizational structure would in our opinion rarely have occurred in the planned economy of the Soviet Union, there was no incitements to reduce unit costs by rationalizing the several functional activities and these did by no means have to be closely coordinated to market fluctuations since the output were determined by the GOSPLAN.
However long before the Second World War the centralized structure was there; ready to be used by any organization who wanted to. In practice this structure of the second chapter of the American Industrial enterprise, of course differing in internal efficiency and external flexibility, came to be the ruling one for the rest of the Soviet Union era. This was also true for Krenholm for the rest of this period 1944 - 1986.

If we put the history of Krenholm into Chandler’s dynamic model of strategy and structure it is easy to see why the structure was static for such a long period. First of all strategy was an unfamiliar term to the managers of Krenholm they were simply managing the operative business, every longer term decisions for the company was given from above. Nor did the stable artificial and planned environment of Krenholm put any pressure on changes.

Hardly surprising the resources of Krenholm did not either push towards change. In the same way as with the strategy the material resources were not even free for Krenholm to develop Changes that would have been possible for Krenholm in relation to the authorities would have been internal ones. That is rationalizing the functional activities and become more efficient. Krenholm’s intangible resources however were of technological and operative art and the management should in line with what was typical for the Soviet Union manager been focused on getting as low production goals as possible. In practice this was so because of the fact that there were no incitements for becoming more efficient. All this circumstances that spoke against change of structure and change in general can be coupled with the fact that a bureaucratic organization structure in itself can make an organization rigid and difficult to change.
It seems as if there were simply no pressures for changes in the organizational structure and not very surprising in reality there was no changes. But were changes in this period even necessary seen from an efficiency perspective?

Chandler found that in the third chapter of the American Industrial enterprise many companies moved on from the centralized functional structure because of pressure from the environment and development of new strategies. We found it as obvious that there was no pressure on Krenholm to do the same, but were there even a need for that? Well the evolvement towards a multidivisional structure in the US was driven by the strategy of diversification and Chandler noted that in enterprises whose products and processing were based on highly complex technology, both skills and facilities were most easily transferred to new lines of goods. Moreover he stated that:

“Where a company’s resources were invested more in marketing than in raw materials or producing facilities, the opportunity for diversification seems to have been greater”\(^{300}\)

This coupled with the fact that the textile industry as such in our view historically has been a stable one, with low complexity and uncertainty implies that a mechanical structure seem to have been appropriate. Thus, even if Krenholm would have operated in a market economy a centralized functional bureaucracy would probably with due cause have been the appropriate organization structure.
Thus the lacks of development during this time were rather of internal characteristics than connected to the overall structure. With internal characteristics we mean what really happened in side of the organizational chart and the different functional activities. There were no incitements for efficiency.

7.3 The development of Krenholm in the period of 1986 to 1991

As we noted in the company description Krenholm from 1986, to a very limited extent but still, got a certain insight into what a market environment entails and demand.

The company got the opportunity to export their goods in an independent way. Moreover the company got the freedom to decide of their own investments. The company no longer had to get an approval from the textile ministry in Moscow.301

The importance of these changes must not be overstated. In some extent it prepared Krenholm for the abrupt changes in the environment that were to come. However in comparison to the extreme revolutionary change of the environment that were to come this small contacts with the conditions of export to market economies and a material development of the resource base was almost of microscopic proportions.

Liuhto reflects our analysis in that he labeled the period of the late 1980: s to early 1990: s as a “pre – management transformation were the

300 A,D, Chandler, 1962
management got a restricted right to do things and started a small adaptation between planned and market economy.

Put into Chandlers model one might conclude that a small change in the environment in form of small contacts with the market economy and a certain degree of freedom affected the managerial resource base. This in turn affected how the strategic freedom of investments was used. After the endless years of the same outlook on our areas of interest environment, resource base, strategy and structure things started to change, not in a revolutionary way but still. Liuhto states that the change of this type was of an “ad-hoc” character.

7.4 The development of Krenholm in the period of 1991 to 1995

In the difficult transition process of Estonia Krenholm faced its hardest time ever as seen by this statement from Krenholm’s managing director at that time:

“It was extremely tough, extremely” .....” I don’t want to remember.”

Krenholm was struggling to find new customers as the companies’ financial crisis got deeper and deeper. In practice one might describe the situation as Krenholm trying to keep it self floating while the Estonian state searched for buyers. Privatization seemed to be the only rescue.

301 Lindahl, C, Olsson, J
In our view all the different difficulties that Krenholm faced in this period came down to one simple reason. There was a complete mismatch between the firm’s resources and its environment. The revolutionary change in the environment called for changes in the strategy and internal changes in the structure but the intangible resources simply did not aloud for this. The managerial and overall knowledge base were so strongly influenced by the old procedures and thinking and lack of knowledge about appropriate way to administrate a business in the new context that what we in the west would call appropriate actions not yet could be taken. The managing director tried the best he could to guide the company and adapt it to the environment but regarding the circumstances, coupled with the financial crisis, it was an overwhelming task.

