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Secondary Privatisation: The Evolution of Ownership Structures of Privatised Enterprises

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Preface

This summary of the results of a comparative study of three Central European countries with different privatisation patterns was prepared on the basis of the following papers:

1. Evzen Kocenda, Juraj Valachy, Secondary Privatisation in the Czech Republic: Changes in Ownership and Enterprise Performance in Voucher-Privatised Firms, CASE Report No. 45, Warsaw 2001.

2. Marko Simoneti, Andreja Bohm, Joze P. Damijan, Boris Majcen, Marko Rems, Matija Rojec, Secondary Privatisation in Slovenia: Evolution of Ownership Structure and Company Performance Following Mass Privatisation, CASE Report No. 46, Warsaw, 2001.

3. Piotr Kozarzewski, Richard Woodward, Secondary Privatisation in Poland (Part I): Evolution of Ownership Structure and Company Performance in Firms Privatised by Employee Buyouts, CASE Report No. 47, Warsaw 2001.

4. Barbara Błaszczyk, Michał Górzyński, Tytus Kamiński and Bartłomiej Paczóski, Secondary Privatisation in Poland (Part II): Evolution of Ownership Structure and Enterprise Performance in Firms Privatised under the National Investment Fund Program, CASE Report No. 48, Warsaw, 2001.

5. Irena Grosfeld, Iraj Hashi, The Evolution of Ownership Structure in Firms Privatised through Wholesale Schemes in the Czech Republic and Poland, CASE Report No. 49, Warsaw 2001.

This summary was prepared and edited by Barbara Blaszczyk and Richard Woodward of CASE - the Center for Social and Economic Research. In the project whose results are presented here, our team investigated the phenomenon of "secondary privatisation" (that is, the post-privatisation evolution of the ownership structures established as the result of initial privatisation) in three transition economies (the Czech Republic, Poland and Slovenia) in the years 1995–1999. Our research covered companies that were privatised under various privatisation schemes which established ownership structures whose nature was heavily determined by privatisation policy rather than market forces (including employee buyout programs and mass privatisation programs in which all citizens were given rights to acquire shares at prices significantly below market value). We present the post-privatisation changes in ownership structures of privatised companies and analyse the relationships between those changes and the economic performance of the companies. Much attention is also devoted to the role of the institutional environment. We hope that the results of this research will be useful for everyone interested in the little-researched question of what has happened to companies after privatisation in the transition countries.

Barbara Błaszczyk
Project Co-ordinator

1. Introduction and Rationale for the Research

In the early stages of the transformation of the majority of post-communist countries, various types of privatisation schemes were applied in order to speed the process of privatisation of the state sector and ensure social support for the privatisation process. In addition to classic commercial privatisation methods "imported" from the West, these schemes took the form of mass (voucher) privatisation and management-employee buyouts. The common denominators were a high degree of state involvement in the creation of various types of ownership institutions (e.g., investment funds and various other types of funds – e.g., privatisation funds, pension funds, employee holding companies, etc. – which became shareholders in privatised companies) and the definition by the state (to a greater or lesser degree) of the ownership structures of privatised enterprises, both by identifying future types of owners and, in some cases, by determining what the proportions of shares held by various types of owners were to be. As a result, in countries where efforts were made to determine ownership structures from on high, enterprises often found themselves with identical ownership patterns immediately following privatisation, regardless of their size, the markets in which they operated, or other specific characteristics. On the other hand, in countries where ownership structures were allowed to arise in the initial stage through processes more closely resembling market regulation, observers were surprised to find that in many cases highly insular ownership structures emerged in which management was under relatively weak control and access barred to outsiders.

The creators of schematic privatisation programs had varying attitudes toward the problem of the further evolution of ownership structures following the initial privatisation. Some countries have chosen a model of gradual state withdrawal from its ownership role in the economy, accompanied by strong state control of subsequent ownership evolution; others have preferred a more "spontaneous," unregulated approach. In both cases, we can observe many surprises and unanticipated results.

In countries where the transformation process began relatively early, we can speak of a "secondary" ownership transformation process which is currently occurring (the terms "primary" and "secondary privatisation" which we use here are inspired by the analogy to primary and secondary capital markets.) Following the primary privatisation, often of a very administrative nature, many enterprises have entered a stage of change in the ownership structure which has been determined more by market forces and newer, more sophisticated regulations. The observation of these changes *can* provide us with important criteria for evaluating the degree of maturity of the systemic transformation of those countries.

One can expect these secondary transformations to occur in all privatised enterprises, since such changes represent an entirely normal characteristic of private firms in market economies. Of particular interest, however, is the question how these evolutionary processes are unfolding in "schematically" privatised firms where the ownership structure was originally set – to a greater or lesser degree – by the government. Can we observe any general trends or patterns in these evolutionary processes, or are they varied? Who are the owners emerging in the secondary ownership transformation process? What factors determine the types of secondary changes? How rapid is the pace of ownership evolution? Under what conditions is it particularly rapid e.g., in cases of the appearance of a strategic investor? If the pace of evolution is particularly slow, can we identify factors, which are inhibiting it, as well as the sources of those factors? To what extent is state regulation or the government itself the source of such inhibiting factors, and to what extent are other actors – e.g., insiders – inhibiting the process? What is the impact of the gradual liberalisation of capital flows and the reform of financial sectors, in the context of expected accession to the EU, on the pace and char-

acter of secondary transformations? Do secondary ownership transformations lead to changes in corporate governance (changes in management style or managerial staff) and the intensification of restructuring efforts? Do they affect the financial performance of the companies?

Research attempting to answer these questions should allow us to evaluate the degree of open-endedness of various privatisation schemes – i.e., the degree to which they allow for flexibility in adjustments of ownership structures to the specific needs of individual firms. This was the central research goal of this project.

In the course of the project, additional research questions arose. One of the most important was the problem of the mutual dependency of ownership concentration and structure on the one hand and economic performance on the other. Here, we are concerned primarily with the question of the endogeneity or exogeneity of ownership structure (i.e., is ownership structure a factor determining economic performance, or is it determined itself by performance and the factors which determine performance?). Another was the search for an efficient ownership structure and corporate governance model. Finally, a very stubborn question concerned the role of governmental and quasi-state institutions in secondary privatisation and the influence of the state's policy on residual state property on the process.

Our attempts to answer all of these questions in our research met with partial success. We were able to identify the new owners emerging in privatised enterprises from the secondary privatisation process in each of the three countries, as well as to observe the trends in evolution of ownership structure and the degree of concentration. Moreover, we were able to identify the factors behind this evolution which lie within the regulatory environment of the companies. We built valuable databases for each of the three countries, and these, in turn, allowed us to assess the economic and financial performance of companies undergoing secondary privatisation. However, the number of observations in these databases is too small (that is, the time series are too short) for us to draw unambiguous conclusions concerning the relationships between ownership evolution and performance.

Throughout the course of our research we sought a common scheme for the analysis of all three countries. It turned out, however, that we are unable to avoid the problems of path dependency and the resultant specificity of the models applied and emerging in the various countries. Differences in the corporate ownership and control structures emerging across countries reflect both the specifics of the various privatisation models which they applied and differences in their regulatory environments and macroeconomic policies. For these reasons, our ability to make meaningful international comparisons is impaired. Practical solutions for secondary privatisation must therefore be sought at the level of individual countries, in response to these specifics. Nevertheless, international research like that presented here provides for comparisons which are of great value in the search for such solutions.

Our research has proved that secondary ownership transformations are an important and still insufficiently researched aspect of enterprise adjustment as well as an indicator of the flexibility and stability of the entire economy. We hope that this direction of research will generate sufficient interest to allow it to continue in the three Central European countries we investigated and in other transition countries. We believe that this research will provoke profound international discussion, which in turn should lead to formulation of policy recommendations, both for countries in a more advanced phase of ownership transformations (e.g., how to change regulations to allow for more flexibility in secondary ownership transformation) and for countries currently developing their own privatisation programs.

2. Objectives of the Research

The main objectives of the research were formulated as follows:

1. Identify the "nature" of secondary ownership transformations of enterprises privatised under formalised privatisation schemes in three Central European countries, with particular focus on:

– the scope and pace of secondary ownership changes and factor affecting them;

– trends in secondary ownership transformations (e.g., identification of types of emerging new owners);

– selection processes for agents involved in secondary ownership transformation;

– barriers to secondary ownership changes, especially those resulting from institutional factors and state regulations;

– the effects of the regulation of primary privatisation schemes on secondary privatisation processes, and

– the impact of pre-accession policies (especially the liberalisation of capital flows and the reform of financial sectors) on the pace and character of secondary transformations.

2. Formulate and examine (using statistical methods) hypotheses concerning:

– relationships between changes in economic performance and primary and secondary ownership transformation;

– relationships between changes in corporate governance and secondary ownership changes, and

– the effectiveness of various privatisation schemes in terms of their open-endedness.

3. Formulate a set of specific recommendations concerning necessary changes in the area of regulations in particular countries and more general recommendations concerning the utility of various alternative privatisation schemes for other countries.

3. Scope and Methodology of the Research

Three countries were included in the project: the Czech Republic, Poland, and Slovenia. In each case empirical studies of the ownership changes that have occurred since privatisation in companies privatised by voucher (mass) privatisation and/or employee buyouts were carried out. These were supplemented by analysis of the relationship between performance and ownership changes. An effort was made to ensure a maximum of methodological uniformity. However, this was not always possible. The approaches used in the research are summarised below.

3.1. The Czech Republic

The data on Czech companies is a combination of data sets on financial indicators, ownership characteristics and employment of companies privatised in the two waves of the voucher scheme. They were prepared by a Czech commercial company (Aspekt) using official company accounts filed by joint stock companies, the Prague Securities Centre and company reports. The financial data are annual and covers the period of 1993–1999. The ownership data included the identity and the equity holdings of up to seven of the largest shareholders of each company since 1996. The owners were categorised into six types: other industrial groups or companies, investment funds, portfolio investors, individuals, banks, and the state.

