

Mass Privatisation Schemes in Central and East European Countries. Implications on Corporate Governance

Edited by Plamen D. Tchipev, Jürgen G. Backhaus
Frank H. Stephen



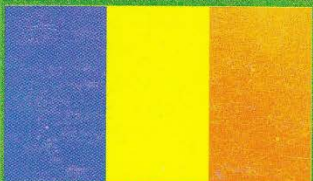
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**MASS PRIVATISATION SCHEMES IN
CENTRAL AND EAST EUROPEAN
COUNTRIES.
IMPLICATIONS ON CORPORATE
GOVERNANCE**

**Edited by
Plamen D. Tchipev
Jürgen Backhaus
and
Frank H. Stephen**

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Preface

Privatisation is a major component in all the transition processes carried out in the Central and East European countries. With different pace and scale across the countries, it took distinct, sometimes even opposing forms.

Nonetheless, almost all these countries have developed also a process of rapid, massive and free of charge transfer of property to large groups of population; the so-called “Mass Privatisation”. It has not started the same time and the countries are now at different stages of its implementation. In some, like Czech Republic, it has already finished, others like Poland and Romania made important steps of it, Bulgaria is about to change it radically and Slovakia seems to have interrupted it.

Although similar, the “Mass Privatisation” forms, developed in each of the CEE countries also vary throughout. This variance is a ground to expect different results from the application of the *Mass Privatisation Schemes* (MPS) as well. Thus, a comparison of that schemes looks a really challenging task for the scholars studying the economic problems of the transition in Central and Eastern Europe, since it ensures a free exchange of ideas not only on the development of the mass privatisations, but also on the whole privatisation programs.

The presented book reveals the results from one such a comparative project, which became feasible due to the financial support of the PHARE-ACE Program (*Project No P95-2043-R*). The project involved scholars from Bulgaria, Czech Republic, Poland, Romania, Slovakia, The Netherlands and the United Kingdom. The participants in the project observe and analyse the concrete development of the forms and the actual results of the mass privatisation in their own countries emphasising especially their role for establishing of the new mechanisms for *corporate governance*.

The underlying field research has been carried out simultaneously in the all five CEE countries, following a common analytical model built on the theoretical apparatus of the Institutional Economics and Law and Economics. The model incorporates two different analytical tools - a questionnaire and a so-called *checklist*.

The questionnaire asks fifty questions to be answered by the authors of the particular East European country studies, placing them within the theoretical context of the *Property Rights*, *Transaction Cost* and *Agency* approaches. It includes a wide range of problems - from the rights' claimants in each country, through rent seeking, PFs' boards appointment, tax treatment of the various groups of shareholders, and eventually to foreign investor participation of the process. We provide its full body in Chapter 1.

And the checklist provides a common model for completing the *country studies*, following the practical logic of each scheme - legal framework, goals, stages, etc. and relative place within the overall privatisation process. Further, the model requires analysis of the position of two different groups of shareholders in the *Privatisation Funds* (PFs) - the voucher and the cash contributors (or fund founders), as well as of the

PFs' management, activities, portfolio objectives and PFs' interaction with the Stock Market, Financial Institutions and the government.

This methodological approach ensured a close treatment of the empirical evidence in the different countries, though, there is no full uniformity of the country papers. Each of them places emphasis on different aspects of the privatisation according to the specific economic, legal or political conditions in the relevant country. Thus, while the Polish researchers put a lot of effort on the analysis of the legal framework of the centrally- created *mass privatisation intermediaries*, the Romanian concentrate on the changing privatisation model and the Slovakian on the crucial role of the political intervention in the mass privatisation. The country studies and the workshop discussions provided the basis for creation of a *market compatibility index* for each privatisation scheme. Its values fluctuate between 0 and 1 showing how compatible is a particular MPS with the market mechanism.

The study has been strongly policy oriented and effort has been made for conveying the results of the study to the policy makers in the CEE countries, including widely disseminated working paper containing comments and suggestions on the mass privatisation policy.

The study showed that the decentralised mass privatisation model chosen by Czech Republic is not the only feasible one; Poland and partially Romania have chosen more or less centralised models. Although, the competitive (i.e. more random) resulting portfolio of the decentralised models, is not an obstacle for creating sufficiently large holdings for strong control over the enterprises. In both Bulgaria and Czech Republic after the official distributive process started an intensive intra-fund exchange of packages of shares resulting in concentrated holdings. In the Bulgarian case the above tendency shaped in almost 90% of all the Privatisation funds acquiring the legal form of a classical *holding company*. Although, it is not clear what is the goal of such a large process; there are signs that it is mostly a willingness to avoid the rigid legal regulation imposed on the investment intermediaries and not a strong inclination against the active monitoring. Those doubts are fuelled by the Czech experience which has already history of such holdings, but still does not show a firm predominance of the governing behaviour over the companies.

Surprisingly, the Polish model does not seem less desirable as an instrument for corporate control because of the opportunity for an administrative decision requiring a more serious involvement, through the appointed managers. It has at least one apparently strong advance to the other models: it provides for a much better maintenance of the intra-companies connections and production chains which were initially broken in the other models.

The main reason for the relatively low level of effort on active control, found in the study, seems to be the high price of an involvement. The strongest controlling mechanism - management take-over has numerous negative features, especially if applied in mass. Some of the newly appointed managers unite their objectives with those of the incumbent managers and the classical shirking take place. The most relevant reason for the initial (only?) reluctance seems to be the cost of such a behaviour. In fact many of the funds acquired the shares at a high premium price and now they enjoy high

(in terms of the western standards) profits just from the trade in securities, which is cheaper, by any comparison to the active governance of the portfolio companies.

Another important reason for such a passive behaviour seems to be the fact that the funds do not have an effective owner themselves. The strongest insiders are the fund-founders, but they have their rights because of their status and *not* because of their property rights. That initiated numerous attempts for take-overs in Bulgaria, and Czech republic. Thus, for a substantially large part of the privatisation intermediaries it seems much more justified to have the efforts applied to secure their claims than to optimise the management of their companies.

Romanian and especially Slovakian cases show how important is the policy applied to the process and particularly the presence of the political will. Slovakian case is very important also because it shows what happens if too many principles are applied to the mass privatisation process. Even the relatively successful beginning experience could be wasted and people's trust eroded. This case has a particular importance for Bulgaria, since a radical change in the model is now planning for the next wave of the process. It is envisages channelling people's activism through newly created institutions - *pension funds*, which are supposed to play the role of the former privatisation funds.

Perhaps, the most important observation in the study is that in all the countries still there is no clear orientation towards one or another of the world-wide known models for corporate governance. In all of them the stock markets are mostly welcomed and many efforts are put on their development, but in all of the countries the banks play or try to play very important role in the privatisation.

Various institutions provided valuable assistance for realisation of this project and I want to express the great appreciation of all the project participants for their commitment. We are grateful to the ACE-Programme for the financial support, to the Institute of Economics of the Bulgarian Academy of Sciences for hosting the project, to the University of Maastricht, assisting the project with its rich collection of relevant literature and to the CERGE-EI Centre of Excellence in Prague for organising one of our workshops. Many colleagues discussed and commented on earlier variants of the texts included in this volume and we are grateful to Erik Reinert, Arno Daastoele, Radek Las-tovicka, Geoffrey Miller, Kenneth Koford, Gerrit Mejer; to all participants in the Maastricht workshops on Law and Economics, in the Belgrade Sasakawa Forum, and in the Forth ISINI Congress.

I would like to acknowledge as well the valuable research assistance of Vesselin Mintchev and Rilka Dragneva who took participation in the project at various stages. Special thanks go for Maria Georgieva, Veneta Alitchkova and Nelly Tchipeva, who provided most of the technical assistance for issuing of this volume.

Sofia, 1998

Plamen Tchipev,
Project Coordinator

Mass Privatisation, Governance Structures and the Appropriate Legal and Economic Environment: A Theoretical and Empirical Investigation

Jürgen G. Backhaus and Frank Stephen***

Introduction

This study covers mass privatisation in Central and Eastern Europe, the programs launched in Poland, the Czech Republic, Slovakia, Romania and Bulgaria.

The paper has the following structure. It first refers to different theories about the production of legal institutions, in particular in the area of corporate law. It would almost appear as if the mass privatisation programs were launched into a legal and sometimes also economic vacuum. The peculiar difficulties often are tied to this problem. Then, the theory of corporate governance with respect to the mass privatisation issue is dealt with in some detail. Abstracts of the five country reports follow. This empirical material, however, is then recast in form of an inquiry, broken down into fifty questions following from the theoretical framework explained before. The fifty questions in principle lead to market compatibility index between zero and one.

Although the market compatibility index itself is not overly conclusive, the different country studies arrive at surprisingly similar final index results, and in depth analysis of how the index is composed with respect to the fifty different issues is highly revealing and offers opportunity for institutional change aimed at improving the mass privatisation process.