In connection to this reasoning we find it interesting to note that the managing director during this time tried to change the structure in order to get more efficient in response to the hardship. In 1993 factories were made more independent and given the right to change their own internal structure. Every factory was charged with the responsibility to calculate revenue and cost, a profit responsibility. This attempt proved to be unsuccessful the managers simply did not manage to understand or implement it. After nine months the old structure was re-introduced. We find that the managerial resource base was at this point not enough developed to be able to successfully implement this new structure, called upon by the market economy environment.

Liuhto label this period as a first stage of real management transformation characterized by crisis management where the key issue was to survive in a

302 Managing director during the Soviet era
market turbulence he also notes that for the first time since before the WWII the managers of Krenholm had “a right to do things”.

7.5 1995 – 2002

In this section we will analyze Krenholm in the period of 1995 – 2002. Since our focus is on this period with a multitude of changes in our areas of interest we believe that it is useful to divide the analysis into two parts, one earlier period and one later. This will hopefully help the reader to grasp the extensive analysis. The most important reason for this division however is that considering our areas of interest and their interrelation there is a clear distinction between the earlier and later periods during the years of 1995 to 2002 as will be shown in the analysis.

The analysis is further divided into our areas of interest and the period put into Chandlers model.

7.5.1 Earlier period

When Borås Wäfveri became a majority owner of Krenholm in 1995 it was clearly a milestone in the modern development of the company. The Estonian state finally found a buyer, the privatization could be realized and Krenholm could move on with new hope in its battle on the market economy arena

On Borås Wäfveri´s behalf the strategy of buying Krenholm, was to achieve cost advantages. The, in relation to Sweden, cheap labor of Narva, Estonia then seems to have been the driving force behind the acquisition. The strategy could with Porters terminology be described as a cost
leadership strategy. However the acquisition of Krenholm and the subsequent access to a large source of cheap labor was maybe not an aggressive move to become cost leader in its domain. Rather it was an adaptation to the general trend in the industry with movement of production to low salary countries. To operate in Sweden and similar countries with profit in the labor-intensive segments of the textile industry is not feasible. Of course one might still say using Porters terminology that it tended to be a cost leadership approach and by no means a differentiation strategy or focus strategy.

At the point of the takeover there was of course still a mismatch between the resource base of Krenholm and the market economy environment. Except for lack of sufficient managerial skills the overall company health called for deep and serious changes.

Thus as in 1991 Krenholm was still in much as a organism adapted to live in water thrown up on dry land by a wave except that this time there was a helpful person standing there with a towel and experience of living on land. Borås Wäfveri provided Krenholm with the necessary power and support that was needed for a possible successful adaptation to the market economy.

Jacobssen and Thorsvik define change as:

“Basically a new way to think or act, something will be done for the first time or something old will be done in a new way”\(^{303}\)

\(^{303}\) Jacobssen & Thorsvik, 1998
We find that Krenholm in this period completely personalize the word change by this definition. A new way to think was demanded and introduced into the company as well as a necessity to act different in response to the market environment. Further on numerous business and operating procedures/acts had to be introduced and executed for the first time while at the same time most of the old procedures/acts had to be done in a new way.

Krenholm had not gone through an evolution during a long period of years as companies in the market economy. Therefore the company had strong lacks in internal and external efficiency.

The earlier years and the severe financial situation called for dramatic changes. One might say that the lack of market economy evolution during the years of planned economy and during the transition process of Estonia called for a revolution. The years to come were therefore of a turbulent character with dramatic changes in a fast pace.

Another way to express the situation is that during the Soviet Union era there was more or less no incremental change either proactive or reactive. In our opinion this was due to the fact that the planned economy system simply was not smooth enough to allow for any fine-tuning or adjustments at the same time as incitements for such did not exist. When the environment then changed abrupt into a market economy this required major changes in the organization in order for it to survive thus a planned revolutionary reactive change was inevitable. In conclusion one might say that during this period the change at Krenholm can be characterized as a transformation or with our organism metaphor a mutation.
The revolutionary changes in our areas of interest will now be analyzed in more detail before we turn to the broader picture including their interrelation from the perspective of Chandler’s model.

7.5.1.1 **Strategy**

We have already discussed Borås Wäfveri’s strategy in purchasing the majority of Krenholm. More of interest to us is of course how the strategy of Krenholm developed now after years of inertia when GOSPLAN provided the strategy and after the year of crisis during the transition of Estonia.

According to the directing manager of Krenholm a high degree of freedom were instantly given to the Krenholm management both in general and in strategic issues. Borås Wäfveri had much of an advisory role Even if this in practice is true we find that in theory the strategic freedom during this period was very low since every strategic decision had to be approved by the board of Krenholm which consists of members from Sweden and Borås Wäfveri.