The primary changes in ownership structure in the 1996–1999 period were first calculated using three ownership concentration measures: the average percentage of the equity owned by the single largest owner (C1), the average percentage of the equity owned by five largest owners (C5), and the Herfindahl Index of ownership concentration (H; this is the sum of the squared shares of each owner). The authors also calculated the mean ownership position for each of the six categories of owners mentioned above, and used density functions of ownership concentration indices to paint a broader picture of ownership structure and its changes during the period from 1996 to 1999.

To capture the relationships between the ownership changes described above and various aspects of enterprise performance, the authors carried out regressions employing the ownership variables described in the foregoing as well as financial indicators including profitability, sales and debt. The performance variables were regressed on various ownership variables as well as industry and sector dummies.

3.2. Slovenia

In their analysis of ownership changes in Slovenia, the authors first presented the C1, C5, C10 and Herfindahl concentration indices for all mass privatisation companies at the end of primary privatisation, and then the changes in those indices which had emerged by 1999. Then, using for a sample of 183 mass-privatised companies, they presented the weighted averages of shares of various types of owners (state funds, investment funds, managers and employees, domestic and foreign external investors) at the time of completion of primary privatisation and in 1999.

To examine the relationship between ownership and performance, data from financial accounts from the period 1995–1999 were used for 426 mass-privatised companies. These companies were divided into groups depending on whether they were publicly traded, owned primarily by internal owners (management and employees), or owned primarily by external owners (for the most part, state and investment funds), and whether they had switched from one of these categories to another. In their analysis the authors were particularly interested in identifying what they called owner effects (the performance effects of staying in one ownership category) and agent/seller effects (the perfor-

mance effects of moving from one ownership category to another). Performance indicators used in this analysis included the growth in labour force, sales and assets, and productivity, and the ratios of operating profit, operating profit increased by depreciation, and net profits to sales revenues.

Correcting for selection bias, the authors regressed measures of performance on various factors not related to the ownership structure which were thought to have an impact on performance as well as dummy variables for different ownership groups of companies.

3.3. Poland – Companies Privatised by Management-employee Buyouts

In this study, 110 firms privatised by the lease-leveraged buyout method between 1990 and 1996 were analysed. First, weighted averages of the shares of various groups of owners (strategic investors, other domestic and foreign external investors, and various groups of insiders) at the time of privatisation and in 1997, 1998 and 1999, as well as the evolution of C1 concentration, were presented and analysed.

In an attempt to analyse factors affecting ownership changes generally, the authors considered trends in ownership evolution by initial ownership structure, branch (industry, construction, services, and trade), size (employment), and profitability. In an attempt to gain some insight into the relationship between ownership and the companies' development prospects, the authors looked at various measures of development-oriented activities, including investment activity, expansion into new markets, etc., examining their correlations with ownership variables.

Finally, corporate governance in the employee-owned companies was examined, with special attention devoted to the role and composition of the supervisory board and the role of owners and top management in decision-making process.

3.4. Poland – the National Investment Fund Program

The data on the 512 companies in the National Investment Fund Program were collected from the Ministry of State Treasury, the annual reports of NIFs and their portfolio companies contained in the publication *Monitor Polski*, and the reports of the Association of National Investment Funds. For some of the companies that have been floated on the stock exchange, further information was obtained from the Warsaw Stock Exchange.

Ownership changes in the 1995–2000 period were analysed by looking at how many companies in the NIFs' portfolios were sold to what types of investors (i.e., domestic corporate, domestic individual, employee, foreign, other NIFs, public trading) in which years. The economic performance of NIF portfolio companies was compared with other groups of companies in Polish economy, and then the group of NIF companies was broken down with respect to type of owner that acquired (or kept) them, and these groups compared with each other. The basis for comparison was annual sales.

A great deal of attention was also paid to the issue of changes in the ownership of the funds themselves as well as the issues of corporate governance in the funds.

3.5. Comparative Study: Czech Republic and Polish NIFs

The authors made a comparison of ownership developments in the Czech sample described above and in Polish NIF companies. Like most of the other authors, they focused on two aspects of the evolution of ownership: changes in concentration and the reallocation of ownership rights between various groups of owners (individual shareholders, financial institutions, other companies, banks, state, etc.).

For the Czech Republic, they analysed the transformation matrix and a breakdown of the companies with respect to concentration of less than 20%, 20–50% and over 50%. For the NIF group, they made an analysis of the evolution of the C1 concentration index, and then looked at changes in the equity holdings of the state, NIFs, and various types of investors (domestic corporate, domestic individual, employee, foreign, other NIFs).

Finally, having shown that ownership structure of firms included in the mass privatisation programmes in Poland and in the Czech Republic has undergone significant changes, the authors test several hypotheses concerning the determinants of this evolution.

4. Research Output

4.1. The Czech Republic

The years 1991–1995 were marked by an ongoing process of voucher privatisation. Although in the Czech privatisation five methods of ownership transfer were employed, almost 40% of the property within the scope of "large" privatisation was privatised through the voucher scheme. The scale of the voucher program can be appreciated by examining the share of total assets placed in it. The first wave of the voucher program included about 7.5% of the total country's capital assets. The second, somewhat smaller wave, was completed by the end of 1994 and accounted for about 4.5% of the country's assets. An additional illustration of the scope of the program is the fact that 988 firms out of the 2,404 firms in the first wave had some or all of their shares allocated to the voucher program. The vast majority of these firms distributed over half of their net worth through vouchers, with an average of 61.4% of capital being placed in the voucher scheme. The second largest share (23.3%) was retained by the Fund for National Property (FNP). Similar trends were observed in the second wave.

Thus, while it was only one of many possible methods of ownership transfer, the voucher scheme in fact became one of the most decisive factors of ownership distribution in the Czech Republic.

Privatisation Investment Funds (PIFs) took an active part in carrying out the voucher scheme. As a result of their participation the PIFs are among the most important owners of equity in the Czech voucher-privatised firms. The funds represented the most popular way for citizens to invest their vouchers in the voucher privatisation. The founding institutions of the privatisation funds originated from a broad spectrum of different legal bodies. A significant number of them were financial institutions of various types, which are referred to as banks for simplicity's sake. The rest of the market with voucher points to be allocated to PIFs was within the domain of funds that were created by other institutions. The majority of these institutions were manufacturing companies.

More than 400 PIFs participated in the voucher scheme, and the most successful ones were connected with existing financial institutions. The 13 largest funds received more than 100 million voucher points each, thereby obtaining control over 56% of all points allocated to PIFs. Altogether, the first five largest PIF founders captured more than half of the voucher scheme market in the first wave and a little less in the second wave. The immediate post-privatisation ownership structure of privatised companies can shed some light on the role of PIFs in the process. Out of 988 enterprises from the first wave, in 102 of them the single largest PIF owned 20% or more of the shares. The two largest funds owned 20% or more shares in 673 companies, and the four largest funds held 40% and more shares in about 400 companies. In comparison, foreign and domestic strategic investors held 20% or more of the shares in 40 firms. Foreign owners acting alone had a 50% share position in 19 companies. This tendency toward overwhelming fund dominance decreased somewhat after the second wave of voucher scheme, which was characterised by the funds selling many of their shares to individuals and corporate entities. It seems that the funds were implementing a strategy of liquidating excess share holdings in order to create well-diversified, risk-minimising portfolios.

The resulting ownership structure after both waves was more or less an outcome of the logistics in the administration of the voucher scheme. In 1995 changes in ownership also reflected regulations to prevent excessive stakes being held by privatisation funds. More economically meaningful patterns of ownership structure began to emerge in the Czech companies in 1996.

An important stage of ownership development during the early post-privatisation period was nicknamed the "third wave of privatisation". Here, heavy inter-fund trading rearranged the PIFs' portfolios. This was carried out under almost complete lack of government intervention in the way of enforcement of legal provisions and regulations. During this stage many funds surpassed the 20% ceiling for shareholding in a single company. In addition, in 1996 several investment companies found a legal

way of circumventing the 20% shareholding cap by transforming themselves into holding companies. Overall, the central features of the "third wave" are the increasing concentration of corporate ownership structures and the attempts of various investors to build up large financial conglomerates.

The "primary" privatisation process brought companies out of state ownership; however, lack of regulation created an extremely soft management environment. As mentioned above, since 1995 investment funds have started to reorganise their portfolios, and a certain part of companies have undertaken the task of restructuring to become competitive. It was argued that the presence of privatisation funds in the ownership structure of a company is desirable up to a certain level of fund involvement as a source of funds for financing restructuring. However, too much proprietary involvement of a fund can have a bad influence on a company, because profits are extracted from the company rather than being used for investments and eventual restructuring. Naturally, such behaviour is indicative of weak corporate governance.

Another important problem, influencing the quality of corporate governance of voucher-privatised firms, was the relatively high margin of residual state property left after the completion of voucher privatisation in the Czech Republic. In exchange for vouchers, the PIFs acquired shares in numerous companies in which the state retained a share. Moreover, a number of these funds were formed by financial institutions in which the state has kept a large share. Thus, these funds involuntarily became to a certain extent institutional managers of the residual state property. Apart from the residual state property that is in reality managed by privatisation funds, the state still maintains an important share in numerous joint stock companies. The most valuable portion of assets falls into the category of 20 companies considered as strategic, in which the state holds more that half (but less than three quarters) of the shares. The relative book value of all companies in which the National Property Fund has a share of over 50% represents a spectacular 41% of all assets in the state portfolio. If we take into account additional means of control (golden shares, strategic company status), then state control reaches 76% of the book value of all companies in the portfolio of the National Property Fund. One cannot but conclude that the state maintained its influence over a significant part of the Czech economy in spite of the voucher privatisation. Additionally, the state explicitly excluded a certain amount of assets from privatisation. Thus, the residual state property in the economy is partly the result of the inefficiency of the privatisation process and partly the intentional outcome of the refusal to carry out further privatisation.

In the years following the formal end of the voucher privatisation, the government did not initiate many changes for further privatisation. Thus, the state has kept massive shares in the already voucher-privatised companies. The privatisation of the commercial banking sector has been one of the most positive achievements of the period following voucher privatisation so far and is well advanced at the time of writing.