The Production of Legal Institutions

It has been known for long. But since Paul Samuelson's (1954) elegant formulation, it is commonplace in economics and some of the neighbouring social sciences that a useful distinction can be made between private goods and public goods. The major policy implication of this analytical distinction is that the production and allocation of the private goods can be left to de-centralised forms of decision making, such as the market; whereas the production of a public or collective good cannot generally be entrusted to private initiative, since individual free riding behaviour may thwart attainment of the allocational optimum. For this reason, production of a public good requires some collective actions, not necessarily on the part of the State, but at least on the basis of some club like arrangement in Buchanan (1965), which may be forthcoming as a consequence of private initiative.

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This is all very well known and could be left for further elaboration to specialists in public economics or else classroom discussion if public goods were exclusively a matter of economic concern. This is, however, not at all the case. It is well known that the law itself is a public good (Buchanan (1975)), and so are legal institutions, such as property, contracts, tort rights and remedies, the legal forms of business organisation etc. What really is involved may be gleaned from this statement found in Douglas North' (1981) most recent book, where at the end of the part on historical economic theory, he lists the following as one of five shortcomings of his otherwise rather encompassing and ambitious approach:

While most of the elements of a theory of institutional change are developed (...), there is no neat supply function of new institutional arrangements specified in the framework. What determines the menu of organisational forms that a society devises in response to changing relative prices? Institutional innovation is a public good, with all the characteristics of such goods, including the free rider problem.

This disclaimer describes the topic of the present essay very well. The treatment, however, takes the perspective of economic policy rather than economic history. Hence, the discussion goes beyond North also in not just picturing a ruler who wants to reap as large as possible a profit from the economy of his state. Substitute "social welfare" for "profit", and you have the approach to economic policy taken by earlier theorists, such as Tinbergen (1959). A more institutions oriented approach is clearly warranted for both the sake of relevance and realism. In modern times, economic policy is not reduced to maximising the rulers' wealth.

In what follows, by legal economic policy we shall understand that type of economic policy, which is designed to shape legal institutions in the interest of economic activity. Legal economic policy is nowadays formulated within a context of rather more complex institutions, which define incentives and constraints to which policy makers respond. It is for this reason that a public choice perspective was adopted for the analysis presented in this paper.

Such a perspective is particularly necessary in the context of transitional economies, as seemingly technical issues such as privatisation and, in our case, mass privatisation can in their specific features only been explained from the point of view of modern institutional theory, including the theory of public choice, law and economics and the theory of rent seeking.

There are basically two different ways in which legal institutions are being produced. They may decentrally evolve through long chains of judicial rule making, as in the common law tradition, or they may be promulgated by central legislative authorities. The latter is commonly referred to as codification. This language suggests an economic

approach to a problem, which has a long intellectual tradition in legal theory. On the continent, we recall the dispute between Thibaut and Savigny (1814), (1815), and in the United States we are reminded of Jeremy Bentham's letters, such as the one to President Madison in 1811,¹ or of David Douglas Fields' code. Resisting, however, the considerable temptation to take off for an excursion into the history of legal doctrines, we prefer to tackle the problem in purely economic terms; all the while being well aware of some of the often noted limitations of this approach, e.g. that economic efficiency may not be the only concern that propels the development (i.e. the production) of legal institutions. As we have cast the problem now, it appears to be a perfectly general one, inviting little but lofty speculation and a lengthy regurgitation of settled ideas. Let me therefore clearly state the objective of the analysis, against which the performance may be judged.

The general problem is readily identified: What determines the efficiency and effectiveness of economic policy with respect to the creation and development of legal institutions? Can we identify conditions which policies must meet in order to be efficient? In referring to a particular case, we hope to show, in at least an exemplary way, what an economic analysis can contribute to this question. In order to argue the problem *in concreto*, we have for purposes of demonstration selected a particular case (BVerfGE, 1979). This involves the German mass privatisation law of 1976, which was challenged before the country's constitutional court. In focussing on a case, we hope first of all to keep the discussion at a sufficiently concrete level. The applicability of general conclusions can thus be readily demonstrated. Secondly, a case which involves the challenge of an effort at codification before a constitutional court in a legal culture dominated by codification is ideal for demonstrating the highlights of the ongoing common laws. Codification debate. Thirdly, the mass privatisation case has considerable economic significance by itself. It is rather apparent that a case involving the basic structure of the industrial firm is a matter of economic policy concern. While finally the case reflects institutional developments which are not confined to any particular of the western legal cultures. Thus, similarities and differences between common law and codification (as differing approaches to legal economic policy) can be brought out with some institutional immediacy. Finally, some of the theoretical literature we are going to refer to has already been applied to the transitional problems discussed here, in particular mass privatisation (Furubotn, Pejovich (1972), Moore (1983)).

The case of mass privatisations is particularly intriguing, and it has stirred interesting discussion. With respect to the recent legislated changes in Central and Eastern European company law, the argument can be made that legal rules imposed by either the legislature or the supreme court cannot by virtue of this very imposition be claimed to be efficient in the sense of containing Pareto superior moves; since, if that were indeed the case, they should have come about as a consequence of voluntary agreement. The proposition is certainly puzzling. Wouldn't it appear that those countries which habitually resort to codification as their method of producing legal institutions are systematically foregoing the benefit of efficient rules? This contrasts squarely with

yet another notion, which is at least as widely held to be self evident within the economics profession.

A considerable part of the economic analysis of the law is built on and around the proposition that features and structures of the law can be explained in terms of their efficiency.² Hence, the process of their creation and development must have consisted of at least some Pareto improvements.³ Sometimes, the notion of the efficiency of the law is extended to the common law only, the implication being that codification is an inefficient way of legal rule formation. Should we therefore rush to the conclusion that the State would be well advised to refrain from legal economic policy? That the State should better not try shaping legal institutions and leave attainments at efficiency in legal matters to processes of gradual development instead of conscious design? (Hayek (1968)). Such conclusions, although they are often explicitly made or at least insinuated,⁴ are really not very compelling from the point of view of the political economist.

It is well known that many a political system uses codification as the foremost technique for producing legal institutions. It would seem that the use of an obviously inefficient technique would run afoul widespread opposition and could only be maintained if its use bestowed considerable benefits on those who exercise the choice between different techniques of legal rule making.

As was mentioned above, this discussion has recently been revived in the economics literature when scholars began to analyse the economic consequences of mass privatisation. Mass privatisation, which entails worker participation in the supervision of enterprise decision taking,⁵ requires a profound change in the legal structure of the modern corporation. Typically, under mass privatisation, several seats on a board of directors are reserved to labour or its representatives.

It is with this particular example in mind that, in what follows, we shall address the central question of this paper: Common law or codification: Which technique leads to efficient legal rules? In what follows, the first section of the paper casts the problem in the more general context of economic policy - where it belongs. The production of legal institutions is to be seen as just one of several tasks of economic policy. Therefore, introducing the problem in the light of the theory of economic policy helps to clarify some otherwise fairly muddled issues. The next section elaborates on those criticisms of the law and legal change, which take the Pareto principle as their point of reference. This type of criticism can be advanced in the context of two different although related schools of thought, the Austrian school and the property rights approach.⁶ These approaches are dealt with in sections two and three respectively. Furthermore, an overview is given over the efficiency-oriented approach to studying the law. This approach is related to the two preceding ones, but separate in the focus of the analysis, the participating scholars and the media of publication preferred. It turns out that there is an overlapping area where both techniques of legal rule making can be efficiently employed. That is, the efficiency-oriented approach to studying the law cannot, as it usually is, be turned into an argument against codification as a suitable technique of

efficient legal rule making. The explanation of these propositions is the main point of section four. The fifth part is devoted to an analysis of the production of the law itself. The analysis is intended to be positive throughout. At first glance, it would therefore seem to have to follow the efficiency oriented approach quite narrowly. This is, however, neither true nor my exclusive concern. Rather, the Austrian approach, apart from its obvious normative contentions and implications, has several positive interpretations too. Although, in the long run, only efficient legal institutions can be expected to prevail, the production of the law can still be dominated by short run interests to redistribute wealth e.g. in a rent-seeking environment. An economic approach postulating rational behaviour of individuals is consistent with efficient as well as inefficient outcomes. As a matter of fact, economic analysis would be at odds with efficient outcomes under some circumstances, which generate inefficiency. The issue hinges on the institutional constraints with which individuals are confronted. Hence, in section five a public choice approach is taken in an attempt to analyse some salient features of the production of the law; all the while keeping in mind that the process of producing legal institutions is seen as an integral part of economic policy. The final and sixth section of the paper summarises the main conclusions and casts these results into the economic policy context: What can we learn from the analysis for a theoretical understanding of legal economic policy?

In particular, the question needs to be addressed what we can get by way of a theoretical understanding of the issues underlying mass privatisations. The questionnaire used later builds on this theoretical understanding.

Economic Policy and the Institutional Framework

Economic policy came into being as a scholarly discipline when it was discovered that wealth could be acquired by other than war like activity and governments increased their efforts to control its flow (Bonn (1931)). Ever since, two completely different issues have remained intrinsically intertwined in the theory of economic policy: the allocational issue of how to further the generation of wealth and the distributional problem of how to divide the social dividend. While epistemologically these issues have a differing status and require different analytical treatment, in the area of economic policy they cannot be completely separated one from the other. Allocational considerations have distributional implications, and vice versa. This state of affairs involves a comparative lack of elegance, which the subdiscipline of economic policy suffers against e.g. pure economic theory. This is reason enough for theorists of economic policy to be more acutely aware of methodological issues (Robbins (1976); Myrdal⁷ (1932)).