Weather Krenholm enjoyed any strategic freedom is however not relevant at this point of the analysis. This is due to the fact that the strategic thinking in Krenholm actually did not accelerate in this period which could be accounted partly by the fact that the managerial resource base was just in the beginning of its transformation. Another reason might be that the kind of structure that Krenholm had in it self might stand in the way of strategic planning. The most important reason for this lack of acceleration though, is that in our view there was simply no time for that. The crew of the Krenholm ship had to focus on preventing it from sinking and prepare it for
future travels before it could start planning the destination and the route of the ship.

What does this mean? Did Krenholm operate without any strategy? No, rather Krenholm’s strategy in this period could be described as a turnaround strategy. By definition this kind of strategy involves survival or rebuild. This requires tightened controls, measures to limit negative cash flows, rationalization of product lines and production capacity in the first hand before any “aggressive” forward looking movements is taken. This was exactly the case for Krenholm in the earlier years 1995 to 2002. Except for rationalization needs in the internal efficiency the managing director wrestled with extraordinary troubles as organized crimes and so on. The managers also experienced that most of their time was reserved to operative issues at this point at the same time as education in western business concept and new experiences were developing continuously.

7.5.1.2 Structure

The first real change in the organization structure from the centralized bureaucratic type that had prevailed in practice since 1944 was implemented in 1995 after being ordered by Borås Wäfveri at the acquisition. It is obvious and the managers of Krenholm themselves admitted the actual organizational structure was in theory not a real holding structure. For example the daughter companies did not possess their own generated financial resources and were not free to sell to whom they wanted to in what quantity the wanted to.

Holding or not, the structure made the managers familiar with the profit thinking which we believe was positive considering the old production oriented thinking from the days of planned economy. Many of our
respondents also expressed that the positive thing with the holding structure was that it helped to adapt the company into the market economy environment. As we will return to the holding structure in that way helped to develop the managerial resource base.

A blessing with the holding structure that must not be forgotten was that it helped the necessary “clean up” of the company. As we mentioned a turnaround and revolution was demanded and with the old centralized bureaucratic structure it was hard for the managing director to get an overview of what had to be done. The holding structure cleared the field from smoke so to speak and he could see what had to be done at the different plants. The structural veil was lifted away with the introduction of the holding structure. More specific, by veil we refer to the Miles Snow and Pfeffers notion that structural characteristics act like filters and limit what the organization can see. In general the larger organizations is the more decentralized they tend to be. As presented in our empirical findings the managing director expressed that:

“We started pretty fast to change all this huge organization. This was one big company just different mills so we went from this huge company to a corporation. For me this was also an early way to understand measurements because before we had only one management, the Christmas three organization. I did not get anything; I did not understand where we lost money.”

304 Managing director of Krenholm
The managing director of Krenholm’s view is supported by Hall who notes that in large organizations it becomes impossible for management to have an overlook on everything that is going on. Decisions must be brought down to a lower level. Seen from this perspective the change to a holding structure was a reasonable action. However as Child notes a crucial factor in a successful move to a holding or matrix structure is the cooperation between the different units and the management. A good cooperation is necessary if the spreading of power and responsibility throughout the organization is to work as a whole. It is striking that several managers during our interviews expressed the opinion that “…we must work as a whole” in response to the sub optimization problems.

As the reader might now the holding structure later caused problems with sub optimization and internal struggle over transfer prices. Perhaps the adaptation to market thinking worked to well and Krenholm caught on of its diseases sub optimization and non productive individualism. Another way to see it is that these problems were due to the fact that the holding structure was not appropriate developed and implemented. Why take on a holding structure but not turn it into an actual holding structure? The managers of Krenholm seem to be of the opinion that the Holding structure was appropriate at first but the needed to be replaced. The change to a holding structure followed the pattern of Chandler that is it followed from intent, from strategy. But what was the strategic intent behind the change to a holding structure? Well according to Borås Wäfveri it was to introduce market thinking into the company. A question that arises is if this is just a way to justify the failure of the holding structure by choosing a positive side effect of it as the strategic intent? Whatever the intention behind the holding structure it seemed to have some significant positive effects but with the differences from a “real” holding structure Krenholm later in the
period ran into contra productive problems. We also ask ourselves if a holding structure in the long run is an appropriate structure for the Krenholm Company and its plants as we mentioned in our analysis of the Soviet Union era a more centralized cooperative structure seem to be appropriate. However if Borås Wäfveri’s intent with the holding structure in fact was to introduce market thinking into the company it seems to have been a rather successful move.

7.5.1.3 Managerial resource base

Of our areas of interest the managerial resource base is most certain the one who underwent most radical changes during the first period. Changes in the resource base are as Chandler’s model points out a necessity for changes in strategy and structure. Therefore we find it as promising that the managerial resource base from the time of the takeover immediately started to develop in a rapid pace.

