

Balaton, Károly

**Article**

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Journal for East European Management Studies

**Provided in Cooperation with:**

Rainer Hampp Verlag

*Suggested Citation:* Balaton, Károly (2003) : Changing patterns of leadership during the transformation period in Hungary, Journal for East European Management Studies, ISSN 0949-6181, Rainer Hampp Verlag, Mering, Vol. 8, Iss. 4, pp. 335-345

This Version is available at:

<https://hdl.handle.net/10419/90390>

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## **Changing patterns of leadership during the transformation period in Hungary**

*Károly Balaton\**

*The paper places the development of leadership patterns in Hungary into a historical context. The author analyses the influence of reforms before the political changes on the behavioural patterns of Hungarian managers. During the transformation period, the influence of political and macroeconomic conditions and of privatisation are analysed. The contextual factors mentioned above formulate the arena where managerial problem solving and learning takes place and contributes to the development of leadership characteristics. The paper ends with some conclusions.*

*Der Aufsatz stellt die Entwicklung von Führungsmustern in Ungarn in einen historischen Kontext. Der Autor analysiert den Einfluss von Reformen vor den politischen Veränderungen auf die Verhaltensmuster von ungarischen Managern. Der Einfluss der politischen und makroökonomischen Bedingungen und der Privatisierung während der Transformationsphase werden analysiert. Die oben erwähnten kontextabhängigen Faktoren gestalten das Umfeld, in dem führungschaftige Problembewältigung und das Lernen stattfinden und zu einer Entwicklung von Führungseigenschaften beitragen. Der Aufsatz schliesst mit einigen Schlussfolgerungen.*

*Key words: leadership / transformation / Hungary / privatisation*

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\* Károly Balaton, born 1951, Professor of management at the Budapest University of Economic Sciences and Public Administration. Major research areas: Strategic management, strategic and organizational changes in transformation period. Corresponding address: karoly.balaton@bkae.hu.

## **Introduction**

Radical political, economic and social transformation involves necessary changes in leadership behaviour as well. This raises the question of what are the roots of leadership patterns observable today in Hungary and the other transforming societies of Central and Eastern Europe. What is the role of previously developed leadership types? Are they influencing the emerging new type of managerial behaviour? Or should we forget them and concentrate on leadership characteristics of developed market economies while searching for possible samples of leadership during transformation?

The present author argues for the need of approaching leadership development historically, highlights some experiences before the transformation period and discusses their influence on the emerging patterns of leadership during the 1990s in Hungary. The paper proceeds with analysis of some environmental characteristics like political and macroeconomic conditions and privatisation and shows how they influence the emerging strategic behaviour of enterprises. From among the internal processes, organizational and managerial learning and the limited problem solving capability of managers are discussed. Based on these developments, the paper ends with drawing up some characteristics of the emerging leadership patterns in Hungary.

## **The role of historical contingencies**

Societies and organisations within them are historically developing systems. Changes in these systems are not only influenced by the external and internal environments today, but by previous developments as well. In order to get a proper understanding of the organizational and leadership patterns today in Hungary, we have to use a historical approach. Characteristics of leadership before the transformation period influence perceptions and behaviours of leaders during the changes.

A common heritage of societies of Central and Eastern European countries is socialism. During the period of planned economy, enterprises were dependent on the central government system (Máriás et al., 1981). This dependency was not normative in its nature, but rather subjective where personal relationships could influence the contacts. Large state enterprises had possibilities to influence central decisions due to their political role and influence.

Behaviour of enterprise managers were characterised as „externally driven” (Nemes, 1981). The externally driven role perception may be characterised by avoiding conflicts, waiting for initiatives from others, avoiding risks and creating friendly personal relations. The contrary type of role perception is the „internally driven” behaviour which involves patterns such as taking initiatives, taking risk and going into conflictual situations (Nemes, 1981). Most managers in Hungary were characterised as externally driven which was favourable for

getting into higher levels in the hierarchy but was unfavourable from the point of view of economic results. Externally driven role perceptions were observable after the political changes as well. This may be explained by the fact that time is needed to change old behavioural patterns and habits. Changes in the political and economic systems and privatisation could not change these behavioural patterns from one day to another. It is understandable therefore that training and development of new corporate culture is regarded as crucially important in privatised companies.