The distinction between positive economics and political economy⁸ is a matter of methodological clarity, not of practical relevance. Nobody has probably made this clearer than Lionel Robbins, to whom the opposite position was often though falsely ascribed:

Economics as a positive science has no status as ethical or political prescription. But no one in his senses would contend that it is reasonable to prescribe what is desirable in this respect without a knowledge of what is possible - of what effects are likely to follow from what specific type of political or individual action - any more than it would be reasonable to proceed to architectural design without prior knowledge of materials and their potentialities (Robbins, 1976, p. 2).

Thus, the scope of political economy is equally large as the scope of positive economics, encompassing any problem on which the economist can hope to provide useful knowledge for the potential benefit of some political actor. Usually, however, economic policy (as a scholarly discipline) tends to be more narrowly conceived in terms of what a government in a western type political economic system is apt to define as its task in the field of economic policy. Here, Jan Tinbergen (1959) has distinguished between quantitative economic policy, qualitative economic policy, and reform policy. Political economy of legal institutions would have to do with the latter two of these three aspects.

A different and somewhat more complex classification scheme was employed by Kirschen (1962) for their ambitious empirical investigation. They combined the objectives of economic policies and the instruments with which they might be attained and thus produced a huge

matrix of different types of economic policies. For our purposes it is sufficient to note that legal economic policy, i.e. those types of economic policy which use variations of the legal order in order to attain economic policy results, is widely used. See Kirschen (1962). Divide economic policy, as far as instrument use is concerned, into four categories, of which legal economic policy which is defined as inducing changes in the institutional framework is one. It is interesting that in his empirical research this type of economic policy was often found to be present, but rarely considered the most important instrument with respect to any particular policy objective. This is hardly surprising. Policy objectives tend to be conceived for the short run, while legal economic policy is often most important in terms of its long run implications.

Another distinction, which is frequently made (Schiller, 1962, p. 210; *passim* 1964, p. 63-90) refers to economic policy affecting

- the economic process and its stabilisation;
- the structure of an economy and its even development; and
- the order of an economic system and attempts at developing rules and institutions compatible with this order, basic structure or general character.

The third aspect in this sequence is that area of political economy which systematically involves a discussion of legal institutions and their compatibility with the economic system, which the legal framework is expected to sustain in its operation.

One important subset of this aspect of political economy is an analysis of corporate legal structures and their impact on the behaviour of collective economic agents, such as firms. In this branch of political economy, we need to be particularly aware of the difference between scientific value judgements and an assessment of the likely effects of institutional changes or variations on individual or collective behaviour. The economist, qua economist, is in no position to discuss the legality of or constitutionality of proposed changes; he can only discuss the likely consequences of (effective) policies on the legal environment.

This statement is as obvious as it is a relevant reminder to be kept in mind when looking at the writings of members of both the Austrian school and the Chicago school. Professor Friedrich von Hayek as well as Judge Posner tend to underemphasize the distinction between economic analysis and legal reasoning.

This is reason enough to note six guidelines for the political economist, which an eminent teacher of the subject has written up by way of introducing a collection of readings in economic policy (Gaefgen, 1966, pp. 11-21 (12-14)).

These six admonitions should be kept in mind by the political economist:

- There should be a sharp distinction between judgements of value and judgements of facts.
- The analysis should be systematically based on economic theory.
- The perspective should encompass general interdependencies in the economic system and not be confined to a partial analysis.
- The analysis should be empirically based, wherever possible.
- We should be institutionally relevant in considering the conditions and constraints, under which actors, and political actors in particular, are taking their decisions.

And

- The analysis should systematically take into account the extent to which information is accessible to both policy makers and economic agents.

There is no doubt that the first of these rules is the most difficult to follow. Although ever since Max Weber's (1904), (1951) influential methodological writings scientific results and personal convictions are to be as clearly distinguished as possible as a matter of scholarly ethics and principle, in practice the political economist may not often be able to disentangle facts and values.

The political economist cannot be reduced to the role of a technician of economic policy - as the quote from Lord Robbins might suggest - who takes political ends as given and designs the most effective means accordingly. This conception is simply untenable, since firstly economic theories can hardly be ideologically neutral,⁹ the analyst must take a conscious choice of aspects, relationships, and data to be considered

with his theory; secondly, because the mere selection of economic problems reflect value judgements; and thirdly because means and ends cannot be sharply distinguished (Smithies, 1955, pp. 2-3). Since these political matters can hardly be felt to the volitional choices and idiosyncratic beliefs of the political economist who happens to address a politically relevant economic problem, there is a long tradition in political economy to base the analysis on the prevalent ideological beliefs or national ideologies of the society for which political economic analysis is being undertaken. For example, Smithies (1955, p. 11) defends the use of national income as an indicator of social welfare with reference to the prevailing "national ideology" although he feels that economic theory could not support such a position. To quote directly:

Whatever the theoretical justifications, which we believe to be slight, the national income has become firmly implanted in the national ideology as a measure of welfare.

This renders an interesting example illustrating the temporary nature of such popular convictions. The normative basis of political economic analysis is a function of both time and of place. Today, about thirty years after Smithies delivered his lecture in the Brookings Institution, it has become obvious that the national ideology would no longer support this choice of a suitable indicator of social welfare. The methodological position outlined by Smithies is, by the way, perfectly pragmatic and by all means individually less demanding than Weber's more stringent ethical standards. Smithies is probably correct in assuming that the political economist has no desire to be esoteric. A political economist who bases his analysis on normative assumptions which are not borne out by the national consensus "would scarcely get a political hearing" (Smithies, 1955, p. 4) which is likely what he most dearly wants.¹⁰ A political economist, in all probability, would therefore try to assess the national consensus as carefully and accurately as possible, in the interest of his own effectiveness. Guided by nothing but his own interests he would fulfil function which (p. 5)

is not to attempt to create a Utopia that conforms to his own predilections. His task is to determine the economic conditions whereby society can realise its aspirations, to recognise that there is continual interaction between the economic means employed and the objectives that a society sets for itself, and to propose changes in those objectives when economic analysis reveals that society may be frustrated through the pursuit of contradictory ends.

The approach is not, of course, at all new with Smithies.

The first economist who consciously employed what only later became to be called the contractarian approach seems to have been Knut Wicksell (1896) with his "New Principle for Just Taxation". The approach consisted in first trying to distill a kind of national consensus, secondly formulate a corresponding principle which captures the essence of the agreement, and thirdly design an institutional arrangement under which the principle would be translated into an improved practice. In Wicksell's classical treatment, he first analysed in painstaking detail the history of financial institutions of

the Swedish kingdom in order to arrive at his New Principle. Essentially, this principle incorporated the idea of quid pro quo relationships in the public economy. Essentially, this New Principle was very much in line indeed with then recent (marginalist) developments in public finance theory.¹¹ But this coincidence should not tempt us to mistake Wicksell's New Principle as an eager application of fashionable theory to an old and thorny problem. Rather, Wicksell followed an inductive approach. The New Principle was indeed nothing more, and nothing less, than an abstraction from the old rational which-had always underlied the Swedish system of taxation; and which he had discovered in the course of his historical studies. It is precisely this historical persistence in the face of numerous opportunities for change, which justifies invoking the notion of a national consensus or social contract, which was found to have been embodied in the Swedish institutions Wicksell had studied. Likewise, the persistence of the consensus justified its generalisation into a Principle with possible applications beyond the national context where it had originally been found to have evolved. Wicksell's approach amounts to consensual (not unanimous) decisions governing the provision of public services as well as the concomitant taxation by which these services are being financed. Unlike his disciple Lindahl (1958), who used the principle as an analytical device, Wicksell designed an institutional arrangement for the socio-political conditions of his time. These conditions were a constitutional monarchy, a heterogeneous citizenry to which corresponded a system of heterogeneous political parties, a parliament vested with the budgetary prerogative and an executive branch of government fitting Leviathan assumptions see Brennan and Buchanan (1980), i. e. eager to grow and to tax.

The mass privatisation programs discussed later show a Leviathan that uses a different strategy: holding on to state assets. Under the guides of privatisation, but making effective capital market control next to impossible. This can, in particular, be shown for Bulgaria and Romania. The case of Slovakia will prove to be different in that incredible commercial and industrial policy seems to be underlying the mass privatisation scenario, whereas in Poland the protection of worker interests give mass privatisation a tinge of co-determination at the same time. This is the context in which the theories discussed here in the beginning will lighter resurface.