At the takeover several managers were replaced, preferably by Estonian managers. One might argue that this helped to remove some of the “Russian management” tendency in the company. The Estonians were at this point probably more biased towards the new way of thinking and not looking back to the times of planned economy with any great enthusiasm. The Estonian Managing director in particularly seems to have been a move that improved the resource base a lot since he had received part of his education in USA and also belonged to a young generation.

A sign that the managerial resource base immediately improved in relation to the earlier crisis period was that the so called holding structure could be implemented without an abortion. In our view the reason that the change succeeded contradictory to the attempted change in 1993 was that the
management was improved in relation to its environment and thus had the skill and support to carry it through. The fact that the managing director was left alone to implement it by himself should have helped further to accelerate the management’s ability to cope with difficult market economy situations.

We would like to characterize the managing director as a popular yet strong leader with the necessary strength to cope with hard times and implement “tough” decisions therefore he managed to implement the change to a holding structure as well as other changes.

At the implementation of the holding structure in 1995 there was, which is understandable a strong resistance to this. As we mentioned Krenholm was a schoolbook example of change and need for change. Naturally this as well included great factors of resistance to change. For example resistance to change is common when individuals must go from a situation that is well known to a situation that is unsure and unknown. This resistance however was over won. In our opinion much because of the managing directors strong hand. On the other hand the structure change and all the other great changes during this period would hardly have been possible without all of the managers being motivated to continuous learning. This is one of the qualities that De Wit and Meyer finds essential in a changing organization.

This motivation to continuous learning led to a strong development of the managerial resource base during this period. The Mercuri program is the best example on how the managers were educated in market business areas as management, marketing, production, accounting and so on. The managers themselves seemed to be pleased with the Mercuri training program but of course it is hard to really know how effective it has been.
The management should also have been developed by the freedom in handling difficulties during this period. The managing director expressed in several matters that difficulties made the company stringer and also that the supposed freedom in relation to Borås Wäfveri forced the management to improve. This corresponds with the clichés that “what does not kill you make you stronger” and “you must try your wings to learn to fly”.

One way to look at this is that the market economy environment excerpted a pressure on Krenholm’s management that worked in addition to the planned developments as training. In combination with the already mentioned effect of the holding structure this meant that the management that summed up to the total effect on the managerial resource base.

Except for development what was the management in itself characterized by during this era.

As with the strategy we would like to say that it carried a turnaround label.

In a turnaround situation there are two demands that need to be fulfilled before a turnaround can be stated as a successful one. The first demand is that a profitable level needs to be regained and the second is that this level must be sustained long term. But before analyzing if a turnaround has been accomplishing, it is necessary to decide if there has actually been necessary to take measures in order to turnaround the company. In short, has there actually been a turnaround situation?
According to Arpi and Wejke a privatization of a company may be similar to a turnaround situation. When Borås Wäfveri took over the company in 1995 from the Estonian state there was indeed a precarious financial situation. Furthermore this situation has been developing for several years, in Krenholm’s case it is even decades. The background for Krenholm’s problem is the differing economic systems. The development in the planned economy had left Krenholm unable to act efficiently or even survive in a market economy system. The demands are so different when comparing the economic systems which in Krenholm’s case meant that much managerial experience and knowledge suddenly became obsolete. The entire management tradition had to be revised. This is one of two major problems; the second is the dire financial situation Krenholm found them selves in. When Estonia gained its independence in 1991, Krenholm lost almost all previous customers. In 1995 the situation was better but much remained to be done. This is why we believe that the situation Krenholm found them selves in when Borås Wäfveri took over in 1995 can be stated to be a turnaround situation. We do this even though it is according to Arpi and Wejke a similar situation but not the same. There are two possible labels that can be put on the situation in 1995; a financial catastrophe or avoidance of a possible financial catastrophe. We have chosen to state the situation as avoidance of a possible financial catastrophe since in our opinion a financial catastrophe more deals with companies that has become bankrupt.

Have Krenholm then been able to turn around the situation according to Arpi and Wejke’s two demands?

305 Arpi and Wejke, 2000
306 Arpi & Wejke, 2000

307 Arpi and Wejke, 2000
First step: Krenholm managed to regain a profitable level already in 1995 and has since then held this profitable level and even some years made improvement. There are investment activities going on at the company which is a good sign. A company in a turnaround situation would and should not engage in such activities.

Second step: The net income in 1996 was negative but that number included extraordinary costs associated with criminal activity. The next year a great improvement was shown. Even if the 1997 years profit level was to be the highest during the years 1995 – 2000 the general profit level shows that a turnaround has been accomplished also according to the second demand. As is shown in the figure below, even if some years show less good results the overall conclusion that a turnaround has been accomplished is supported by the result.