The Central and Eastern European countries are often described in Western publications as a homogeneous group having common cultural heritage. Going into deeper analysis, we may identify that this is only true at the surface level. Beside commonalities there are important differences having relevant consequences for the transformation process. We mention three factors having differentiation roles in the changes: the timing of socio-political and economic changes, the reforms before the radical changes and the role of foreign direct investments.

In Hungary there were important reform steps before the socio-political changes in 1990. The introduction of the „New Economic Mechanism” in 1968 gave possibility for using some elements of market economies. Possibilities for starting private companies during the 80s, the two-level banking system, the Company Act, opening the Budapest Stock Exchange were important steps helping to develop market economy during the early 90s. The above developments in the economic system had direct influence on managerial perceptions. The limited market economy conditions forced managers to take into account the horizontal relations among enterprises as well. Although the vertical hierarchical relations had their dominance in influencing the functioning of the economy, the emerging market conditions helped enterprise managers to get some experience with market economy type relations.

These reform steps created favourable conditions for foreign direct investments during the first years of transformation. Until 1994 Hungary could absorb much higher amount of foreign investment than the other countries of the region. Due to the accelerated rate of privatisation the structural changes were made relatively quickly in Hungary. The economic recession period ended in 1993 and the economy started to grow. Compared with other Central and Eastern European countries there are differences concerning the starting period and the intensity of changes, especially during the early 90s. These alterations have to be taken into account in order to understand the present situation in the transforming economies and societies.

## **The role of political and macro-economic conditions**

Organisational changes and change management are today the most frequently discussed issues in organisation and management theory. Technological changes, globalisation and the increasing need to satisfy customers force companies to develop new strategies, structures and processes (Wind/Main, 1998). Organisational changes in Central and Eastern Europe are often analysed by relying on frameworks developed in market economies of Western Europe and North America (e.g. Stark, 1992; Dittrich/Schmidt/Whitley, 1995). These approaches place organisational changes into a market economy context. Changes in the technological and economic environments are of course important factors to understand organisational changes in the region, but we cannot leave out of consideration the radical shifts in the political-institutional and social conditions (Kovács, 1999). We should not forget that the primary movers of organisational changes are the system level political, social and economic changes.

Political changes are not only important from the point of view of initiating modifications in the other subsystems of society. During the 90s relevant shifts have been made in Hungary in the political and macro-economic conditions. Trade liberalisation, stabilisation of the economy and creation of the basis of market economy involved the following steps in economic policy (Temesi/Zalai, 1999):

- Reformulation of the legal, financial and institutional frameworks,
- Search for new markets to replace the collapsed COMECON market,
- Initiation of structural changes in the economy,
- Reform of the social welfare system.

As a result of the free elections in Hungary, new governments were formed after each of the elections. Although there is certain stability in the policies of the changing governments (e.g. creation of market economy conditions, democratisation, joining international alliances), the changes are relevant for the restructuring of enterprises. Economic growth and stability have got shifting priorities, influencing the strategic development capabilities of enterprises. Privatisation was also managed by altering priorities by the changing governments (Mihályi, 1997).

Deep economic recession during the early 90s involved defensive and survival-oriented company strategies. As the economy started to grow, innovative and growth oriented strategies became more and more frequently observable.

Our analysis shows that changes in organisations and their leadership can only be understood by taking into account both the macro- and micro-level characteristics.

## **The role of ownership structure and privatisation**

Ownership changes have got special attention in the studies of organisational and leadership changes in Central and Eastern Europe. Privatisation is seen as an important influencing factor in the transition approach as well. According to Flecker (1994) privatisation in West-European countries nearly automatically led to substantial organisational changes.

Our studies revealed that although privatisation is an important influencing factor, in itself it can not solve the existing problems of formerly state-owned enterprises (Makó/Balaton, 1994). We could observe a general tendency of performance improvement after privatisation, but the specific results were dependent on the extent privatisation could solve the basic challenges enterprises were faced with (Adorján et al., 1996). During the early 90s the basic problems of state-owned firms in Hungary were the following:

- access to markets,
- technological renewal,
- acquiring financial resources.

The influence of ownership structure was observable in the content of company strategies in Hungary as well. During the early 90s strategies of enterprises in the specific ownership categories could be characterised as follows:

State owned enterprises:

- short-term strategies,
- preparation for privatisation,
- survival,
- lack of innovative strategies.