This historical example is the proto-type of political economic analysis in the contractarian tradition, which was later fervently popularised in numerous writings by James M. Buchanan¹² and has recently found a very neat and concise expression in an article and a textbook by Bruno S. Frey (1979), (1981). The predominant characteristic of this approach and comparative advantage as contrasted with other and at times competing versions of political economy consists in its crystal clear criterion for analytical success. If the theoretical analysis is correct and if the national consensus has been properly and perceptively appreciated, and if thirdly the institutional design is realistic, inherently logical and behaviourally sound and robust, chances are that (some version of) the political economic proposal will become reality. Political implementation is the ultimate success criterion for contractarian political economic analysis. While it is quite true that democratic societies experience the continued and unchallenged

persistence of inefficient institutions which benefit some powerful interests, a contractarian approach which reflects the interests predominant in a particular society will, if the economic analysis embodied in a particular proposal is correct, invariably produce the optimal institutional solution which cannot any further be Pareto improved. Accordingly, the basic tenets of the contractarian approach to political economy are the attainment of Pareto efficient solutions (consequent to an informational input into the system), improvements that are generated by the work of the political economist. The whole approach is obviously consensus based. Likewise, using a contractarian approach requires an analysis which takes the interdependence between policy and economy systematically into account. We note that Professor Gaefgen's criteria are indeed met by the contractarian approach.

1. A clear distinction between judgements of value and judgements of facts is maintained. However, for the contractarian, societal values are facts and inputs into his analysis.
2. Contractarian analysis is systematically based on economic theory.
3. The contractarian perspective encompasses general interdependencies in the economic system and is not confined to a partial analysis.
4. The analysis is empirically based, because it would otherwise be unlikely to be successful.
5. It is institutionally relevant in considering the conditions and constraints, under which actors, and political actors in particular, are taking their decisions.

And

6. The analysis systematically takes into account the extent to which information is accessible to both policymakers and economic agents. The last two points deserve a couple of further remarks.

The advisor's task is then seen in the arrangement of constitutional contracts (Frey, 1979, p. 310). A constitutional contract meets the following conditions (pp. 308-309):

- It applies to fundamental and long range decisions.
- It is formed in a natural state, i. e. behind a veil of ignorance.
- It must have the (unanimous) consent of all individuals and/or groups concerned.
- It is the result of a Pareto superior improvement which may be due to new information or social innovation.

The constitutional contract is like a blueprint for institutional reform, designed on the basis of political economic analysis. Since the entire approach in its efficiency orientation is tied to the Pareto principle, one may wonder why any such improvement is held to be at all possible. Why should the improvement not already have come about as the consequence of some spontaneous development, instigated by benefit seeking agents?

There are several reasons why new possibilities for social improvements may not have come about spontaneously (Frey, 1979, p. 310). They may exist because of

- a lack of information on the part of the relevant agents;
- high transactions costs in the market, where a political solution can be more efficiently rendered;
- strategic behaviour on the part of individual or groups, especially in the 'small numbers' case, which can leave the participants in a prisoners' dilemma type situation.

The political economist can find himself in a position to be able to overcome these obstacles and bring about consensus either by generating uncertainty in order to induce interest groups and other participants to take a long run perspective, or by secondly proposing compensation schemes - which is always a possibility if efficiency gains can indeed be claimed for the proposal - or thirdly by pointing out convincingly that non-co- operation is not in the best interest of the party trying to free ride.

Obviously, the mere scheme of a proposal for a constitutional contract is not yet sufficient. The proposal for a constitutional contract must be accompanied by provisions for the post-constitutional period. A scheme for implementation is required which ensures compliance in order to avoid free riding behaviour on the part of some or all economic agents who rely on the constitutional contract being enforced. Free riding behaviour would invariably result in a breakdown of the entire reform and, consequently, prevent the constitutional contract from being adopted in the first place.

What can we learn from this discussion for the political economy of legal institutions. Before proceeding in the agenda to the contributions of the Austrian school, let me give an intermediate summary.

There are six conclusions that we should like draw at this point.

- ONE: The law is a crucial component of any economic system. Its features determine the overall efficiency of the economy.
- TWO: In that the law is a public good, its production cannot be completely entrusted to the market. Rather, ensuring the production of the proper legal institutions is an important task of economic policy.
- THREE: It follows that a theory of legal economic policy cannot be but an important subset of any theory of economic policy.
- FOUR: Economic policy as a theoretical endeavour is plagued by the problem of value judgements. This is even more crucial in legal economic policy than it may be in such areas as quantitative economic policy because of the inherent normative implications of legal problems.
- FIVE: Two approaches to the theory of economic policy may be usefully distinguished; they deal with the problem of value judgements in different ways. The pragmatic approach lists a number of guidelines for the

theorist of economic policy to observe. In this study, the guidelines serve as important benchmarks for a critical analysis of the literature.

SIX: The contractarian approach aims at embodying empirically relevant value judgements held in a particular society into political economic analysis. Its specifically economic significance lies in the systematic reliance on the Pareto criterion. The two approaches are neither mutually exclusive, nor are they equally applicable under the same conditions. Both approaches, in this study, are frequently incorporated into the analysis.

These aspects all play a certain role in explaining the peculiar features of mass privatisation's in the five countries studied.

The Austrian School

Legal institutions and the change of the law occupy central positions in Austrian thought on economic policy. The Austrian school is not, of course, a homogenous intellectual unit. We shall therefore focus on the contributions of only two of their leading protagonists, notably Friedrich von Hayek and Ludwig M. Lachmann. The former is undoubtedly the most prominent and widely honoured of the living Austrian economic and social scientists. He has succeeded in developing a coherent interdisciplinary conception of the interdependence between economics, the law, the economy, legal institutions, and economic policy. Ludwig Lachmann, on the contrary, has taken these and earlier Austrian contributions and applied them to the problem of legal change in corporate structure. This is important, because the value of a theory can best be determined in specific applications.

Hayek's Approach to Economic Policy

Before introducing the slightly bewildering taxonomy of the Hayek system, this section will first deal with the Austrian approach to economic policy in general. Other subsections try to synthesise the Austrian view on what makes for good legal institutions and to suggest what an economic analysis of legal institutions in accordance with this approach can accomplish for a better understanding of economic policy as it affects legal institutions.

The most succinct statements on economic policy in the Austrian tradition we probably find in the condensed treatment in Hayek's inaugural lecture which, more than twenty years ago, he delivered in the University of Freiburg in West Germany. (The lecture was given on June 19, 1962.)

As compared to most theories of economic policy, Hayek's approach is quite particular. This uniqueness involves at least two respects:

- as regards the limitations of economic policy and the knowledge thereof;
- as well as concerning normative conclusions.

While the approaches to economic policy described above, i.e. the pragmatic approach and the contractarian approach, presuppose the existence of an art which enables policy makers to achieve desired results by applying available means, von Hayek denies this basic presupposition almost altogether. There are according to him two basic limitations to economic policy as a scientific discipline. The first limitation has ever been well recognised since Max Weber (1904), (1951) issued intense warnings.

It is a matter of intellectual honesty to distinguish between "ought" and "is", value judgements and analytical insights; it is equally important to make this distinction patently obvious to anyone who otherwise might be misled to take value judgements for fruits of scientific labours. (Hayek, 1962, 1969, p. 3. Significantly, Hayek adds that some societies make it more difficult for the researcher to be honest than others.)

This point, however, does not carry as far as some have suggested it does. In particular, it cannot serve to justify the complete elimination of normatively based, applied economic analysis, a point forcefully brought home by the contractarians. It is also interesting to note that Lord Robbins, to whom this argument has often been often attributed, literally turns the point around into a plea for political economy, as a pursuit separate from but by no means less important than theoretical or else empirical economics (Robbins (1935)).

Hayek, again, takes a more radical position. In his view, honesty and sincerity in the social sciences, require an attitude which questions widely held beliefs and may thus easily be mistaken for a political statement. (Hayek, 1962,1969, p. 4).

Avoiding politically delicate issues is obviously as much a manifestation of a political choice as is explicitly taking them up. Consequently, theoretical purists who avoid politically debated issues cannot be said to be any less political in their research attitudes than political economists who take a critical posture vis a vis contemporary politics. In Hayek's view, then, the political element in the theory of economic policy, is more apparent than real. For him, the more important limitation of a scientific approach to economic policy lies elsewhere.

The economy in the Austrian view (Hayek, 1969, pp. 9-14) is interpreted as a self regulating spontaneous order, a catallaxy, which governs itself through the use of knowledge; this knowledge is unavailable to any one agent who is part of the catallactic game. Consequently, any one political measure will lead to multiple repercussions and reactions on the part of the single agents in the economy, who react to impulses and economic incentives unknown to the policy maker and do so in the light of a stock of decentralised knowledge (information) and individual experience equally unknown and inaccessible to the politician. Thus, the political economist can only hope to offer meaningful predictions of a very general kind. He can discuss the behaviour and change of general patterns or orders, while at the same ignoring particular manifestations compatible with the general pattern. This methodological insight has immediate consequences for practical economic policy. To the extent that economic scientists

ignore the precise consequences of measures of economic policy vis a vis the economy, all other agents will share the same ignorance, and so will policy makers.