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<td>Million</td>
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<td>45,6</td>
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**Figure 10: Net Income 1995 - 2000**

7.5.1.4 *The period put into Chandlers model*

We find it useful to summarize the Krenholm scenario during this period from 1995 and forward with the help of Chandler’s model. First of all the

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Ibid

Borås Wäfveri annual reports 1995 – 2000
environment excerpted a strong pressure on Krenholm to change its resource base and strategy. This had of course been the case in the crisis period 1991 to 1995 as well but Krenholm then lacked the financial capacity or backup to for example improve the managerial resource base by recruitment or education. Thus the environmental pressure at that point led to minor changes in the resource base, strategy and structure and the mismatch between these areas and the environment pushed Krenholm deeper and deeper into its crisis.

With the support and initiative from Borås Wäfveri necessary changes were possible and our areas of interest underwent dramatic change as we described the managerial resource base underwent both dramatic changes as the appointment of a new managing director and change of some other managers and more slow changes as the training and education. This was coupled with necessary material investments including investments aimed at improving the internal efficiency. Thus the resource base rapidly adjusted itself to the market economy and textile industry reality. At the same time environmental pressures and hardship directly boosted this adaptation.

According to Chandler’s model one would expect that the strategy now changed and that an appropriate structure then was implemented, of course this might be a process spanning over several years. Changes however appeared almost instantly but hardly in this order. The structure was changed instantly, ordered by Borås Wäfveri and in fact before any great changes in the resource base started to show. In this case rather the structure affected the managerial resource base and according to Borås Wäfveri this was also the intent. In a sense then structure seemed to follow
strategy, Borås strategy. Krenholm though at this point had no developed strategic thinking.

However we must consider that the holding structure newer worked as a “real” holding structure and therefore must be seen as a quasi structural change. Rather during this period the focus was on internal structural changes that is an improvement of the internal efficiency. This was also the case concerning the strategy that had the character of a turnaround.

We find that in line with the development that Chandler saw in American industrial enterprises the first step was to rationalize the use of resources and first second to create an appropriate structure for the whole organization. This period in Krenholm’s history had strong characters of the first period. In our view this period only entailed dramatic changes in the Resource base and minor changes in the strategy and structure. To debate if structure followed strategy or the other way around therefore seems irrelevant. Considering the turnaround strategy and the structures positive effect on the resource base and turnaround character in improving the internal efficiency we find that the structure and strategy at this point seemed to match each other. According to Hall and Sias inefficiency follows if strategy and structure don’t match but the sequel of them is of small importance.

Liuhto label this period as the second stage of real management transformation but more important he label the management as ”operative” and states that the key issue was internal efficiency improvement. The change in this period he characterized as active. Our picture of the period in much corresponds with Liuhto’s only that he did not use Chandler as a tool in his analysis.
7.5.2 The later period

7.5.2.1 Strategy

At the beginning of the second period of the years of 1995 to 2002 Krenholm’s turnaround might have been considered completed. That is the revolutionary changes and focus on internal efficiency was no longer a priority. This coupled with the fact that the managerial resource base was strongly developed seemed to open up possibilities of a more aggressive and forward looking strategy then the turnaround strategy of the first period. Our interviews also gave us that expression. Of interest for our analysis therefore is what kind of strategies has emerged during this later period and in what degree has Krenholm enjoyed strategic freedom.

To start with the latter. As we know before 1991 there was in practice no freedom at all as GOSPLAN dictated what should be done and what not. After the takeover by Borås in 1995, Borås Wäfveri in our view excerpted a major influence on Krenholm’s strategies. The structural change to a holding structure was ordered by Borås for instance. Every strategic decision also has to be approved by the board. The management of Krenholm themselves stated in our interviews that they are independent for example the board has never rejected any proposal. But when it comes to it we don’t find that this can be labeled as independence.

An additional factor that that limits Krenholm’s strategic freedom was the potential loan from IFC. The negotiations started in 1998 in order to acquire this loan, certain terms needed to be fulfilled. Terms such as a change from a holding structure into a divisional structure. IFC put demands on the strategy in order for Krenholm to receive the loan. When the loan was granted in the year of 2000 this meant that IFC would continue to excerpt
influence in strategic matters long into the future. Krenholm will be under regular control in financial and strategic matters.

So far the strategic freedom but what strategy has there been during these years. The strategy used after 1995 can be characterized as either a develop strategy or a stabilize strategy. In our view it is a mix of both. There is some empirical findings that would suggest that cost minimizing and therefore a stabilize strategy has been a very important focus for Krenholm from 1995 and forward. However, strong brand can not be said to be strength of Krenholm during this period. But product specialization is. Mainly through the chosen area of products. There has been substantial investments in order to maintain and improve the quality of production and this may be a sign of a stabilize strategy.