Hungarian private owned companies:

- strategies of growth,
- high level risk-taking,
- innovation,
- diversification,
- short-term profit making.

Foreign owned companies and joint ventures with foreign partners:

- joint ventures as preferred form of market entry,
- realisation of first-mover advantages,
- use of cheap but skilled labour,
- cautiousness in making major investments,

- future steps depending on initial results and consolidation in the larger region.

Privatisation policies followed by the Central and Eastern European countries had also an influence on organisational changes. The Hungarian policy preferred the sales type of privatisation; that is, preference was given to owners who had the necessary financial resources to buy state property. Due to lack of capital inside the country, that policy resulted in major ownership of foreign organisations. Privatisation was followed by radical changes in the profile, the strategy, the technology used and the organisation structure of companies. Hungarian companies became integrated into the world economy within a short period of time. Radical structural changes after privatisation resulted in accelerated growth rates toward the end of the century.

### **The role of managerial problem-solving and learning**

In the previous sections we stated that political, social and economic environments of enterprises influence changes within business firms. This however does not mean that changes inside business organisations are determined by the environment. Members of organisations, especially the leaders influence the course of action as well.

Students of modern decision theory discovered that there are limited possibilities to make optimal decisions in complex situations. Instead of searching for optimal solutions decision-makers generally arrive at satisfactory decisions (March, 1994). Under conditions of ill-structured decisions search for information and possible solutions discovers only part of the possible alternatives and accepts solutions providing satisfactory outcomes.

Findings of modern decision theory seem to be relevant under conditions of transformation in our region as well. Complex decision situations of organisational transformation provide ample examples for limited attention and problem-solving capability. Business and non-profit organisations are faced with situations, which are not only complex but also new, where there is only limited knowledge and experience available on how to solve them. Old reflexes and routine solutions are not useful any- more and decision-makers have to find solutions within a short period of time. Typical handling of such solutions is to select certain problems and possible solutions without discovering the whole range of possible course of actions.

During the early 90s we were astonished when we first recognised that leaders of state-owned Hungarian companies are not interested in developing systems successfully used in market economies like controlling or logistics. During our interviews we learned that leaders knew these systems and might evaluate their contribution to management of firms. But the basic problems these managers were faced were others, like who would be the new owner of the company, what

type of privatisation would be applied, when would the company be privatised, would the company be restructured or not, who could remain in managerial positions etc. We learned that leaders were faced with many important problems and they were incapable of paying attention to each of them. Their real possibility was to select certain problems and concentrate on their solution. Subjection factors were strongly present when they selected problems to be dealt with.

It was our experience that problems selected for solution by managers were different in the early and the later stages of transformation. Bellow we mention some typical problems selected by managers of state owned companies in the respective phases of transformation in Hungary.

Typical problems selected during the early stages of transformation:

- Preparation for privatisation,
- Getting into ownership position,
- Maintaining managerial position,
- Securing the survival of the firm.

Typical problems selected during the later stages of transformation:

- Quality improvement,
- Developing human resources,
- Redesigning organisational structures and processes,
- Implementing new management control systems.

Changing priorities and answers to emerging problems in the transformation period are partially connected to changing knowledge basis available for organisations. Both individuals and organisations learn during the changes. We found it useful to analyse organisational learning processes by relying on two concepts:

- Single-loop and double-loop learning (Argyris/Schön, 1978) and
- Learning by exploitation and learning experimentation (March, 1991).

Single-loop learning refers to capabilities of organisational members to change their behaviour within the framework of existing strategies, structures and values. Double-loop learning involves changes in objectives, structures and values of organisations as well (Argyris/Schön, 1978).

Both single- and double-loop learning were observable in Hungarian organisations (Dobák, 1999). Single-loop learning was characteristic for most of the organisations studied. In Hungarian private owned companies we found mainly single-loop learning. The presence of only single-loop learning was connected with limited capabilities for implementing structural changes. Such

examples were found in fast growing private firms, which were incapable of implementing the necessary structural changes parallel with high-speed growth in their sales volume. Lack of double-loop learning characterised state-owned enterprises before privatisation. Many of them lost their previous markets in the COMECON region and were not capable of the necessary technological and financial renewal necessary for finding new markets (Adorján et al., 1996).