A specific feature of the Czech voucher privatisation was the collective investment opportunities offered by numerous privatisation funds at the onset of the voucher privatisation scheme. This scheme resulted in the distribution of enterprise shares not amongst a large number of individuals, but amongst a large number of privatisation investment funds. Specifically, one third of the investment companies gained control of over two thirds of the total enterprise shares obtained by all funds. The lax legal environment and the absence of any notification and disclosure requirements facilitated a wave of mergers and acquisitions, which contributed to further concentration of ownership. These mergers and acquisitions created an extensive web of relationships. Concerns were raised about a financial oligarchy controlling a considerable part of the economy and exercising undue influence over the market structure.

Under severe pressure from the public, the press and the opposition parties, the government speeded up legislation establishing the Securities Exchange Commission. Additionally, the Czech National Bank has prepared new draft laws on the banking system which will introduce new restrictions on the ownership of banks and on the structure of their portfolio investment. The government has also drafted the Law on Investment Companies and Investment Funds, aiming to reduce the maximum limit of a fund's ownership of a company from 20% to 11% and, more importantly, preventing the representatives of investment funds from sitting on company boards. Although these changes to the regulatory framework may solve some of the problems of the existing system, they are also likely to affect the system of corporate governance adversely.

A 1998 OECD report sums up this post-privatisation situation when it states that the Czech voucher approach to privatisation produced ownership structures that "…impeded efficient corporate governance and restructuring." The essence of the problem was that insufficiently regulated privatisation investment funds ended up owning large or controlling stakes in many firms privatised by vouchers, as citizens diversified risk by investing their coupon points in these funds. But most of the large funds were owned by the major domestic banks, in which the Czech state retained a controlling or even majority stake.

Many conclude for these reasons that Czech firms privatised through vouchers, in which investment funds hold the controlling stakes, have not been sufficiently or persistently restructured. Authors looking at financial performance in a set of Czech firms concluded that while ownership concentration

in hands other than those of the funds has a major (and positive) effect on performance, there is no evidence of a positive effect of ownership shares by funds on the performance of operating companies. The proximate and most visible reasons of inadequate restructuring are weaknesses in capital and financial markets. On the other hand, the reason for failures in the voucher privatisation method is the method itself, with its emphasis on speed, its postponement of consideration of the legal and institutional framework aspects, and its atomisation of ownership.

An analysis of changes in ownership structure and their effect on firms' economic performance pointed to a set of essential outcomes. Results from the immediate post-privatisation period show that between 1996 and 1997 ownership concentration in a sample of the voucher-privatised companies generally increased and was, in comparison to many developed countries, extremely high. The average single owner (C1) held close to 39% of shares in a company in 1996 and more than 42% in 1997. The five largest owners (C5) held almost 58 and 62 percent of shares in these years, respectively. The highest concentration was found among the domestic and foreign strategic investors, the lowest among banks and portfolio investment companies. The largest increase in ownership concentration was recorded for the category of state ownership (!) and domestic strategic investors, followed by investment funds and non-bank sponsored PIFs in particular. Remarkably, the average share ownership of the state was still very high (almost 35%) and was mostly concentrated in such strategic industries as energy, banking and utilities. The number of firms with foreign strategic investors was still relatively low in 1996–1997. Since, at the end of 1990s, the Czech Republic faced an accelerated inflow of FDI, we can expect an increase in this group of firms, perhaps crowding out state ownership to some extent. The number of firms in which the PIFs had a share was very high in 1996 (566 companies – or almost the half of voucher-privatised firms), but declined in the next year to 348, while the average share of the PIFs rose from 31 to 34%.

Further outcomes were derived for the years from 1996 to 1999. The ownership concentration in voucher privatised firms was analysed with respect to different concentration levels. Single largest owner was found as a decisive shareholder. It was found that important changes in ownership concentration happened on three intervals that characterise the degree of ownership. These are the intervals where a single largest owner holds 0–35, 35–63, and 63–100 percent of shares. During the relevant period the largest changes in ownership concentration were found in those voucher-privatised firms where single largest owner held a stake of 15 to 35 percent of shares.

The overall change during years 1996–1999 can be characterised by saying that only 40% of firms belonging to the first interval in 1996 remained in this cluster through 1999. On other hand, 53% of all firms belonging to the second interval <35,63> in 1996 remained in this cluster through 1999, and 79% of firms that were in the third cluster in 1996 remained in this category through 1999.

The changes in ownership structure were analysed by looking at which of six types of owners (industrial companies, banks, investment funds, individual owners, "portfolio companies"[1], and the state) was the largest shareholder in each of the companies. In general, the highest average concentration increase between 1996 and 1999 was recorded for investment funds (50%) and portfolio companies (40%) as single largest owners. A negligible change was observed in case of banks (4% increase).

More detailed information about changes in the type of the single largest owner between the years 1996 and 1999 can be condensed in the following observations: Industrial companies are the most stable type of largest owner, followed by individual owners. The most unstable type of owner is the portfolio company. Only 5% of firms owned by portfolio companies in 1996 had the same single largest owner in 1999. Industrial companies recorded by far the largest ownership gains in this period.

Based on the sector division made by the Prague Stock Exchange (19 industry categories), the authors conclude that the firms did not exhibit excessive ownership differences with respect to sector-specific attributes in 1996. This outcome is different in 1999, when such sector-specific features are present for five categories. Further, the authors observe that in their sample, firms concentrate into five sectors: construction and building materials, mechanical engineering, trade, services, and investment funds. These five sectors cover about 60% of all firms in 1996 and 1999.

In an econometric analysis of performance a broad set of financial variables was defined in order to capture different aspects of performance. These included profitability, strength and size of the firm, its financial position, and its scope of business activity. Moreover, in order to analyse the effect of the type of owner on a firm's performance, the models incorporated two types of dummy variables, one for five different categories of owners, and one for the total share of owners from each of the six aforementioned categories in a given firm. Based on pre-testing procedures, the authors adopted a random effects model.

[1]This term refers to a category of owners whose strategy is solely to realise profits through dividend payments or, more frequently, through capital gains and who normally do not have ambitions to participate in corporate governance.

The authors concluded that ownership concentration does not explain changes in company performance. Further, no industry sector was found to have a specific effect with respect to performance. Using a random effects model, they found that if the single largest stake is held by a portfolio company the change in total and fixed assets, gross operating profit/sales, and operating profit is higher than in other cases[2], where coefficients were insignificant. In addition, firms where an individual is the single largest owner exhibit higher growth of sales of own production. No evidence of an effect of a specific type of owner was found for two other performance criteria: value added/staff costs and cash flow/equity.

4.2. Slovenia

After prolonged debates about how to privatise companies in Slovenia, a compromise model was adopted, which in principle allowed for paid and non-equivalent (i.e. mass) privatisation. The basic model of privatisation (20% + 20% +20% + 40%) according to the Ownership Transformation Act (OTA) envisaged:

1. Transfer of 20 percent of shares to para-state funds: 10 percent to the pension fund and 10 percent to the restitution fund.

2. Transfer of 20 percent of shares to privately managed privatisation funds in exchange for ownership certificates collected by them from citizens.

3. Exchange of 20 percent of shares at favourable terms for ownership certificates of internal owners (managers, current and former employees).

4. Optional use of 40 percent of shares:

(4i) for buyouts at favourable terms by internal owners,

(4ii) in exchange for ownership certificates of citizens in public offerings,

(4iii) in exchange for ownership certificates collected by privatisation funds or

(4iv) for purchases by strategic owners.

Since the latter part of the privatisation model was optional, it had the potential to lead to the emergence of differing ownership structures, adapted to the needs of individual companies. However, the legal principle of autonomy, by which managers and employees were granted the right to prepare privatisation plans, was a factor that critically determined the selection of privatisation options and led to domination of the entire process by the "insider model".

Thus, companies usually did not opt for sales of shares to strategic owners (4iv). Of approx. 1,500 companies, which were privatised under the OTA, only a few dozen acquired strategic owners. Thus, primary privatisation was a lost opportunity for numerous companies in troubles that required strategic investors for restructuring. Secondary privatisation represents an opportunity for such companies to find them. The owners that emerged from mass privatisation are largely transitional owners that play a role of privatisation agents in search for strategic investors.

The second characteristic of selection of privatisation options was that managers and employees in general exercised their priority buyout right to 40 percent of shares at favourable terms (4i) to the maximum extent that their financial resources allowed. Residual shares were either exchanged for certificates collected by privatisation funds (4ii) or directly distributed to citizens in public offerings (4ii). Thus, apart from privatisation to insiders (i.e., internal privatisation) and privatisation to funds (i.e., external privatisation), privatisation to citizens (i.e., public privatisation) acquired significance in large and capital-intensive companies. The choice between external and public privatisation was made on the basis of judgements as to which of the two options represented a lesser threat to internal owners. Obviously, initial public offerings were not an option in poorly performing companies, whereas the privatisation funds were forced to accept the shares of such companies.

As a consequence, three typical groups of companies were formed, according to the relative importance of the three forms of privatisation and in view of the statutory rules that applied at the commencement of secondary privatisation:

a) public companies quoted on the stock exchange as the result of combined internal, external and public privatisation;

b) non-public internal companies not quoted on the stock exchange, with employees holding majority stakes, and

c) non-public external companies not quoted on the stock exchange, with employees and funds holding comparably large shareholdings.

Privatisation in Slovenia was decentralised on both the supply and demand sides, and in principle a wide spectrum of options was made available by the privatisation law. Nevertheless, in practice, that model limited the selection of privatisation methods on both sides. Of 1,386 companies that underwent mass privatisation less than one tenth (albeit the largest ones)

[2] This is not so surprising, given that a portfolio company is the most unstable owner, as mentioned earlier. Consequently, they have strong incentives to produce profits in short time. On the other hand, individual owners are one of the most stable groups, and may therefore be focusing on more future-oriented tasks such as sales growth.

used public offerings and are quoted on the stock exchange. All public offerings were oversubscribed, some of them by several hundred percent. The majority of citizens, however, invested certificates in companies (as their current and former employees) and in privatisation funds (all of which were quoted on the stock exchange).