However, considering the fact that Krenholm is a very new actor at the international market and can therefore be said to be a new and young business it is very easy to assume that the major strategy has been of a develop type. It can certainly be stated that the company has had many new opportunities to consider with the new economic system and the new owners. We can point to some empirical findings that would suggest that R and D has been (and is) of outmost importance. The fact that a lot of investments are made in order to produce specific material that is Krenholm´s own can be seen as evidence of this. A lot of resources are allocated to this purpose. There is a conscious effort to profile Krenholm as a brand name on the market. This is something that will take time to develop and can therefore not be expected to produce profit at once. The demand that cost efficiency is less important than a long term financial orientations is therefore fulfilled.
There is however a third possibility. Considering the fact that Krenholm is a subsidiary of Borås Wäfveri and that they may have a completely different strategy which Krenholm is a part of may mean that there is another possible strategy. The history of the textile industry suggests that this is an industry that moves between countries depending on the national level of wages. That is when a country’s wages makes it impossible to compete on the international market. The purchase of Krenholm can be seen in as a way to make sure that low wages may be maintained. It is rather a deliberate harvest than an emergent harvest since this is a known problem since way back. There is however a contradiction present. In a deliberate harvest no new and large investments are made. This is not the case with Krenholm. The fact that the workers salary problem is a well known fact at Borås Wäfveri and other companies in this industry makes this odd. There is a possibility that Borås Wäfveri to some extent has lost control over Krenholm and that this company now goes its own way.

When applying Porters generic strategies no single identifiable strategy emerges. There is evidence for a cost leadership strategy but also a differentiation strategy. The cost leadership strategy can be noted in the importance that is put on low wages. The differentiation strategy can be easily seen in the effort that is put into making new and own designs.

7.5.2.2 **Structure**

Krenholm does not have complete freedom in implementing strategies as mentioned earlier. The divisional structure is an example of this. According to some respondents this structure was a demand from IFC in order for Krenholm to receive the loan. In accordance to these demands Krenholm changed its organizational structure into a divisional structure in 2001. This
type of structure has had its own problems however. In a divisional structure, that by nature is decentralized, may and often do lead to problems when trying to achieve a coherent and integrated strategy. This is also the case with Krenholm. The change was however a step in the right direction when considering the previous holding structure. The holding structure with internal pricing and such was an even greater obstacle when trying to make the entire company move in the same direction. As it turned out, which is often the case with holding structures, the individual companies focused to much on their own results rather than on the entire company? The holding structure at Krenholm led to what we would like to call “alienation” in the company. We feel that this structure, which is supported by our findings, made managers of individual companies focus too much on their own divisions instead of the whole.

The larger an organization is the more decentralized it will be. This decentralization as previously mentioned may cause problems. It is important, when implementing or trying to find the best structure solution for a company, to look at the specific demands of that organization. It is very possible in our opinion that Krenholm constitutes the sort of organization that should not be much decentralized. The industrial environment that Krenholm operate in is of a character that does not need a high degree of decentralization in our opinion. It is even likely that some sort of a mechanical structure would suit Krenholm better. According to Robbins the more complex the environment the greater the decentralization needs to be. Burns & Stalker made a similar conclusion in their research. The question for Krenholm is then, is the environment and so on requiring a decentralized organization? We are of the opinion that this is not the case. The environment in which Krenholm operates suggests that a form of a

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mechanical structure would be better suited to Krenholm’s needs. It is however necessary to make a distinction between this type of structure and the one that was used during the Soviet Union era. Even though we feel that the current structure is not the optimal one, it did serve an important purpose. When Estonia became independent and Krenholm found themselves in an entire different economic system changes in the structure were necessary in order to make this clear for the managers and workers. It was important to make a clean break from the previous system. This sometimes means that in order to make a point go to extremes. The change into a holding structure and later a divisional structure is in our view a way to make this point. The change from a holding structure and then into a divisional structure can be interpreted as management feels that the point has been made and that it is time to find a structure better suited for Krenholm’s specific needs. Even if this change was initiated by IFC, we believe that the holding structure would have been abandoned in any way sooner or later.

We have mentioned in our analysis that the Holding structure was a mixed blessing and that it later led to problems mainly with sub optimization in the form of struggle between the daughter companies. Notably these problems did not disappear with the change into a division structure. The problem thus remained after the change. With a division structure it is quite possible that the different divisions and managers lose sight of the overall goals and instead focus too much on their own goals for the division. The problem as with a holding structure is to make the organization work as a whole. As stated earlier the managers today are aware of this problem and in fact the managing director are taking measures in order to get rid of these problems:

309 Robbins, 1987
“I need a new organization and new tools of measurement to get a better result for the group”

These future changes will not affect the division structure rather it is a question of what measurements that will maximize the overall profit and minimize the sub-optimization.