One would be wrong to expect Hayek to be led, by this reasoning, to an agnostic liberalist attitude towards economic policy. Far from decrying any kind of economic policy as interventionist and potentially harmful or disruptive, he tries to formulate general criteria which economic policies have to meet in order to be successful. As we recall, the contractarian view had an exogenous success criterion, the final adoption of a policy proposal. Hayek tries to arrive at criteria, which would be (necessary) conditions for success, but more specific than the Pareto criterion on which the contractarians rely. While single incoherent economic measures should generally be avoided, even if a partial application of economic theory suggested that they might be beneficial, policies should be discussed in terms of their general character and approach and underlying (ideological) principles. (Hayek, 1969, p. 13. Compare this with Eucken's "Systemgerechtigkeit" und "Funktionsfähigkeit" in the jurisdiction of the BVerfG.)

This seems to fly in the face of a positive approach to economics. Again, the suggestion follows straightforwardly from Haek's theory of knowledge. Any social system is built around certain basic values on which agents rely in forming their expectations. As long as policies are solidly based on these same values held in a particular society, individuals are likely to be better equipped to deal with the intended and unintended consequences of economic policy and less likely to circumvent or avoid the political norm. Hence, in the Austrian view, economic policies should be evaluated in terms of their general character, not with respect to particular effects they have on certain individuals or groups. (Ibidem)

This is a standard of policy effectiveness with a minimum of normative implications. Value judgements are taken as societal realities, which economic policy has to take into account. And the status quo, as far as it has evolved over time, is taken as the point of departure for pragmatic reasons. There are no normative qualities attached to it. Finally, the value judgements held by the individual researcher are not professional group of researchers, such as economists, are again societal realities and, as such, subject to economic analysis and scrutiny. (See e.g. Hayek (1949). Also witness Hayek's long standing interest and steady contribution to the history of economic analysis.)

It is indeed surprising how close Hayek comes to the contractarian tradition, which has developed in Wicksell's footsteps. This proximity shows up in his insistence on coherent economic policy programs, broadly based on a historically stable ("constitutional") national consensus. Still, implementation of such policies on particular individuals or groups who, each individually and in turn, have to be persuaded to co-operate in the economic policy effort.

It almost goes without saying that Hayek's theory of economic policy suggests a very cautious approach. But as far as economic policy is concerned, Hayek is certainly not an abstentionist. As a matter of fact, a number of his policy proposals, such as the more

recent one concerning a denationalisation of money (London: Institute of Economic Affairs 1978.)

would involve major reconstructions of the Western monetary system and, in consequence, would leave strong marks on the entire Western world. Hayek's approach to economic policy, favouring, as it does, restraint on the part of government in pursuit of particular objectives and interests, suggests a strong role of government as maker of economic policy with respect to the development of legal institutions which further economic development. He finds himself firmly entrenched in the German tradition to economic policy, which dates back to the cameralists in suggesting as the basic guideline of economic policy maximisation of the social product as opposed to e.g. the maximisation of individual net present values. (Hayek, 1969, pp. 161-198 (167)).

From this basic principle which takes note of the possibility that social dilemma type situations may evolve over time in the absence of government intervention,

This is the vantage point from which Buchanan tries to unfavourably compare the Hayek system with his own contractarian approach; he writes:

I have no faith in the efficacy of social evolutionary process. The institutions that survive and prosper need not be those that maximise man's potential. Evolution may produce social dilemma as readily as social paradise. (Buchanan, 1975, p. 176)

Likewise:

The forces of social evolution alone contain within their workings no guarantee that socially efficient results will emerge over time. (Buchanan, 1977, p. 31).

It is precisely because Hayek shares this view that he envisions a broad scope for economic policy at all.

The approach suggests, then, three basic postures. First, economic policy is predominantly legal-economic policy. Second, there are two different sources of the law: social evolution and legal economic policy. Very often legal institutions, which have evolved over time, may be efficient. (Of course, there is no guarantee that they will be.) From this it follows that one should avoid the constructivist trap of an overzealous design of new legal institutions. Third there are a number of basic guidelines, which should be observed when new legal institutions are being suggested. These guidelines may be summarised as follows:

1. Efficient economic activity relies on the unquestioned acceptance of three basic legal institutions, namely, property, contract and tort (Hayek, 1969, p. 179)
2. These should not be questioned or otherwise made uncertain.

2. New legal arrangements should be scrutinized with respect to the incentive structures they determine (Hayek, 1969, p. 181).
3. Legal rules need be mutually consistent one with the other. Hence, new rules have to fit into the dogmatics or "system" of the existing legal order (Ibidem)
2. In general, new legal structures should be made so as to favour the development of the market economy (Hayek, 1969, p. 183).
3. In particular, they should be so designed that a maximum use of existing information ("knowledge" in his earlier writings).

He writes:

Also, "information" is clearly often preferable to where I usually spoke of "knowledge", since the former clearly refers to the knowledge of particular facts rather than theoretical knowledge to which plain "knowledge" might be thought to refer (Hayek, 1979, xii). For his earlier writings, see his classical article: Hayek (1945).

All this implies that there should be restraint with respect to policy makers' desire to achieve particular ends as compared to the more broadly conceived goal of maximising the social dividend. More technically it implies that the legislative procedure should not be used when the legislative act cannot be expected to be enforced in the long run and remain generally applicable, but only one isolated instance or problem is to be regulated (1969, p. 191).

As is well known, Friedrich von Hayek has since worked out these conceptions in greater detail. In 1971 appeared *The Constitution of Liberty* (with respect to the problem of codification, see in particular ch. 13) and in 1973 through 1979 his work of three volumes *Law, Legislation, and Liberty*. Here he proposed a detailed methodological framework in volume I, his criticism of the interventionist welfare state, which he sees as marred by blurred distinctions between the difference functions of government (i.e. policy making and rule making) in the second volume, and the proposal of a bicameral system of government (reflecting the aforementioned distinction) along with several other desirable features of "the political order of a free people" in the third volume. Obviously, for the task at hand, the first volume is the most important of this set of three.

At the heart of his conceptual framework, we find several important distinctions. In particular, there are two types of order.

By 'order' we shall throughout describe a state of affairs in which a multiplicity of elements of various kinds are so related to each other that we may learn from our acquaintance with some expectations concerning the rest, or at least expectations which have a good chance of moving correct (Hayek, 1973, p. 36).

One type of social order, namely what is commonly referred to as an organisation, Hayek terms "taxis" which he defines as a man made or

exogenous order or an arrangement (that) may again be described as a construction, an artificial order or, especially where we have to deal with a directed social order, as an organisation (Hayek, 1973, p. 37).

The other type of order has evolved over time, and he terms it "cosmos". It is self-generating or endogenous, a spontaneous order which has gradually incorporated the reactions of individuals to different social states as well as the adaptations to these reactions (Hayek, 1973, p. 39).

One salient implication of this distinction concerns the purposes of orders. Organisations typically are intended to serve a purpose intended by their founder or architect, whereas order, having evolved over time, is not readily identified as such unless an intellectual effort is made to uncover their patterns, do not serve any single purpose. They may serve a multitude of purposes, and being aware of their existence and the way of how they function will greatly facilitate one's furthering of different purposes within the "cosmos" (Hayek, 1973, p. 39).

Hence, again, ignoring the order may cause a policy maker to pursue economic policies which may not only not achieve the desired end, but also conflict with the unrecognised order and in due course produce all manner of unintended consequences which, in turn, can be attributed to the initiated policy only by identifying the order with which they have conflicted. This demonstrates the important place which economic policy occupies in Hayek's system. He places great emphasis on the necessity of intellectual work in order to help pursue effective economic policies. The next quote shows how economic policy can properly be achieved and when it will fail:

While it is sensible to supplement the commands determining an organisation by subsidiary rules and to use organisations as elements of a spontaneous order, it can never be advantageous to supplement the rules governing a spontaneous order by isolated and subsidiary commands concerning those activities where the actions are guided by the general rules of conduct. This is the gist of the argument against interference or "intervention" in the market order. The reason why such isolated commands requiring specific actions by members of the spontaneous order can never improve but must disrupt that order is that they will refer to part of a system of interdependent actions determined by information and guided by purposes known only to the several acting persons but not to the directing authority (Hayek, 1973, p. 51).

Hence, economic policy can indeed even aim at particular objectives. But achievement of these objectives cannot be legislated. Rather it is necessary to set up some type of order, such as an organisation or "taxis", as an element of the overall spontaneous order. Where the success of the "taxis" or organisation depends upon achievement of this goal or policy objective, and hence, members of the organisation will strive towards

attaining it. On the other hand, achieving a particular policy objective may also be tried by singling out an order that has historically evolved over time, a "cosmos", implementing the policy objective as one of the several purposes which the cosmos may serve, and, towards that end, defining incentives compatible with the order of that cosmos. E.g., instead of intervening into the market by decree, the State may set up organisations that operate within the market framework and under the market rule, but achieve objectives different from those other firms may try to attain. In the sphere of social policy, not for profit organisation which have a well defined and sensible mission may serve as a convenient example.