Mass privatisation was formally completed at the end of 1998, but has actually remained incomplete on both the demand and supply sides. The portfolio of the state holding company (Slovene Development Corporation-SDC) consisted of a few hundred companies that were excluded from mass privatisation at its early stage, voluntarily for prior restructuring or compulsorily within the state-led rehabilitation of two dominant banks. On the demand side, substantial portions of certificates remained unused in the portfolios of privatisation funds (they represent the so-called privatisation gap).

There was a wide agreement that the success of mass privatisation would ultimately depend on the speed and success of restructuring at the micro level. The argument that the ensuing concentration of diffuse ownership and consolidation of control would serve as a prelude to the entry of strategic investors to companies and their access to external financing to ensure such restructuring pointed to difficult trade-offs. Whereas mass privatisation was state-administered, it was argued that secondary privatisation should be essentially market-driven. For that reason the market would have to be appropriately regulated, and questions arose as to whether the standard Western regulations were adequate for the purpose and whether they actually would not hinder the speed of secondary privatisation and invite fraudulence in its course.

The authors argue that the ownership and control structures created in mass privatisation are sub-optimal for strategic management and restructuring of companies and will have to undergo profound changes in secondary privatisation.

Factors that prevent fast, transparent and effective secondary privatisation stem from the legal and regulatory framework of capital markets and companies, i.e. the corporate governance and finance regime that was established in mass privatisation and is perpetuated in post-privatisation due to the slowness of the legislative and regulatory process. The legal and regulatory framework adopted to guide secondary privatisation postpones transferability of large volumes of shares and applies standard rules for ownership concentration and consolidation of control to all privatised companies with tradable shares, although only a fraction of them are quoted on the stock exchange. Introduced on the basis of flawed assumptions and presented as protection of small shareholders, such restrictions and rules hinder taking private companies and privatisation funds in an orderly fashion. They are evidently abused in practice, while rules for voting on legal changes and reorganisations of corporations (which in the given conditions may be a better protection of small investors), have not been established. As many companies (as well as privatisation funds) ought to be taken private, a systemic solution to that effect is required.

The regulatory and legislative process lacks sensitivity regarding the specific ownership and governance deficiencies concerning the three ownership groups of companies and awareness of the need to regulate and facilitate different routes of secondary privatisation. To that effect, different forms of consolidation of diffuse employee ownership and different routes of transformation of privatisation funds ought to be allowed, regulated and facilitated. Moreover, secondary privatisation depends directly on the manner of privatisation of residual state property (including the exit of para-state funds as owners or financial investors from companies), and indirectly on the manner of privatisation of public utilities and financial institutions.

The empirical analyses show that the first phase of secondary privatisation failed due to limited (foreign) competition, low transparency and low speed. Moreover, problems emerging from primary privatisation as well as regulatory failures in other areas in Slovenia have led to a waste of the momentum for fast and orderly secondary privatisation and made the search for solutions in secondary privatisation even more cumbersome.

The second part of the paper examines the data on evolution of ownership structures and concentration following mass privatisation in Slovenia. Companies are grouped according to the prevailing privatisation model into public, internal and external. Public companies are traded on the stock exchange, in non-public internal companies internal owners dominate over external owners (mostly privatisation funds and para-state funds), while in non-public external companies the situation is reversed. Internal and external companies are not traded on the stock exchange, and the consolidation of ownership in these two groups is therefore less transparent than in public ones.

The data reveal that between the completion of privatisation and the end of 1999 almost 40% of initial shareholders have already exited companies privatised through mass privatisation. Ownership concentration was strengthened in all groups of companies, but most intensively in internal companies. At the end of 1999 ownership concentration is relatively high in all groups of companies: the five largest owners on average hold 61.5% percent of the votes in mass privatised companies. It seems that the principal-agent relationship between managers and shareholders is less of a problem than the conflict between large and small shareholders. Moreover, in Slovenia large shareholders are para-state funds and privatisation funds, both lacking the ability and motivation for proper corporate governance. On

the other side, many small shareholders are company insiders who act as a homogeneous group vis-à-vis external owners. It might well be that with concentration of ownership in the period 1994–1999 the problem of managerial discretion was reduced, while the conflict of interest between internal and external owners has become worse.

Small shareholders, the state and para-state funds are reducing their ownership stakes in the companies from mass privatisation, while managers and strategic investors are increasing them. It is observed that both of the latter groups are accumulating their shares more intensively in companies not traded on the stock exchange. Therefore, transactions are made on informal markets with limited competition and transparency. In addition, new strategic investors appearing through the end of 1999 are almost exclusively of domestic origin. Initial privatisation, with free distribution of shares and limited foreign and strategic investors, is followed by non-transparent domestic consolidation of ownership, where domestic companies, managers and funds are the key players. A more intensive entry of foreign portfolio and strategic investors in privatised companies can be expected only later, in the course of accession of Slovenia to the European Union. On the basis of available data the overall assessment of the post-privatisation ownership consolidation in Slovenia is that the major problems are quality and transparency of the process rather than its low speed.

The authors argue that in mass privatisation schemes, in general, initial ownership structures were intended to be transitional, with optimal ownership structures emerging gradually as a result of secondary transactions. Therefore, they suggest that the success of mass privatisation should be judged by its "agent/seller" effect, i.e. considering if temporary owners sell fast and successfully to other owners (primarily to strategic owners). The success of secondary sales is hence not to be evaluated by the achieved price but by the recognition, how successfully companies perform after the sale to new owners.

The econometric results presented in the study indicate that secondary privatisation has had practically no positive effect either on economic efficiency or on financial performance in the 1995–1999 period in Slovenia. The analyses by individual privatisation models, individual years and for the whole period did not render any different results. The authors concluded that this confirmed their earlier hypothesis that improvements cannot be expected by acceleration of secondary privatisation only, and that the prime problem of secondary privatisation is related to its quality, whereas slow speed is only a secondary problem.

4.3. Poland

In Poland, the two privatisation paths that may be classified as "schematic" or "wholesale" were the employee buyout method in the framework of direct privatisation and the National Investment Funds Program. Two separate studies of each of these programs have been prepared, because the two schemes differ significantly from each other and deal with two different groups of companies. Why do the authors treat EBO privatisation as a wholesale scheme, despite the fact that it was a bottom-up privatisation procedure, initiated by the managers and employees themselves? The authors do so because the legal framework for this method was highly regulated by the government and fairly strict criteria concerning the structure of ownership had to be met (specifically, it was required that at least 50% of the employees of the state enterprise become shareholders in the new company). Also, the preferences given for insiders in this type of privatisation influenced the lease/sale contracts to a great extent. For these reasons, the ownership effects of this privatisation probably diverged considerably from the ownership structures that would have emerged without government regulation, supervision and preferences. On the other hand, it should be noted that this privatisation path required much organisational and financial input from the buyers and differed considerably in this respect from give-away methods. More importantly, the ownership structures established by this procedure were simple and did not include the artificial construction of the mass privatisation schemes.

4.3.1. Employee-leased Companies in Poland

The vast majority of employee buyouts in the Polish privatisation process have been generated via the leasing variant of direct privatisation, therefore, they will be often referred to as employee-leased companies.

In the leasing variant of direct privatisation, at least 50 percent of the employees of the state enterprise being liquidated must form a company to lease the assets of the enterprise. Moreover, no corporate investors or foreigners were allowed to participate in the absence of special permission from the privatisation ministry. For this reason such companies are commonly referred to in Poland as "employee-owned companies". By 31 December, 1998, 51.1 percent of all ownership transformations were conducted under direct privatisation[3] and the lease-leveraged employee buyout represented about one third

[3] As of 31.12.1998, 2966 state enterprises had completed either privatisation or liquidation, with 240 cases of indirect privatisation, 512 firms transferred to the National Investment Funds, 1515 cases of direct privatisation and 699 Article 19 liquidations.

of the completed privatisation cases carried out under the supervision of the privatisation ministry[4], thus constituting the single most frequently used method. It is important to note that this privatisation method was intended by Polish legislators to be applied in the case of small and medium-sized enterprises, and for the most part this has been the case in practice. Most of the firms in this category are small- to medium-sized firms, usually with less than 500 employees.

The ownership structure of Polish employee-leased companies, especially immediately after privatisation, was characterised by large holdings of dispersed insider owners. From the very beginning, employee leasing has been the most "employee-oriented" privatisation path, in terms of ownership structure. Immediately following privatisation, insiders possessed, on the average, 92 percent of the shares in the sample of employee-leased companies, and in 95 percent of those companies, insiders owned over 50 percent of the shares.

Subsequently, the shares of non-managerial employees gradually decline, while those of outsiders grow. In employee-leased companies, the share of non-managerial employees in ownership has steadily decreased, from 58.7 percent immediately after privatisation to 31.5 percent in 1999. It is worth noting, however, that despite widespread selling of their shares by non-managerial employees, by 1999 only in 6 percent of firms had this group of owners vanished completely. In most companies, non-managerial employees retained minor blocks of shares at least. Often, those blocks were very small: in 17 percent of the companies they did not exceed 10 percent, and in almost half of the companies (43 percent) non-managerial employees did not have blocking capabilities at shareholders' meetings (at least 25 percent of the votes). Because of the dispersed character of these blocks of shares, in practice the voting capacity of non-managerial employees is even weaker than these numbers indicate. If we assume that this group would need at least 50 percent of the shares in order to block certain decisions at a shareholders' meeting, then it is clear that in at least 76 percent of the companies under review, non-managerial employees lack decisive influence on the decision-making process as owners.[5]

While non-managerial employees were losing their shares, the number of shares in the hands of outsiders increased fivefold (from 7.6 percent to 38.5 percent). Almost all of them are domestic investors; only three firms in the sample have foreign investors (in two cases, strategic investors). A large portion of the outsider shares represent concentrated holdings: 44.4 percent of the outsider shares were held by owners whom respondents referred to as strategic investors. There is also a large group of private firms and entrepreneurs (18.7 percent).

However, the second largest group of outsider owners consists of unidentified "others" (34 percent of outsider shares). One might hypothesise that this group consists mostly of former employees of the companies who lost their jobs due to layoffs, retired, or left for other reasons.