7.5.2.3 Managerial Resource Base

The managerial resource base during these years continued to develop and notably the end result of the different external and internal pressures towards a market oriented management has proven rather effective. For example, now the management seems to be working itself towards an effective division structure with the help of new measurements. This corresponds to Chandler’s model in the sense that the management as a resource earlier was not so developed that it could find the appropriate structure immediately. In fact the holding structure as we note helped to develop the managers and so to speak prepared them to implement a more efficient structure as planned.

In more detail we find that the managerial situation as we find it in the year 2002 is completely different than when Lindahl and Ohlsson committed their research at Krenholm in 1995. The traces of the old way of thinking are much less noticeable and market oriented thinking in much has replaced production oriented thinking. To prove our point the managers of Krenholm in 2002 had a revolutionary better understanding of the concepts strategies and plans then in 1995. In many cases these were the same managers. There are still some signs of a production oriented thinking left though, even if in a small extent. Therefore there are still rooms for a
positive development of the management in this sense. One must not forget however that in the textile industry as in other industries there are some biases towards production thinking at the plants and a “dispute” between production and marketing.

What can be said of the future development of the management at Krenholm? Today there are no major educational programs planned or underway. The major problem is recruiting new managers that are trilingual, managers who are fluent in Russian, Estonian and English. The major problem is just that lack of lingual skills. Some managers need assistants in order to speak to customers in English. This is of course not a good thing but parts of the problem will be solved through educational problems and other parts through recruitment of new managers when the old ones retire. The language problem is however outside the scope of this thesis and will not be further addressed.

7.5.2.4 The period put into Chandlers model

In this period the changes in the environment and resource base finally affected the strategy and structure of Krenholm. The managerial resource base was now improved to the point that strategic thinking without a doubt existed at Krenholm. At the same time one might say that the turnaround was completed and the complete focus on improving internal efficiency was no longer necessary. The strategic thinking of the Krenholm management however was not left alone to freely develop the strategy since IFC and Borås Wäfveri had a great impact on the chosen strategies. The change to a division structure is an example, which was a demand from the IFC. The division change thus like the change to a holding structure was triggered by the strategic intent of a second part. On the other hand one might say that the loan from IFC was a part of an aggressive strategy from
Krenholm and therefore this strategy indirect was the cause of the change to a holding structure.

The management now seem ready to find the optimal structure for Krenholm and get rid of the problems associated with the both the old holding structure and the new division structure. The spirit in this desired and upcoming change is that Krenholm must work together as a whole. Who knows maybe Krenholm is returning to a more centralized structure know that the internal efficiency has been improved and the situation seems to stabilize?

To repeat what we stated in our analysis of the earlier period Chandler found that in American industrial enterprises the first step was to rationalize the use of resources and first second to create an appropriate structure for the whole organization. Therefore a conclusion would be that this is where Krenholm now is at preparing to create a fruitful structure for the whole of Krenholm. We also believe that the resources are adequately developed to be able to implement such a structure.

Finally we would like to note that our view that the operational turnaround character of the management was replaced with a strategic and forward looking approach is supported by Liuhto who labeled the management of this period as “strategic” and noted that the key issue no longer was internal efficiency improvement but organizational effectiveness improvement.
8 Summary and conclusions

Krenholm of today is a profitable international company on the market economy arena. Krenholm of yesterday was a gigantic industrial enterprise in the planned economy. What then can we learn from the period in between? What measures of action has to be taken in order for a company to successfully change from operating in a planned economy to operate with profit in a market economy.

We have followed the evolution of Krenholm by analyzing its history with the help of Chandler’s model. In particular we have focused on the later part of its history. From 1991 and forward. By this analysis we might conclude somehow obvious that the needs of change Krenholm was faced with was enormous and build up during a long time of planned economy. More important we find it easy to conclude from this analysis that there are some steps in a successful change of this type that can not be overseen. We find it both in practice impossible and dangerous for a company in this situation to immediately try to develop new competitive strategies and implement a dramatically new structure. There is a necessity for intermediate steps as improving the internal efficiency and develop the managerial resource base. This aside what can in more detail be learned from the successful change of Krenholm?

We believe that there are some vital explanation factors which are tied to the type of industry that Krenholm has and is operating in. These factors has in much made the successful change of Krenholm easier.
Krenholm were active in industry production in a market that is quite stable without any rapid technological developments or other types of turbulence. In a sense the textile industry in the larger segments can be seen as rather production oriented where internal efficiency and logistics are more critical factors than marketing activities. The production orientation of the planned economy era in this sense was not as fatal in the new market economy system as one might suspect. The tradition in the Soviet Union with emphasis on operational and technological skill combined with the slow technological development in the textile industry assured that Krenholm was not as far behind the rest of the world when considering market related technology and production. They had not suffered to great of a loss during the almost 50 years of a planned economy and could therefore more efficiently adapt to a market environment. The lack of development in the internal efficiency was therefore the major cause of the great need for a turnaround that was evident when Borås Wäfveri acquired Krenholm.