It is important that both criteria be met. E.g., in the social services, the success of a charitable organisation should not be made dependent upon the plight the organisation can show to exist, but upon achievement of a positive goal of reducing a pre-existing ill or providing a general level of welfare. Organisations that care for the blind should receive allocations in keeping with the number of blind persons they make independent, not on the number of people they claim to care for. The latter incentive system locks the easy-to-care-for blind into continuous care, while neglecting e.g. the blind and mentally retarded whose care and schooling is expensive and tedious. When combating cancer is the goal, a cancer research foundation would put itself out of business if it ever found the cure against cancer, provided such a cure exists, unless the prize were set in terms of finding that cure. If a civil service based on merit promotions and honorary distinctions is to regulate a business, it is wrong to offer money bonuses to the civil servants, instead of promotions and honorary distinctions, in due course, which serve to set the civil service apart from the business world. In each single case, the incentive system in which it is to be implemented; where uniform across the board provisions are apt to either fail of be inefficient.

The legal design of such elemental parts of the larger cosmos of which they form a part is, then, one of the central concerns of economic policy. It is this context which makes the common law such a noteworthy subject of economic study. Hayek explains this well:

The important insight to which an understanding of the process of evolution of law leads is that the rules which will emerge from it will of necessity possess certain attributes which laws invented or designed by a ruler may, but need not possess, and are likely to possess only if they are modelled after the kinds of rules which spring from the articulation of previously existing practices (Hayek, 1973, p. 85).

It would, of course, be absurd to infer from this quote that a particular legislative proposal is doomed to be inefficient and will upset the existing legal order unless we can point to some precedent in the common law. There is no transcultural pre-eminence of the common law, from an economic policy point of view. E.g., if a new legal form for a publicly held corporation is debated in a legislature, Hayek's argument suggests that it

would be wise to look for parallels in similar legal-economic systems. The search is for parallel legal institutions, which have already withstood the test of practical experience and judicial review. Imitating these parallels may be preferable to legislating new legal designs, provided the relevant traits of the legal cultures under review are at all comparable.

This is exactly what has always happened in preparing grand legislative successes. (BGB)

Far from belittling the importance of legislation as a source of the law, Hayek explicitly stresses the complementarity of common law and legislation as well as the importance of legislative corrections in the development of the common law. There are several reasons why corrections are required. The first, of course, is the familiar 'social dilemma', into which spontaneous developments may lead:

For a variety of reasons, the spontaneous process of growth may lead into an impasse from which it cannot extricate itself by its own forces or which it will at least not correct quickly enough (Hayek, 1973, p. 88).

Secondly, "wholly new circumstances" (Hayek, 1973, p. 88) may arise which require a reversal of the law, a task for which courts are ill suited.

(It) is not only difficult but also undesirable for judicial decisions to reverse a development, which has already taken place and is then seen to have undesirable consequences or to be downright wrong. The judge is not performing his function if he disappoints reasonable expectations created by earlier decisions (Hayek, 1973, p. 88).

A related reason is that legislation can look into the future, while judicial decisions necessarily look into the past. That is, judges decide cases about matters past, and their decisions rendered on cases past will reflect on cases in the future. While legislation can, without affecting the proper adjudication of past cases, promulgate different rules for future cases, new rules to which individuals can readily adapt (Hayek, 1973, p. 89).

He adds that often the perception of what is just undergoes a change which, in turn, may require new legislation:

The necessity of such radical changes of particular rules may be due to various causes. It may be due simply to the recognition that some past development was based on error, or that it produced consequences later recognised as unjust. But the most frequent case is probably that the development of the law has lain in the hands of members of a particular class whose traditional views made them regard as just what could not meet the more general requirements of justice. There can be no doubt that in such fields as the law and the relations between master and servant, landlord and tenant, creditor and debtor, and in modern times between organised business and its customers, the rules have been shaped largely by the views of one of the parties and their particular

interests - especially where, as used to be true in the first two of the instances give, it was one of the groups concerned which almost exclusively supplied judges (Hayek, 1973, p. 89 (fn. Omitted)).

We might add that the same reasons would probably apply to the relationship between the corporation and its employees.

Another important terminological distinction, which corresponds to the differentiation between the different types of orders, *cosmos* and *taxis*, parts "*nomos*", the lawyers' law, from "*thesis*" i.e. those rules of organisation of government with which legislatures have been chiefly concerned (Hayek, 1973, p. 94).

Hayek makes the surprising remark that *nomos* is actually the more abstract type of law. This is surprising as one should think that legislation concerns the general, while adjudication deals with the particular. But it should be kept in mind that in distinguishing *nomos* and *thesis*, Hayek is not interested in addressing the question "*common law vs. Codification*", that e.g. Jeremy Bentham had concerned himself with. Codification tries to cast *nomos* into one readily accessible document. It is not an ad-hoc attempt to organise a concern with a particular end in mind. And therefore, the judge made law revolves around general principles that the judges have tried to develop over time. And on which, it might be added, codification typically builds.

It seems that the constant necessity of articulating rules in order to distinguish between the relevant and the accidental in the precedents which guide him, produces in the common law judge a capacity for discovering general principles rarely acquired by a judge who operates with a supposedly complete catalogue of applicable rules before him. When the generalisations are not supplied ready made, a capacity for formulating abstractions is apparently kept alive, which the mechanical use of verbal formula tends to kill. The common law judge is bound to be very much aware that words are always but an imperfect expression of what his predecessors struggled to articulate (Hayek, 1973, p. 87).

The same would certainly apply to the judges sitting on the benches of supreme courts in the continentalsystem, and to the judges appointed to constitutional courts in particular who, in trying to resolve particular cases, have nothing to apply but the general principles laid down in the constitutional document.

This document, incidentally, often uses unduly vague language, designed at the time of its drafting to patch up rather diverse political intentions of the "founding fathers".

Since Hayek views judge made law and legislation as mutually symbiotic, the decisions of supreme courts and constitutional courts in continental legal cultures which rely on codification as their prime source of the law must be expected to be a particularly fertile depository of *nomos*, the law of the spontaneous order.

The rules on *nomos* "are discovered either in the sense that they merely articulate already observed practices or in the sense that they are found to be

required complements of the already established rules if the order which rests on them is to operate smoothly and efficiently. They would never have been discovered if the existence of the spontaneous order of actions had not set the judges their peculiar task, therefore rightly considered as something existing independently of a particular results will be free inventions of the designing mind of the organiser (Hayek, 1973, p. 123).

All this implies that legal economic policy should be firmly based on these general rules of *nomos*, which have developed in a particular society. There is, hence, a much more complicated interdependency between the legal order on the one hand and economic policy on the other. While the legal order certainly constrains economic policy, this should be read to imply that legal economic policy is constrained by the rules of *nomos*; while thesis is constrained by the rules under which the economy operates; and economic policy is a scientific attempt at uncovering existing orders and the regularities and requirements of their performance in order to fit political purposes into existing systems.

It is clear that the collapse of the state socialist system is provided the new circumstances Hayek talks about which require extensive legislation on the part of the state in order to make the formation of market forces possible. The in-depth analysis of deficiencies of mass privatisations in the five countries studied that the questionnaire method makes possible can effectively build on the Austrian approach in spotting chances for improvement.

The headline of this subsection promised a fifth neologism after *taxis* and *thesis*, *cosmos* and *nomos*. *Catallaxy* refers to the economy as a whole, but Hayek suggested, and most scholars writing in the Austrian tradition pay heed to this advice, not to use the word *economy*, which originally referred to the micro unit or household economy, which is but a network of many interlaced economies (Hayek, 1976, p. 108).

The distinction is significant and corresponds to what has been' previously said about *taxis* and *cosmos*. Economies, i.e. households and firms, in the Austrian view are organisations which have been deliberately set up and which serve a limited number of goals. Their operations are consciously planned, and they dispose of idiosyncratic information, which is not generally available, or of interest to other economies. A *catallaxy*, on the other hand, is the special kind of spontaneous order produced by the market through people acting within the rules of the law of property, tort and contract (Hayek, 1976, p= 109).

In a *catallaxy*, an unknown variety of different goals and aspirations is being pursued, and there is no one conscious will directing the operation of the whole. Would this imply that Austrian economics hold economic policy to be something impossible, a contradiction in terms? The answer must be a resounding no.

There is room for *catallactic* economic policy. Although there can be no substitution of one political will for the multitude of ends pursued by the different economic units in a *catallaxy*, the State may very well pursue political ends within this order. This may be

either by means of influencing the legal environment of economic activity, or it may be through economic pursuit within this legal environment, which is when the State operates as one economic entity among many equals, pursuing economic goals under the rules of the market.

The Status Quo

Hayek's approach to economic policy has often been charged with being ultraconservative, among other things because of the importance it attaches to the status quo. In this respect, by the way, the approach is in now way different from the other approaches to economic policy discussed. Both the pragmatic and the contractarian approach take the status quo as the point of departure from which policy proceeds and as the reference point of the analysis. Whenever the Pareto principle is used as the benchmark of economic analysis, the status quo assumes a particular importance (Backhaus, Samuels interchange).

But Hayek gives a particular justification for this reliance on the status quo which is proper to the Austrian view. This reasoning revolves around the notion of uncertainty.

Since any established system of rules of conduct will be based on experiences which we only partly know, and will serve an order of action in a manner which we only partly understand, we cannot hope to improve it by reconstructing a new the whole of it. If we are to make full use of the *experience which has been transmitted only in the form of traditional rules*, all criticisms and efforts at improvement of particular rules must proceed within a framework of given rules which for the purpose in hand must be accepted as not requiring justification (Hayek, 1976, p. 24).