Concentration of shares in the hands of managers can be seen from the very moment of privatisation. Later, however, managerial holdings stabilise and even decrease somewhat in favour of outsiders.

The sample of employee-leased companies is gradually becoming more and more heterogeneous. We observe three chief directions of ownership structure changes:

– perpetuation of a dispersed shareholding structure, with dominance of insiders (an approximation of an egalitarian, worker co-operative ownership structure);

– consolidation of ownership in the hands of insider elites;

– concentration of ownership in the hands of outside investors.

In general, however, change is incremental. Radical changes in the ownership structure are rare, and ownership structure seems to be fairly inert. It would, nevertheless, be wrong to conclude that significant change is not possible when it is in the interests of the incumbents, as new strategic investors had appeared in about 10 percent of the sample by 1998. (It is, however, worth noting that there is a negative relationship between the size of top management's share and the appearance of strategic investors; it appears that once managers have decisive control over the ownership structure of a company, they are reluctant to relinquish it.)

A number of factors which influence the direction and the dynamics of ownership changes, among others sector affiliation, company size, initial ownership structure, etc., but the most important is the economic condition of the company, which, when it is poor, favours concentration and "outsiderisation" of ownership (as well as changes in corporate governance). Management ownership on the average appears in relatively small companies, while strategic investors appear in companies whose average employment is above the sample average. This is probably due to the fact that, given low levels of personal savings at the beginning of the transformation, it was more difficult for an individual or small group of individuals to buy a large block of shares in a large company than in a small firm.

Post-privatisation ownership transformations were achieved not only by trade in existing shares but also by issues of new

[4] Since about 66 percent of the direct privatisations were leasing cases. See Central Statistical Office (1999), 31.

[5] Of course, they can influence decision-making in other ways, for example, through trade unions, workers' protests, etc. However, analysis shows that the situation in almost all employee-leased companies is largely free of conflicts, with trade unions passive and even – in many companies – ceasing to exist.

ones. Nineteen firms had carried out new share issues by mid-1997. Most frequently, new share issues serve to promote concentration of shares (especially in the hands of management and strategic investors).

Access to credit and company size seem to be the most significant determinants of investment spending. Very surprisingly, the presence of strategic investors seems to be unrelated to investment spending. Many firms in the sample refrain from making dividend payments, but there is no indication that this leads to increased investment and may simply be a result of abuses by management. There is some evidence that concentration of shares in the hands of management is positively related to investment, while the evidence concerning the relationship between the share of non-managerial employees and investment is ambiguous. There appears to be no relationship between ownership structure and marketing activity or expansion into new markets (the former is most strongly related to company size, and the latter to the branch in which the company is operating). However, companies with strategic investors do much better than others in the area of ISO quality certification.

There is (very) slight evidence that the extent of non-managerial employees' share in the ownership of the firm had a negative effect on economic performance in the early 1990s. In particular, there is a case – albeit a weak one – to be made for the claim that companies whose employees constitute the dominant owners follow a policy favouring consumption (wages, dividends and the like) over investment and development. However, the situation in the companies is likely to be differentiated, with the character of relationships between ownership structure and economic decision-making dependent on many factors, which the authors were unable to analyse here.[6] An example of such differences is found in the opinion encountered by one of the authors of this paper in case studies of Polish employee-owned companies, according to which the most consumption-oriented attitudes are exhibited by former employees. One of the company presidents expressing this opinion about former employees also said that he regretted the fact that new employees were unable to acquire shares in the company, since such employees (young, well-educated persons hired in the 1990s) are often the most valuable in the firm. From this point of view, it is possible that employee-owned companies in Poland could gain certain advantages from the creation of trust funds, which would hold employee shares on behalf of the employees, issuing shares to new employees and purchasing them from those that leave the company. Such a mechanism might resemble, for example, the Employee Stock Ownership Plans of the United States.

Turning to issues of corporate governance, the authors conclude with a brief look at executive boards and supervisory boards.

The membership of the executive boards is dominated by persons who had managed the companies before privatisation, when they were still state enterprises. The reproduction of elites is more frequently halted in firms in which over 50 percent of the shares are in the hands of outsiders than in the "insider" firms, especially those in which the majority of shares belong to non-managerial employees.

When viewed over a longer period of time, the evolution of the composition of the supervisory boards has not been unidirectional. Contrary to what one might expect in view of the process of ownership "outsiderisation", the position of insiders measured by numerical dominance in the composition of different boards was markedly strengthened in 1998–1999. In companies belonging to the employees, institutional control is increasingly concentration of in the hands of insiders, while in the "outsider" companies their employees are more and more often allowed to participate in the organs of corporate governance. Moreover, when we look at the evolution of supervisory board composition, we see evidence of increasing representation of stakeholders on this body.

The supervisory boards did not use all the powers they were given, at least during 1998–1999. The use of these powers depends not only on the character of the board, but also on the company's need for such actions. For example, it can be assumed that all supervisory boards are active in reviewing financial documents, statements, etc., while, as a rule, their participation in appointing and dismissing the executive board, approving large transactions, etc., occurs much more rarely.

Extension of the supervisory boards' activities is observed most frequently in companies in economic distress. Interrelationships between the ownership structure and the extension of the supervisory boards' powers are of a more complex nature. Lack of any dominant owners' group is linked to extension of the supervisory boards' activities to the organisational sphere and to the control over the capital and the firm; dominance of employee ownership is linked to the board's "social" activity and control over the firm's assets, and dominance of the managerial staff in the ownership structure is, in general, not accompanied by any

[6] We must remember that each firm in fact constitutes a complex social organism, and the number of groupings and factions is probably proportional to the number of employees. For a clear and comprehensive picture of the decision-making process in such firms, we probably need an in-depth sociological analysis which would reveal the differences among such groups as current and former employees, new and old employees, white-collar and blue-collar employees, employees of various departments and divisions, etc.

extension of the supervisory board's powers, except to the area of finance. Generally speaking, the small role of owners in the decision-making process is striking. The owners most frequently act as decision makers where ownership is concentrated in the hands of a strategic outside investor. The role of owners in decision-making also grows in loss-making companies (at the expense of the powers of the executive and supervisory boards).

4.3.2. National Investment Founds Program in Poland

Our research on the factors behind, and effects of, the ownership evolution of the National Investment Funds (NIFs) and their portfolio companies was concentrated in four areas:

– the changes in the ownership structure of the funds and their concentration;

– the management of the funds (with a focus on corporate governance and management costs);

– the strategies of the funds, especially their privatisation efforts;

– the changes in the ownership structure of the portfolio companies and the trends in their performance.

The analysis presented in the first part of this paper showed significant shifts in the ownership of the funds in the stage of secondary privatisation and a strong tendency to ownership concentration of shareholdings. The share of the State Treasury and small investors decreased significantly, in contrast to the increasing share of institutional domestic and foreign investors and cross-holdings between the NIFs.

At the beginning of the NIF Program (in 1995), the State Treasury (representing the owners of Certificates of Ownership – COs) was the main shareholder of the funds and fully controlled them. Its ownership share started to decrease when the process of exchanging COs for NIF shares began. The share of the State Treasury decreased significantly at the end of 1998, when the validity of the COs expired. As of the beginning of 1999, the state continued to hold only shares corresponding to certificates not redeemed by the citizens and shares reserved for remuneration of the management firms. Since that time, the ownership share of the state in the NIFs has continued to decrease and the Minister of the State Treasury has started to play a passive role in the funds. As a result, by the beginning of 2001 the state's share amounted to 13.4%.

The second important point is the decreasing share of small institutional and individual investors[7] who at the beginning of the program owned 85% of the total NIFs' shares. After the completion of the exchange process, at the end of 1998 these investors owned almost 50% of the total shares of the NIFs. By the beginning of 2001, the share of small and individual investors had dropped to 41% – less than half of its original level.

While the share of the State Treasury and small investors in NIFs has been decreasing, the share of institutional and large investors has been rising. The share of institutional investors, starting at 0% in November 1995, jumped to 46% by the end of 2000. Analysing the shareholdings of large investors, the authors have observed that foreign investors are the chief group responsible for the rapid increase in the involvement of large investors in the Program. In June 1998, foreign investors had only 2.5% of the shares of NIFs, but by January 2001, they had more than 26% of the shares, which constituted 57.5% of the total shareholdings of large investors. At the same time the shareholdings of Polish investors increased much less significantly. In June 1998, Polish investors held 4.1% of the NIF shares, and in January 2001, they held only 13.5%. Analysing the shareholding of large investors, the authors also observe the increasing involvement of other NIFs. As of the end of 2000, almost 6% of NIF shares were owned by other NIFs. All the observed trends – the decreasing share of the State Treasury and small investors, the increasing share of institutional domestic and foreign investors and the growth of cross-holding relations among the NIFs – reflect progressing ownership concentration.

Over a period of 2.5 years (from June 1998 to December 2000) the C1 index (that is, the share of the single largest shareholder) increased from 5.41% to almost 24%, and the C3 index (the share of the three largest shareholders) increased from almost 7% to 42%. the authors' analysis thus demonstrates the impressive pace at which the ownership concentration of the NIFs is progressing. As of the end of 2000, just four years after NIFs' quotation on the Warsaw Stock Exchange and two years after the State Treasury lost its majority stakes in the NIFs, all NIFs achieved a concentration level[8] and ownership structure ensuring full and stable control over the funds. As a result, opportunities for new entries into the NIFs are practically limited to portfolio investments. Any investors interested in acting as large and active players on the NIF share market will have to buy blocks of shares from other large investors who are already playing that role.

The main institutional investors on the NIF share market can be divided into two groups. The first group includes the largest institutional investors, who are interested in controlling the funds. The second group includes the most active portfolio investors.

[7] Small investors are defined as investors who own less than 5% of the shares in a single NIF.

[8] That is, one in which one large investor owns 30–40%, given the dispersed character of other shares.

As of the end of 2000, the three most active investors were domestic financial groups (two banks and one insurance company) who had directly or indirectly gained control over 11 funds. The remaining four funds are controlled by foreign investors.