Formerly state-owned enterprises provided clear examples for double-loop learning during privatisation. The strategy and organisation structure of these firms was radically changed in most cases and new management teams were put into position. Double-loop learning was observable in joint ventures with foreign partners after a few years of operation in Hungary. Ownership was often changed into sole foreign owned firms and composition of top management also changed. While during the first years top managerial positions were filled mainly by expatriates, later more and more Hungarian managers were nominated into executive positions. In the manufacturing industry foreign owned firms and joint ventures started with relatively simple assembly-type activities. Later on knowledge demanding new functions like research and development were added to the profile of firms. For example, General Electric has set up its European lighting R&D centre in Budapest.

Theory of organisational learning developed by James G. March makes a distinction between learning by exploitation and learning by experimentation (March, 1991). Learning by exploitation refers to learning by relying on past experiments and accumulated knowledge and involves categories like refinement, choice, production, efficiency, selection and implementation. Learning by exploration is basically future oriented and involves search, risk-taking, innovation, flexibility and discovery (March, 1991).

Learning by exploitation was observable in formerly state-owned enterprises both before and after privatisation. Previous managers of these firms often preserved their position and used their bargaining position during privatisation. Their personal connections with managers of other firms proved to be a valuable resource for the privatised company.

In joint ventures and foreign owned firms we observed another type of learning by exploitation. In these companies learning was orientated to acquiring the business practice of the foreign owner or partner. Learning was required from the Hungarian managers and employees. Mutual learning was much less frequently present in these firms.

Learning by experimentation is a characteristic form of learning in Hungarian private companies. These firms continuously search for new and better solutions: they develop new products and services, develop new technological solutions, and enter into new market segments.

Formerly state-owned firms after privatisation also provided examples for learning by experimentation. They changed their products and technologies, searched for new sales markets and purchasing possibilities.

### **The emerging patterns of leadership in Hungary**

Both macro and micro-level changes described above contribute to the emergence of new management patterns in Hungary. Mass privatisation of formerly state owned firms has led to radical changes in the composition of top managements of enterprises. Executives appointed by the previous socialist system were replaced in many cases partially due to political considerations and partially due to the new requirements created by the emerging market economy (Dobák, 2003). Top managers of the old system were able to adjust to the new conditions and change their managerial behaviours or those who managed to use their existing network and connections.

It was a consequence of the Hungarian privatisation process that many large firms became owned by Western companies, in many cases by large multinational firms. These companies set up a new management system and selected leaders capable of effectively running the company as part of the multinational firm. During the first years of transformation top managerial positions of these firms were filled by expatriates. Later on more and more Hungarian nationals managed to get top positions in foreign owned firms. The leadership style of these firms are similar to the characteristics of the parent company. In many cases young Hungarians managed to get into top managerial positions. In foreign owned companies we observed the importance of transfer of managerial and organizational knowledge from the parent company to the acquired unit in Hungary. This knowledge transfer is not only relevant in the foreign owned companies but contributes to organizational and management changes in Hungarian owned firms as well. Leadership patterns of foreign owned firms are diffusing throughout the population of business firms in the country. We may observe a convergence among the managerial and organizational characteristics of companies working in Hungary. There are lots of examples of managers moving from a Hungarian owned to a foreign owned company and vice versa (Dobák, 2003).

Newly emerging private Hungarian firms develop their leadership characteristics based on the examples of established firms located in the country. Privatised Hungarian firms often serve as role models for developing the management and leadership systems of these companies. Transfer of managerial knowledge is present in these firms as well. In spite of the radical changes in organizational and leadership characteristics of the small and medium sized Hungarian companies, the level of development of such firms is generally lower than the large and foreign owned firms. This is a dangerous situation in a period just before joining the European Union. As competition

will be increased after the EU accession, rapid changes are needed in this sector in the management systems.

## Conclusions

We tried to show that development of leadership patterns during the transformation period is a gradual process. Historical contingencies together with new developments inside and outside companies contribute to the emerging patterns of leadership. Learning and transfer of managerial knowledge also have relevant role in the development process. Leadership patterns of successful firms and foreign parent companies provide samples often followed by managers of Hungarian firms. Convergence in leadership patterns may be observed among the companies. Managers often move from top managerial position of one company to another one's and take acquired leadership patterns with them.

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