This does not mean that any particular legitimacy is attributed to the status quo. This (latter) statement is correct even though the status quo is emphasised as being singular in embodying past, present and in most cases relevant information not embodied in any other system of rules or, for that matter, social states.

When we say that all criticism of rules must be immanent criticism, we mean that the test by which we can judge the appropriateness of a particular rule will always be some other rule which for the purpose in hand we regard as unquestioned. (...) The ultimate test is that not consistency of the rules but compatibility of the actions of different persons which they permit are required.

It may at first seem puzzling that something that is the product of tradition should be capable of both being the object and the standard of criticism. But we do not maintain that all tradition as such is sacred and exempt from criticism, but merely that the basis of criticism of any one product of tradition must always be other products of tradition which we either cannot or do not want to question; in other words that particular aspects of a culture can be critically examined only within the context of that culture (Hayek, 1976, p. 25).

Hence, which aspects are to be taken as given and which are to be variable is up to the volitional choices of the political economist. This choice is not predetermined by the approach to the analysis, rather by the purposes of the inquiry.

We are forced to conclude that the Austrian approach is really not very conservative at all, at least in so far as economic policy is concerned. Any aspect of the reality accessible to the political economist may be questioned; only provided that the question is well defined, including a proper delineation of what is not going to be addressed and hence taken as given.

A Separation of Rule Making and Policy Making

In concluding this section, let us note one important institutional recommendation which follows from Hayek's legal theory. As the reader will recall, Hayek distinguishes between two processes, which create order. The first involves the spontaneous order or cosmos resulting from the many different and mutually interdependent actions of the agents in a social system. Secondly, the equally spontaneous order, which produces, rules governing the first process. Both the spontaneous orders and the rules, which govern their evolution, are the unintended social product of a continuous chain of mutual adaptations. It is in this sense that *nomos*, the evolved law, embodies lasting principles of jurisprudence pertinent to a particular culture in which it reigns. *Nomos* should indeed not be confused with natural law of which Martin Luther said: "De iure naturae multa fabulamur." (Werke. Kritische Gesamtausgabe in 58 Bänden. Weimar, 1883, Vol. 56, p. 355)

One reviewer of Hayek's political economy (Gordon (1981)) who equated *nomos* and natural law which, since the middle ages, has many an authoritarian ideology to justify all kinds of grave injustices and infringements of the conduct of people, rather speechlessly in view of this grave inconsistency exclaimed:

In view of the political history of natural law doctrine, it is astonishing that Hayek, whose dedication to individual freedom is sincere beyond question, would engage in the slightest flirtation with, much less embrace, such a diseased and meretricious old drab (Gordon, 1981, p. 479 (fn. omitted)).

It is not "the old drab" which Hayek embraces. Hayek's *nomos* is characterised and singled out by the openness of the process through which it develops, it is not pronounced *ex cathedra* but has, instead developed through a chain of many interlaced and mutually interdependent but *decentrally* taken decisions. *Nomos* is thus the product of a self organising structure, after the elements that constitute an order have gone through many interactions and reached a certain consensus, and it is the independence from outside interference which insures that *nomos*, the law of liberty, cannot degenerate into a natural law of the scholastic tradition, which, after all, was conceived to serve a hierarchical world committed to the single end of praising the lords in words and deeds.

How can we judge a particular piece of legislation, e.g., in order to decide whether it is good law or bad?

Hayek says that overall order does not necessarily result from individuals following rules: "Individual responses to particular circumstances will result in overall order only if the individuals obey such rules as will produce an order." But we can never know in advance what rules will produce order. Hayek says that those groups that survive and adapt to their environment better than others have done so precisely because they have adopted the most appropriate set of rules. It would appear that we are conducive to survival by looking at those groups that have survived. But we cannot know which particular rules are most conducive to survival, and which may be copied by others, because clearly some rules survive in any system even though they serve no useful purpose (Barry, 1979, p. 82, (fn. and Italics omitted)).

Hence, there is no philosophers stone which can help us tell the good law from the bad, beforehand. But this is not a limitation of Hayek's philosophy, as Barry claims (*Ibidem*).

It rather has to do with the uncertainty about future states to which individuals respond while observing. This implies that requirements for good law can never be substantive, they have to be procedural, e.g. in ensuring that individuals are left free enough to develop new ways of reacting to the law and unforeseen events.

Therefore, in passing a law, the legislature has to make sure that, while binding, it leaves individuals (and firms) enough flexibility to react to it differently, to opt for legal ways not to be bound by the law. The law must offer alternatives to individuals, to take either one choice or the other, depending on their particular circumstances. The procedure of implementing the law must be such that adverse (and unforeseen) consequences, not intended by the legislature, can be avoided by the citizen.

There is one procedural principle on which Hayek places particular importance. We are referring to what has become the cornerstone on which resides his proposal for "the political order of a free people." The principle requires that in a social organisation, the rule making body be distinct from the policy making body.

We want, and I believe rightly, that both the laying down of general rules of conduct binding upon all and the administration government be guided by the wishes of the majority of the citizens. This need not mean, however, that these two tasks should be placed into the hands of the same body, nor that every resolution of such a democratically elected body must have the validity and dignity that we attach to the appropriately sanctioned general rules of conduct (Hayek, 1979, p. 22).

Though, if we want democratic government, there is evidently need for a representative body in which people can express their wishes on all the issues which concern the actions of government, a body concerned chiefly with these problems is little suited for the task of legislation proper. To expect it to do

both means acting it to deprive itself of some of the means by which it can most conveniently and expeditiously achieve the immediate goals of government. In its performance of governmental functions, it will in fact not be bound by any general rules, for it can at any moment make the rules which enable it to do what the momentary task seems to require. Indeed, any particular decision it would make on a specific issue will automatically abrogate any previously existing rule it infringes. Such a combination of governmental and rule making power in the hands of one representative body is evidently irreconcilable, not only with the principle of the separation of powers, but also with the ideals of government under the law and the rule of law (Hayek, 1979, p. 25).

It should be fairly obvious that this principle has numerous applications well beyond the range of government proper, i.e. whenever a social organisation has achieved a certain size and conforms to rules that guide decision taking, and where, hence, rule making and policy making need to be separated. The modern corporation is just one of many examples that come to mind.

Hayek's political economy in the Austrian tradition bears on the science of economic policy with respect to economic rule making, i.e. with respect to economic legislation. Hayek's contribution to economic policy is immense, but it is concentrated on an area, which is typically not the focus of economic policy research. While most of what is written in the area of economic policy is concerned with policy proper, Hayek's political economy addresses the question of what legislation will best suit catallactic orders.

The Economics of Property Rights

Having discussed (1) the pragmatic approach to economic policy, (2) the contractarian method, (3) the Austrian school, and (4) the property rights paradigm, the remains whether any of them, and if yes, which one(s) will likely provide incentives for efficient economic decisions. How is it that an efficient company law may at all come about? Although this question goes to the roots of the law as such, and has concerned legal scholars for millennia, in economics it has only recently attracted wider attention.¹³ Not surprisingly, the problem remains somewhat elusive. E.g. Douglas North¹⁴ regrets that while most of the elements of a theory of institutional change have been developed, there is no neat supply function of new institutional arrangements that might enter the neo-classical framework. What determines, he asks, the menu of organisational forms that society devises in response to changing relative prices? And his answer suggests a difficulty, not a solution:

Institutional innovation is a public good, with all the characteristics of such goods, including the free rider problem (p. 68).

This, however, already provides a first hint. The free rider problem in economics is the more relevant, the more an individual is able to rely on others for the provision of a good while withholding his own contribution towards the provision. That is, free riding

occurs when the free rider faces only minimal or no consequences of his behaviour. To take an example: If in a community of a thousand there were one thousand legal solutions to provide, and each issue were to be decided by a different individual randomly assigned to the case, any one in this society would be a free rider with respect to providing efficient law. The incentive to decide efficiently would be minimal, the resulting decisions pitiful. And this is why North (1981) suggests that institutional innovation will come from rulers rather than constituents, as the rulers may be able to reap some of the benefits from efficient institutional innovations and hence will be personally interested in providing efficient law. Rulers who provide efficient legal institutions would be attractive to constituents, and would therefore also be able to levy a tax in reaping a reward for providing efficient legal institutions. The reverse would hold when a service deteriorates *or* the tax price increases. With respect to the decline of Rome, North is explicit:

The gains to individual constituents of being members of the world wide empire called Rome had significantly declined enjoyed had ended. More and more individual parts of the empire found that local units provided them with more protection than they could get from the bickering, internally agonised Roman state. Thus, they came to the conviction that their well being depended on local autonomy (p. 167).

And with respect to the modern state after the second industrial revolution, the explanation of structural change relies on the provision of new property rights that protected innovators and inventors. The emphasis is, indeed, not on technological developments, but rather on positive government action (p. 187) in the development of more efficient markets and the better pacification and enforcement of property rights over goods and services. Likewise, he notes an activist government approach to cope with some repercussions of the newly created property rights structures.