Thus we believe that the characteristics of the industry that Krenholm was developed in many respects helped Krenholm to succeed in its successful adaptation to the market economy environment. We find that similar factors had made the steel and oil industry so vital for Russia in that their change in response to the new economic system were easier than in many other industries and business. Today energy goods accounts for 42,4% of and metal goods account for 15,1 % of Russia’s total export.  

When comparing organizational structure between western companies and the companies during the Soviet Union era there are many similarities when looking at companies involved in producing activities. Companies which is best suited to have a centralized mechanical structure. Krenholm
is such a company. We believe that this was one important factor when trying to adapt to the market economy, the similarities made the transition much easier. This corresponds with the fact that structural changes to holding and a division structure in much only were changes on the paper and that Krenholms managerial resource base at this point are so developed that a internally and externally efficient structure are planned and seems to be feasible to implement. Krenholm is going to work as a whole.

The single most important factor in Krenholms successful adaptation was the privatization of the company. The period between 1991 to 1995 showed that Krenholm could not manage to adapt to the new situation on their own. Krenholm needed help preferably from a foreign actor in order to survive. Financially it was a necessity because Krenholm was not trusted by banks, customers and so on and therefore the company was so to speak trapped in a bad situation- We conclude that without Borås Wäfveri’s entrance into the company in 1995 Krenholm would not exist today.

The takeover gave Krenholm a number of advantages. This meant that Krenholm had an external “partner” with an interest in Krenholms well being. This partner could be used in order to get feedback and suggestions on what to do when trying to solve problems. Getting access to the market connections made the work of finding new customers a much easier task. Borås Wäfveri also meant a vitamin injection that gave Krenholm the possibility to rapidly expand. Borås gave Krenholm a substantial operational freedom after the take over. They put a new managing director in place and told him initially what they expected. But more importantly, they did not interfere in the day to day activities. This was important in order to avoid cultural clashes and misunderstandings that otherwise very easy could occur. We believe that the freedom was a critical factor in the
success in that it developed the management of Krenholm. A cliché that comes to mind is that to be able to learn to fly you must try your wings.

On a micro level we find that it seems to be of vital importance who guides a company in the times of difficult and revolutionary changes. The managing director of Krenholm had played a vital role in the making of this profitable textile plant. We do not believe that for example a Swedish or American managing director would have succeeded in this. For instance to be able to handle the kind of threats that organized crime elements put forward one must be an exceptionally strong character but also native to be able to cope with this psychological game.

One important conclusion that can be made is that is vital to develop the managerial resource base immediately in order to be able to survive and also later to develop competitive strategies for the future. With managerial resource base we as stated earlier mean the knowledge of the management in areas as marketing, strategy, accounting and so on. It also includes attitudes and values. We find it easy to see how important it is that knowledge and attitudes/values as fast as possible can be developed in a direction that is more suitable for a market economy. If the crew of a ship does not possess appropriate knowledge in navigating or posses the view that the appropriate place for a ship is in the harbor it will never reach its destination.

With the help of the Krenholms case we can see that a fast development of the managerial resource might be achieved by extensive replacements, training and a considerable freedom in the operational and structural side of the business. This freedom makes sure that the management feel the environmental pressure towards change. In our view these factors together
creates synergic effects and we are very doubtful that the fast successful development at Krenholm would have occurred if only one or two of these factors had been present.

We are very aware of a certain tendency of glorification of Krenholm and its management that has been present throughout this study as well as in the conclusions. We find however that this in a sense has been impossible to avoid, partly because of the tendency of glorification of Krenholm by the managers we have interviewed and partly because the purpose of our study in fact was to through Krenholm investigate how a company can successfully change from operating in a planned economy to operate with profit in a market economy. There are no tendencies of glorification in our last remarks though

We feel a need of questioning the freedom and strategic independence of Krenholm. In a way considering the relationship with Borås Wäfveri and IFC one might somehow over dramatically state that IFC and Borås Wäfveri has replaced GOSPLAN as the strategic body and Krenholm itself is left to manage the operational side of the business. This in a market environment but in an industrial context that in some aspects carries traits of the old times. Thus in harsh words Krenholm might not have transformed into what we would call a market economy company. But rather to an efficient and profitable Soviet company working in a market economy context.
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• Mai Palginõmm – Financial director

• Kadri Rattasepp – Personnel director

• Anatoli Ilkevitch – Ass. Managing director – Textile

• Oleg Klusin – Managing director – Spinning

• Raino Erlich – Ass. Manager – Spinning
• Konstantin Gorlov – Managing director – Weaving

• Nina Zaitseva – Managing director – Finishing

• Vladimir Altukhov – Managing director – Service

• Svetlana Makarova – Managing director – Terry

• Nadezda Sinjakova – Managing director - Sewing

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