Analysing the concentration process on the NIF market, the authors hypothesise that the main incentive driving it consisted in the profits that the funds' shareholders derived from management contracts between the management firms controlled by those shareholders and the funds themselves. The very high management fees paid to the management firms consumed a significant part of the funds' financial base, reaching during the years 1997–2000 as much as 50% of the entire market value of their assets. Investors obtained the lucrative management contracts by first achieving shareholdings which gave them dominant position on the supervisory boards of the NIFs and subsequently directing the funds to sign such contracts. Additionally, the synergy effect from managing more than one fund allowed the management firms to maximise their profits.

In the second part of the paper, focused on the management system of the funds, the authors found that the main problem connected with the management of the NIFs resulted from the very complicated corporate governance structure of the funds. The division of tasks, rights and obligations among the three management organs (management boards, supervisory boards, and contracted management firms) and the relations between them and the State Treasury have been unclear from the beginning. There was a confusing combination of subordinate and superior roles of the management firms in this system, but the main difficulties resulted from the ambiguous position of supervisory boards, which acted both as corporate management organs on the one hand and government representatives on the other. Additionally, the members of the NIFs' supervisory boards often tried to interfere in the day-to-day management of the funds. The State Treasury, in turn, was very active in influencing all participants in the early stages of the NIF Program (using both direct and indirect means for exercising such influence).

All these facts created a very confusing situation, in which the mutual relations among the three NIF management organs and the State Treasury had to be clarified day by day in practice, often by the use of political power. This in turn caused many conflicts and sometimes real battles, as well as disappointments all round. Mutual blocking mechanisms in the corporate governance structure of the funds hindered any decisive activity on the part of the fund management.

A second important factor bearing on the overall effects of NIF privatisation consists in the number and contradictory definition of tasks assigned to the funds. Including in these tasks both the economic and financial restructuring of portfolio companies and the privatisation and raising of the value of the NIFs' assets made it difficult to realise all these goals simultaneously, at least in the short or medium term. There was political pressure from the State Treasury as well as from the trade unions of portfolio companies to avoid bankruptcy and liquidation of the companies. Often, there was also resistance from the portfolio companies' unions and management against radical restructuring. In effect, the restructuring activities of the funds, insofar as they extended beyond changes in the management boards of the portfolio companies, had a rather soft and defensive character. Privatisation activities of the funds were sometimes blocked by the State Treasury. The Ministry felt responsible for the performance of the program, and was especially interested in "restructuring before privatisation." It therefore tried to set limits on some of the activities of the fund managers, which were directed toward quicker distribution of shares in portfolio companies. Long lasting battles between the funds and the State Treasury on the choice of "proper" strategies were endemic in the early stage of the program, when the majority of shares were in the hands of the state.

Finally, it turned out that the NIF managers strongly preferred secondary privatisation (i.e., sale to other investors) as the main method of restructuring the portfolio companies. On the basis of the research, the authors suspect that other kinds of restructuring were neither possible in this concrete systemic context nor desirable. The impossibility was due to the huge needs of the portfolio companies and the lack of financial means and industrial restructuring know-how (the lack of "enterprise doctors") at the fund level. And it was probably not desirable due to the doubtful quality of the investment decisions, which would likely be made by players so strongly driven by political forces.

Analysing the costs of management firms services, the authors found that their remuneration was from the beginning set at a very high level, unjustified by the value of managed assets. Additionally, it was clear that the fixed element of the total fee (the annual flat cash fee) was too large relative to the remuneration for financial performance (yearly and final), potentially distorting the incentive system for fund managers. The actual costs of management, moreover, far exceeded all expectations. As of the end of 2000, the total amount spent on management services in the NIFs exceeded the huge sum of 756 million PLN, equalling 42.4% of the entire capitalisation of the funds. By the end of 2000, for example, one NIF had a ratio of costs to capitalisation of 91.3%; in contrast, the only fund in which this ratio did not exceed 15% was the only NIF that was not run by a management firm. Moreover, the relative significance of the fees for financial performance in the entire remuneration of the fund managers was remarkably low.

This shows that the use of contracted management companies was very expensive business for the program. However, in

the case of several management firms, strong efforts undertaken to privatise a large number of companies may explain their management costs. Analysis of the ratio of management costs to capitalisation of the funds shows clearly that the management costs of the funds may soon consume the entire value of their assets. The general conclusion is quite obvious – unless there is an unusual growth in the price of fund shares or a radical reduction in managers' fees, the management costs will exceed the market value of the managed property. In this situation it is very likely that the NIF Program will be concluded sooner than planned (in 2005).

The next question that the authors tried to answer was whether the NIF Program accelerated the privatisation process in Poland, in comparing the privatisation efficiency – i.e., the quantitative privatisation results – of the National Investment Funds (NIFs) and the Ministry of the State Treasury. The "privatisation efficiency" measure used for both these institutions was the ratio of companies privatised in each year, respectively, to the pool of companies available for privatisation at their disposal. The type of investor to whom companies were sold was also taken into consideration. It turned out that the privatisation efficiency (or speed) was much higher at the funds than at the ministry. It was also showed that NIF efficiency, both in absolute terms and relative to MST privatisation efficiency, reached a peak in 1998. Since 1999, in which privatisation and bankruptcy exceeded the critical amount equal to half of the companies held by the NIFs, their privatisation efficiency has been decreasing, possibly because of the internal and external barriers that appeared in the program.

In the next part of the paper the authors looked at the reaction of the market prices of NIFs' shares to the differences in the privatisation activities of the funds. The analysis of the correlation shows a very strong positive relationship between the real price of a fund share on the one hand and the number of companies sold to foreign investors. There is also a positive correlation between the real price and the number of companies quoted at the public market, the number of companies sold to domestic investors and the total privatisation activity of funds. The authors conclude, therefore, that the capital market places a premium on funds whose privatisation strategies put special emphasis on selling companies to foreign investors and, to a lesser extent, selling companies to domestic investors and quoting them on the public markets. Finally, it seems that the capital market rewards a high rate of privatisation activity, which is reflected in the higher prices of the funds' shares.

With respect to the evolution of ownership structure of the NIF portfolio companies themselves, it was found that as of December 2000, over half of these companies (278) have gained new investors, including companies quoted on the stock exchange (27) or over-the-counter market (12). In addition, 78 companies were under bankruptcy or liquidation procedures (of which nine have already been liquidated at the time of writing). In all, secondary privatisation has affected, in the authors' estimation, 330 firms. Some of them have mixed structures; for instance, part of the shares of a company with an active shareholder may be traded on the stock exchange. In 57 firms, foreign investors have appeared. In 89 companies the State Treasury share has been reduced to zero. Each NIF sold between 5 and 23 of its portfolio companies to investors. Of the 278 NIF companies transferred to date, 91 were sold in 1999 and 2000. On the whole, therefore, the authors did not observe a significant acceleration in this area. All categories of investors participating in other types of privatisation in Poland are represented among the new owners of the NIF companies. The most numerous new owners are domestic strategic investors (large domestic companies), who became shareholders in over 134 companies. The next, most numerous category of new owners consists of foreign investors, who have taken over 57 firms. Individual private owners took over 48 firms. Employees became shareholders in 14 NIF companies.[9] Finally, 25 companies were publicly quoted (on the stock exchange and the over-the-counter market). Among these publicly traded companies, 16 companies also have leading shareholders.

To conclude this section, the authors turned their attention to a more detailed examination of the ownership structure of the NIF portfolio companies. According to these data, the concentration in the companies began to increase, more slowly than in the funds, but remarkably. By the year 2000, the largest shareholders were in near-absolute control in about one third of the companies.

With respect to the concentration of ownership stakes, on the average, most strategic investors have gained absolute control (more than 50%) of the firms' equity. Financial institutions and other NIFs have, on average, about 33–35% of shares. The employees, who were given special privileges in the Polish mass privatisation, have acquired control of only a small number of companies. It seems likely that the character of the secondary ownership changes in the NIF companies provides some promise for the development of their future potential. The structure of ownership emerging in these companies is different from the structure that had been created in the pool of firms privatised

[9] Given the fact that investors from this group are generally unable to provide the capital support necessary to these weak companies, the fact that the participation of employee-owned companies in the secondary privatisation process has been so limited should be seen as fortunate.

by other methods in Poland, since in most cases new strategic investors, who can be future agents of changes, have appeared.

One of the main research questions, to which the authors are at this point only able to provide a partial answer, is the extent to which the construction of this privatisation scheme influenced the economic performance of the enterprises privatised thereby. At this stage, it seems that the initial ownership structure of the NIFs, the associated corporate governance regime, the financial situation of the funds and their regulatory environment have not motivated fund management to engage in restructuring activities in enterprises, but have rather encouraged sales and liquidations. This tendency has been strengthened by the management incentive system existing at the NIF level. At the same time, strong government influence has hindered faster privatisation of the NIF portfolio companies and the consolidation activities of the funds. The internal inconsistency of the NIF system, together with the unfavourable conditions on the capital market, unfavourable tax regulations and the activist stance of the State Treasury, narrowed the scope of possible activities of the funds and might be among the main reasons for the unsatisfactory results of this program.

The next part of the paper deals with the economic performance of NIF portfolio companies. The authors report that the economic and financial performance of the NIF companies deteriorated in the early stage of the program because of its delay and the lack of restructuring activities during the waiting phase. This resulted in a very sharp decline of all economic and financial indicators of the whole NIF sector. Other systemic reasons that were discussed above seem to have strengthened this tendency. The authors discussed selected economic and financial indicators for the entire group of NIF portfolio companies from 1991 to 1999, in comparison with other groups of Polish firms, categorised by the character of their ownership. This analysis gives little grounds for optimism. In 1995, profitability fell rapidly, and the NIF group became unprofitable. Their performance continued to deteriorate in each subsequent year (with the exception of 1997).

In 1999 this group of Polish enterprises had the worst profitability of those presented in the analysis. Net profitability started to decrease for the NIF companies in 1995 and never recovered. Much better results were achieved in 1999 by other groups of privatised enterprises, and even by State Treasury companies. It is clear that the strategies of other investors in privatised enterprises were more effective in generating improvements in companies than were the NIFs. The percentage of NIF firms achieving profits was also one of the lowest, and was systematically declining. The entire financial analysis of NIF companies in comparison with other Polish companies leads the authors to the conclusion that control by the funds has not caused an improvement in the performance of the portfolio companies which are in weak condition.

In the final section of the paper the authors investigated the financial situation of NIF companies that have undergone secondary ownership changes (i.e., have been sold entirely or partially to new owners), using a database on individual companies that they compiled. They then divided the NIF companies into groups by the type of new owners emerging as a result of secondary ownership changes (domestic and foreign strategic investors, private individuals, employees, companies quoted on the stock exchange, and those companies in which National Investment Fund continues to be the main owner). They additionally divided the firms that had undergone secondary ownership changes into groups by the date of their sale, in order to take into account the length of the period of influence of the new owners on the enterprises. In analysing the economic indicators and financial ratios they also took into account the number of the companies that have undergone bankruptcy or liquidation in each ownership group.

Because of methodological problems described in the paper, it was very difficult to find significant results from this investigation. In a group of companies as large and diversified as the NIF portfolio companies, given these methodological problems, the best measure of performance appears to be sales. The ratio of sales in 1999 to sales in 1995 allowed the authors to draw conclusions concerning the change in the companies' financial and market situation during that period. They observed the worst situation in companies sold to domestic individuals and employees. The drastic drop in sales (ranging from 30 to 60% for the whole period) for these groups shows that they experienced no positive effects of privatisation during that period. This result is supported by the fact that the highest percentage of companies which have entered bankruptcy or liquidation is found in the group of companies sold to domestic individuals (of 40 such companies, 10 – or 25% – entered bankruptcy or liquidation).

A significant decline was also experienced by companies which were not sold by the NIFs (i.e., where the largest block of shares still belongs to the leading NIF) and by companies which were traded publicly (with the exception of two companies which were only listed in 1999). Although at first glance the status of these two groups of companies appears to be different, it turns out that from the point of view of ownership control they are in similar situations. The largest block of shares in a typical publicly traded company continues to be held by the company's leading NIF or is held by a large, dispersed group of shareholders. Thus, these companies continue to lack a strong outside investor who could bring them capital, know-how, etc.

The authors observed the smallest deterioration in 1995–1999 sales performance in the groups of companies sold to domestic corporations and foreign investors in 1996 and 1997. The groups in which these surprisingly good indicators are found are those which were sold relatively early. Companies sold in 1998 (especially to foreign investors) had much worse results. The worst figures are observed for companies sold latest – in 1999 (these figures are comparable with those for publicly traded companies and those which continue to be owned by the NIFs). The authors seem, therefore, to have confirmed their hypothesis, that quick, efficiently organised privatisation and secondary privatisation help enterprises to maintain or improve their economic and market standing. The NIF Program, which in effect "privatised" the process of privatisation of the portfolio companies, was a success only to this extent in which it led to the rapid sale of medium-sized and large companies to domestic corporations and foreign investors, which helped those companies to at least maintain their market position. However, the financial situation of small companies sold cheaply to domestic individuals and employees, companies sold relatively late (1998–1999), and companies listed on the stock exchange is much worse and can be ascribed to the lack of a strong investor over a relatively long period of time. The results of this study seem to confirm the hypothesis that the pace of secondary privatisation (time efficiency) and the quality of the investor taking part in it may have more influence on its effects than the level of concentration of ownership.

4.4. Wholesale Privatisation in Poland and the Czech Republic

In spite of the explicit objectives of wholesale privatisation, it was clear from the very beginning that the initial ownership structure it created would not be a permanent one. It was expected that with the development of market institutions, and notably with the development of the secondary market for shares, it would evolve into more effective forms.

The author stress, however, that it is not clear how to assess the quality of wholesale privatisation or, more specifically, what could be considered as a "good" ownership structure. The usual benchmark is the concentrated ownership structure, which is commonly considered as the most efficient one. Dispersed ownership is generally viewed as inefficient, leading to insufficient monitoring of managers. Ownership concentrated in the hands of outsiders is, on the contrary, advocated as creating better conditions for monitoring and facilitating the provision of capital. However, the authors argue, the existing economic theory provides us with ambiguous hypotheses concerning the impact of ownership structure on firm performance. Concentrated ownership may not always be the best solution. Firstly, it may play against minority shareholders of the company, secondly it may too strongly restrict managers and negatively affect their initiative and incentives, thirdly it may be costly in companies requiring very high capital because it increases risk for the concentrated owner. Finally, in an indirect way, high concentration may negatively affect the informational role of the stock market.

This discussion suggests that it may not be appropriate to try to evaluate the effectiveness of wholesale privatisation taking concentrated ownership as a benchmark. If we do not know what the characteristics of a "good" ownership structure or "good" corporate governance system are, the flexibility of the ownership structure may rather appear as a virtue. It is important that the ownership structure be able to adjust to the firm environment. It is also interesting to look at the determinants of the ownership structure. In other words, rather than considering ownership structure as exogenous and given, and look at its impact on firm performance, the authors see ownership structure as endogenous and try to determine how it adjusts to various constraints.

Such perspective could be traced back to Coase. According to Coase, the distribution of property rights has no effect on economic efficiency, provided they are clearly defined and there are no transaction costs, because people can organise their transactions in ways that achieve efficient outcomes. A possible consequence of such approach could be, that in order to assess the efficiency of a privatisation strategy, we should be mainly concerned with the extent to which the reallocation of property rights takes place.

The proponents of wholesale privatisation could claim that their strategy relied on the Coase theorem. They could argue that ownership structure does not matter; what really matters is the possibility of freely reallocating property rights. However, the Coasian result strongly depends on the availability of contracting and re-contracting opportunities, backed by an established legal system and law enforcement. In particular, the process of evolution of ownership structure is closely related to the ease with which the original owners can maximise their gains by selling their shares (or claims) to other potential buyers.

Conditions of resale play a crucial role in enabling new outsider owners to gain ownership and control of firms by buying the claims of insiders.[10]

The impact of privatisation and ownership structure on firm performance is difficult to identify as it obviously depends on a number of factors characterising firm environment. We may expect that strong complementarities exist between privatisation and the quality of business environment, determined by such factors as institutional infrastructure (including law enforcement); development of financial markets; degree of product market competition; macroeconomic stability. For instance, in countries in which the institutional environment is weak, privatisation may not bring about expected effects. The fact that in CIS countries it is more difficult than in CEE countries to identify the effect of private property on firm performance (e.g. Djankov and Murrell, 2000) may precisely be attributed to the lack of some of these necessary complementary factors which make privatisation work.[11] Given the particularities of the transition process, we need to consider not only the determinants of ownership concentration identified in the studies of developed market economies, but also examine transition-specific factors.

This paper aimed at investigating the evolution of ownership structure in firms privatised through "wholesale" schemes in two countries: the Czech Republic and Poland.

The authors found that a significant evolution of ownership structure has taken place in both countries. Not only has there been a strong tendency towards the concentration of ownership in fewer hands, but also a large-scale reallocation of ownership rights has taken place. In the Czech Republic, starting from a highly dispersed ownership structure, the large majority of companies have found a dominant shareholder. In nearly half of them, the dominant shareholder owns more than 50% of equity and has absolute control over the firm. In Poland, starting from a particular ownership structure imposed by the privatisation program, the majority of companies involved in the scheme have come out of NIFs' control and have found dominant owners, some 10% of them being foreign investors.

There has also been much flexibility in both schemes with a significant reallocation of ownership claims between different groups of shareholders. Other companies and individuals have emerged as major dominant shareholders in both countries. In Poland, employees took control in a couple of companies. After the initial distribution of ownership claims, the ownership evolved in response to various pressures and constraints characterising firms' environment. The conditions for the evolution of ownership were, of course, not the same in both countries. Despite a variety of shortcomings, at least in the Czech Republic, ownership still developed rapidly. Indeed, the concentration of ownership in the Czech Republic may be a response to the poor legal framework and the low level of protection of minority shareholders.

Finally, in so far as the determinants of ownership concentration is concerned, the results obtained by the authors are not unambiguous. Observable factors alone are unable to explain in a satisfactory way the variations in ownership concentration. In some cases, controlling for industry fixed effects and firm fixed effects, allows to significantly improve the quality of regressions. But firm specific factors do not always appear significant. Dominant ownership at the beginning of the process seems to result in the firms becoming more concentrated than firms that did not have a dominant owner in the beginning of the period. In particular, the probability of a group shareholders gaining dominance over a firm, is closely linked to the dominant position of that group at the start.

Usually, the empirical literature looks at the impact of ownership on the firm's performance. And usually this type of approach is criticised because it does not take into account the problem of endogeneity of ownership structure. In this paper, we have taken ownership structure as endogenous and have looked at its determinants. The results, however, are not unambiguous. There is a need to continue working on the specification of the model used in order to track any endogeneity. If further regressions do not confirm that ownership and performance are determined both by unobserved fixed effects, then it would be possible to study the impact of ownership (especially the ownership by different types of dominant shareholders) on performance. Further work on the data set is expected to shed some light on these vexing questions.

[10] Aghion and Blanchard (1998) implicitly take such Coasian view. They argue that while, ceteris paribus, outsider ownership is more conducive to restructuring than insider ownership, the important point is the ease with which the existing owners can transfer their ownership claims to others.

[11] For the analysis of the complementarity between ownership and competition see Grosfeld and Tressel (2001).

5. Conclusion

In this project we investigated the phenomenon of "secondary privatisation" (that is, the further evolution of the ownership structures establishment as the result of initial privatisation) in three transition economies (the Czech Republic, Poland and Slovenia) in the years 1995–1999. Our research covered companies that were privatised under various privatisation schemes which established ownership structures whose nature was heavily determined by privatisation policy rather than market forces. These included employee buyout programs and mass privatisation programs in which all citizens were given rights to acquire shares at prices significantly below market value.

To carry out this research, we collected data on large groups of enterprises privatised by such methods (either entire populations or representative samples) in all three countries. These data covered changes in the ownership structures of the companies, as well as their economic performance.

The research team analysed these data using various statistical and econometric methods. In spite of a number of differences between the three countries, we believe the following generalisations can be made on the basis of the common factors in the experiences of the countries.

1. Our results show that in the majority of enterprises privatised under mass privatisation schemes in which insiders were not privileged, secondary privatisation processes have taken place (that is, new owners have taken over). Transfer of ownership to new owners in insider-owned companies like the Polish employee-leased companies and most privatised enterprises in Slovenia, however, remains limited to a minority of such companies.

2. In almost all enterprises we witness a concentration of ownership.

3. What is surprising in our results (given what seems to be a fairly broad, albeit far from universal, agreement among economists dealing with corporate governance, theory of the firm, etc.) is that the aforementioned concentration process is not accompanied by improvements in performance. Only some of the companies in the Polish National Investment Fund Program seem to exhibit such a relationship, and this was a relatively small group of companies sold by the funds relatively early in the program to strategic (especially foreign) investors.

4. This result may be an indication that ownership evolution is first and foremost an endogenous process which is determined by, rather than determining, the economic performance of the enterprise. It could, however, also simply result from the short period of time which has elapsed between the acquisition of the companies by their new owners and the time of the research.

5. We believe that the type of owner is very important. It seems that a detailed analysis of the identity of the new strategic investors emerging in the secondary privatisation process should be the subject of further research in this area. Are they foreign or domestic? Do they come from the same branch as the purchased enterprise (thereby representing examples of horizontal integration), or do they have supplier or customer relationship with the acquired company (thus constituting examples of vertical integration)? Are they financial investors? What connections have they had with the acquired firm in the past? What are the strategies underlying their acquisitions? These are some of the questions we think will be very important in further research.

6. The regulatory and institutional environment of the privatised enterprises is also crucial – as crucial for the success of secondary privatisation as it was for that of initial privatisation. Does this environment impede the entry of new owners, or does it facilitate their appearance in the privatised companies? This is a very broad topic, which was dealt with often and from various angles in our work, and we believe that it, too, demands further, more systematic research in the future. When the legal and regulatory system, as well as the macroeconomic environment (in a broad sense) are highly unfavourable, we observe either blockages or pathologies in the secondary privatisation process, as a result of which the end results of this process turn out to be very different from those expected by reformers. Some of these unexpected, pathological results include the creation of monopolistic structures and the entrenchment of owners

who are unwilling and/or unable to make the changes necessary to improve the economic viability of the companies.

7. Poorly designed privatisation institutions do not fulfil the roles assigned to them, but rather take on lives of their own and begin to create new problems. A cardinal example can be found in the investment and privatisation funds, which constitute one of the central legacies, and the greatest problems, created by the privatisation schemes we investigated in this project. Emerging as a result of various mixtures of spontaneity and state design in all three countries, they were ori-ginally intended by the designers of privatisation policies to solve the corporate governance problem in one of two ways. Either they were to solve the problem (chiefly, the principal-agent problem) of an enormous group of shareholders extending to practically the entire population by concentrating managerial control over the enterprises whose ownership was widely dispersed, or – quite the opposite – they were to quickly sell their shares in companies, allowing for concentration of ownership to eliminate the principal-agent problem altogether. They have lived up to neither expectation. They have had neither the capacity nor the motivation to engage in active corporate governance, but became major player in the economies of at least two of the three countries we studied. Far from delivering improved corporate governance and company performance, they have often been used in schemes to drain companies of their assets (most notoriously in the case of the Czech Republic, whose experience gave rise to a new element of financial terminology – *tunnelling*. Another important institutional factor is the regulation of capital markets. There has been much commentary on the poor regulation of the Czech capital market and the high-quality regulation of the Warsaw Stock Exchange, and it seems that the Slovenian exchange bears a number of disturbing resemblance to the one in Prague. These problems often reduce the transparency of the secondary privatisation process, creating difficulties both in the raising of new capital by companies seeking it and in the protection of the rights of minority shareholders.

8. The inertia of ownership structures frequently observed in our samples is not accidental, but rather results from the entrenchment of incumbent owners that emerged in the primary privatisation process and frequently bar entry to all outsiders. Since the state can no longer exercise influence on this situation from the position of an owner, it can only act through the creation of new regulation, which could at least partially reduce some of the barriers to entry.

Having commented on what we feel to be the common denominators emerging from our research, we would now like to comment on some of the differences between the three countries studied, as well as some of the similarities between various groups of companies studied.

The picture of the Slovenian situation presented here bears much resemblance to the situation in Poland. Similarities are especially striking with regard to the behaviour of investment funds, managers and employees as owners in the post-privatisation phase, as well as with respect to the behaviour of the state (both as an owner and as a regulator). In the case of the latter, both the Slovenian and the Polish experience (for the latter, see the Polish paper on the National Investment Funds) shows that it is difficult if not impossible for the state to refrain from exercising the power it reserved for itself in maintaining residual property in the privatised enterprises, as well as via its influence in the investment funds themselves. Both states have also shown a tendency to make too many promises that they cannot keep, and to try desperately to keep those promises by utilising privatisation revenues (which, ironically, gives the state an incentive to keep as much residual property as possible, in order to have a reserve from which it can deliver on such promises). In both Poland and Slovenia, generally speaking, companies with more or less average performance became employee owned, those with the best performance were often sold in IPOs, and the weaker performers went into the portfolios of investment funds via voucher privatisation.

Other similarities include:

1. The role of party politics in the exercise of influence in the economy. Parties use their influence in various funds and enterprises to provide their people and friends with employment and sources of revenue.

2. The extraordinarily high costs (particularly in Poland and Slovenia) of the social insurance system, as well as problems and delays in the reform of this system (leading to the making of promises as described above, as well as the use of privatisation revenues to make good on those promises). It is worth mentioning here that in Poland, the Czech Republic and Hungary we observe a pattern of accelerating privatisation of large companies in response to the growth in the needs of the state budget associated with fiscal and/or economic crises faced at various times in the 1990s. At the same time, in none of those countries (with the possible exception of Hungary, with the reform package introduced by Lajos Bokros) have we observed a serious, successful attempt to reform the structural causes of these fiscal problems (in fact, a number of Polish reforms in the late 1990s increased these problems). As a result, these extraordinary revenues from privatisation, which could have been used to finance real reforms, have been largely wasted.

3. In both Polish and Slovenian employee-owned companies we have noted that problems seem to arise from the fact that many people keep their shares after leaving companies (due to retirement or other reasons), as well as due to the fact that shares are often not available for new employees hired after privatisation. The problems are due to perceptions that the most consumption-oriented attitudes are exhibited by former (and not current) employees, and that new employees (young, well-educated persons hired in the 1990s) are often the most valuable in the firm. In both papers it has been suggested that it is possible that employee-owned companies could gain certain advantages from the creation of trust funds which would hold employee shares on behalf of the employees, issuing shares to new employees and purchasing them from those that leave the company. Such a mechanism might resemble, for example, the Employee Stock Ownership Plans of the United States. The Slovenian authors report that while a similar mechanism has been introduced in Slovenia, it has not been availed of in a significant number of companies, and point to the lack of promotion of the mechanism via tax incentives. However, tax incentives are not the only means of promoting this sort of arrangement (and it is debatable whether they are a desirable one)[12]. Public education campaigns and training programs (e.g., for trade unionists) might well prove to be sufficient in raising public awareness concerning the advantages of such arrangements.

On the other hand, some differences need to be mentioned as well. These are:

1. Slovenian "employeeism". The heavy emphasis on both codetermination (employee representation on supervisory boards) *and* employee ownership in Slovenia was not duplicated in any other transformation country. It seems that Slovenia was unable to find an appropriate balance with respect to the regulation of various forms of employee participation, adjusting forms of participation not based on ownership to the ownership situation in a given company.

2. The limited role of foreign investors in the Slovenian economy. This strongly differentiates Slovenia from transformation countries like Poland, Estonia, and Hungary (and more recently – following the conclusion of voucher privatisation – the Czech Republic). Perhaps in the 1990s, due to the Slovenia's GDP per capita being much higher than in other transformation countries, Slovenes felt they could afford this. One can expect, however, that a failure to open the country more will have increasingly severe adverse effects. At any rate, such opening will be made necessary by the process of accession to the European Union.

In terms of policy recommendations from this research, we suggest the following:

1. "Optimal" ownership structures in privatised enterprises cannot be identified *ex ante*. Therefore, the most important task is to assure the flexibility of initial ownership structures, guaranteeing to the maximum extent possible the ability of interested actors to adjust those structures to the environment through re-allocation of property rights.

2. This flexibility depends on the ease of contracting and re-contracting, backed by an established legal system and law enforcement. In the case of privatised enterprises it is important to ensure that the privatisation scheme will not block future re-allocation of ownership rights by providing selected groups of owners with privileged position.

3. Institutional factors (some of them specific to transition countries), such as contract law enforcement, development and transparent regulation of financial markets, degree of product market competition, and hard budget constraints in a stable macro-economic environment, are necessary for privatisation (both primary and secondary) to bring about expected effects.

4. Special privatisation institutions tend to acquire functions extending beyond their originally intended roles, taking on lives of their own. Therefore, special care in their design (including, for example, establishment of explicit time limits for the period of their activity in the case of relevant ministries or agencies) is suggested.

5. Wholesale or mass privatisation, because of its transitional nature, is not expected to establish "real" owners for the companies but only temporary owners. Hence, it may be inappropriate to evaluate the effects of this kind of privatisation taking the outcomes of its first stage as a benchmark. The speed and quality of the secondary privatisation of those enterprises are more important for this assessment.

6. The temporary owners should be assessed on the basis of their "agent-seller" effect rather than their "owner" (restructuring) effect on enterprises. This means that the quality of mass privatisation should be measured by the speed at which investment funds find new owners for the companies and by the positive influence of these new owners on the performance effects of companies, rather than the effects of the funds themselves on company performance.

[12] Certain tax incentives might be advisable in the case of the use of employee stock options as a form of retirement insurance, but this would have to be part of a comprehensive pension reform.

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