The development of intellectual property rights posed complex issues in the measurement of the dimensions of ideas as well as complex problems over the trade off between raising the private rates of return and innovation and monopoly-restraints of trade as a result of the grant of exclusive rights over time. While the private rate of return has been raised by better specified property rights over invention and innovation, a good part of the basic research has been financed by government and takes place in universities - reflecting the growing public awareness of the high social rate of return of scientific advances (p. 173).

Hence, the production of property rights posed some unanticipated consequences that the property rights producer, i.e. the legislature, took up to tackle as well. Note that the perspective is one in which the legislature, i.e. the ruler, set out to maximise wealth. This highlights well the basic themes of the approach taken by North:

It is important to combine incentives for legislative efficiency with the power to legislate.

We summarise the argument by saying that efficient institutional change will come about when the institutional innovator, notably the powers in charge of the state, will benefit from efficient institutional change while suffering considerably from inefficient legal institutions.

While the economic theory of efficient legal institutions has served some economic historians well in explaining the rise and decline of states, the notion that a particular type of law, i.e. the common law reflects a concern for efficiency was suggested both as a yardstick for legal doctrine and as a basic principle to generate hypotheses on legal economic research. Posner and Landes formulated a model which asserts that the common law is economically efficient while statutory law is not. The basis of this theory turns on the respective forum in which the judicial, i.e. the common law, and the legislated, i.e. the statutory law are decided. Posner et al. Claim that judicial cases are settled in a forum where the lawmaker is isolated from elections, special interests, etc.; it is seen to be necessarily more efficient than legislated law which is formed in a less objective arena. The efficiency of the judicial system is further fuelled by the positive motivation of the judges. Posner initially asserted that a judge's aspiration for higher offices, promotion etc. was the driving force behind his positive motivation. He later amended this reason to the idea that the judges' more general desire to impose their adjudicated preferences on society was one of the causes. Although Posner's common law theory is an evolutionary one, subscribing to the theory that inefficient rules impose greater costs on society and are therefore more likely to be relitigated and overturned than efficient rules, it differs from other evolutionary theories in that it uses the positive motivation of judges as a major force in driving common law toward efficiency.

While Posner tends to see the cause of the efficiency of the common law in the motivation of its judges, Paul Rubin e.g. focuses on litigants' motivation as the key to understanding the forces that drive the common law towards efficiency. His evolutionary common law model depends on re-litigation of inefficient rules until they become efficient, and according to Rubin, this re-litigation depends on parties with an interest in precedent taking their cases against inefficient rules to court. Rubin identifies three types of situations that are possible in involving parties to a dispute. These three situations are:

1. both parties are interested in a particular precedent;
2. only one party is interested in a given precedent, while the other is not; and
3. neither party is interested.

In the first case, where both parties are interested in precedent, Rubin believes that the precedents will eventually evolve towards efficiency. The reason for this is that if the rule or rules are inefficient, the party held liable will have an incentive to force litigation. If, however, the rule or rules involved are efficient, then the liable party will meet resistance against shifting the burden and the efficient rule will prevail over time. In the second case, where just one person is interested in the precedent, there is a

tendency for the precedent to evolve in favor of that party, whether the precedent is efficiently decided or not. This is because the party with a stake in future cases will find it worthwhile to litigate the case as long as liability rests with him and the party with no stake would not find the litigation worthwhile.

In the third case involving no interested party, there would be no change of the rule. The present rule would stay in effect regardless of its efficiency, because neither party cares enough to litigate the matter. All three scenarios imply, of course, that there are powerful incentives in the common law tradition towards efficiency.

A third approach was taken by George L. Priest, who in contradiction to both Posner and Rubin states that efficient rules are more likely to endure as controlling precedent regardless of the motivation of the individual judges or of the interests in precedent of the litigants in the allocative effects of the rules. Priest goes on to point out that this drive is also present in judicial interpretations of constitutions and statutes. Instead of relying on the motivation of judges and litigants, Priest's theory depends on people's treating a legal rule as a commodity.

A change in relative prices (as between efficient and inefficient rules) will change the distribution of consumption choices towards relatively cheaper and away from more expensive commodities (1977).

Since the costs of rules imposed are always higher than efficient rules' costs, it follows that disputes arising under inefficient rules will be more likely litigated than those arising under efficient rules.

And to further contradict Posner, Priest states that a random pick or even a bias against efficiency by a judge, because a judge can only preside on a case brought before him, would still not change the judicial system's propensity towards efficiency. How would this compare with the formation of statute law? Along with their previously mentioned differences regarding the motivation of judges and litigants, Posner and Rubin also disagree on the relative efficiency of statutory law. Although they both seem to agree that the common law is more efficient than statutory law, they do so for different reasons. Posner states that statutory law is not very efficient because it is not decided in an objective forum. It is more often than not just a means for redistributing income or wealth. Rubin holds that statutory law is generally less efficient than the common law because of the time period in which the respective law was drawn up. According to Rubin, most of the law written before the 1930s was generally efficient and most law drawn up after that time which coincides with an increase in statutory law tends to be less efficient.

Rubin sees the major reason for this peculiar chronological phenomenon in the ease with which interest groups can be formed to form effective political organisations as contrasted to earlier times. He is careful, though, to point out that although up to present times the inefficiency effects of the formation of interest groups have probably outweighed the efficient ones, it is not necessarily true that this will always be the case.

Rubin says that there are some aspects of interest groups driving statutory law towards efficiency, too. As an example he draws an analogy between litigants who spend resources on influencing judicial law making, and interest groups who spend on statutory law making. He believes both of these types of spending to contribute towards efficiency.

One of the fiercest critics of legislation and staunchest defender of judge made law is the late Bruno Leoni who felt that the relationship between the market economy and a legal system centered on judges and/or lawyers instead of on legislation tends to much less clearly realized than it should be, although the equally strict relationship between a planned economy and legislation is too obvious to be ignored in this turn by scholars and people at large. As a yardstick, he advanced the following three principles:

It seems to be unquestionable that we should, on this basis, reject the resort to legislation whenever it is used merely as a means of subjecting minorities in order to treat them as losers in the field. It seems also unquestionable that we should reject the legislative process whenever it is possible for the individuals involved to attain their objectives without depending upon the decision of the group and without actually constraining any other people to do what they should never do without constraint. Finally, it seems simply obvious that whenever any doubt arises about the advisability of the legislative process compared with some other kind of process having for its object the determination of rules or behaviour, the adoption of the legislative process ought to be the result of a very accurate assessment.

Again, the whole argument hinges on the possibility of legislation to be an instrument for the distribution of income or wealth from the constituents to the legislators. Where this is not feasible or imminent, the criticism would not seem to apply.

The theoretical approach outlined in this section forms the basis for the questionnaire approach used in the empirical part of this comparative study. The questions draw on the relevant theories of the firm in both the property rights, the public choice and the Austrian tradition, emphasizing aspects of the production of law.

Corporate Governance

Any discussion of the implications for corporate governance of mass privatisation in the transition economies in Central and Eastern Europe must take cognisance of the growing literature on economic institutions which has developed over the last quarter of a century. This has become known as the *New Institutional Economics*. Definitions of sub-disciplines or research programmes are apt to be arbitrary or for the convenience of the writer, nevertheless the term New Institutional Economics has entered the lexicon of economics. Although it is possible to quibble over its exact boundaries most commentators would agree that it encompasses the literature on the *economics of property rights* (PR), *transaction cost economics* (TCE) and the *positive theory of agency* (AT).

Writers in the PR literature (e.g. Pejovich (1972), Furubotn and Pejovich (1972)) argue that the distribution of property rights in society determines the incidence of costs and

consequently effects resource allocation and thus efficiency. Alchian and Demsetz (1972) using a PR framework developed an institutionalist theory of the firm highlighting its team nature and emphasising the importance in the 'classical capitalist firm' of a central monitor (the entrepreneur). The central monitor is party to a series of bilateral contracts with all input suppliers to the firm. Only the central monitor who is the residual risk bearer has the incentive not to 'shirk'. Any attenuation of these private property rights, it was argued, would lead to deviations from efficiency. In subsequent work others (see De Alessi (1983)) have tested these predictions by, *inter alia*, examining the relative performance of organisations in the same industry, which differ in the extent to which the property rights of owners have been attenuated. Although Alchian and Demsetz stress that they see the key issue to be that of monitoring and shirking and not the nature of long-term contracts, others see their work as stressing the *contractual* nature of the firm (Jensen and Mechling(1976)). What is clear is that the PR approach and the line of research derived from Alchian and Demsetz (1972) lays stress on 'post-contractual monitoring' rather than on the selection of the 'team'.

The second strand of literature in the NIE is *transaction cost economics* (TCE). The research agenda of TCE is wider than that of PR and, perhaps as a consequence of this, its impact on economics has been greater. Indeed many of the attenuations of property rights referred to in the PR literature arise from the existence of positive transaction costs. Building on the fundamental insights of Coase (1937), Simon (1957) and others, Oliver Williamson (1975), (1985a), (1985b) developed the framework of TCE to explain the fundamental reasons why many 'transactions' take place within firms rather than between firms. TCE has issues of contracting at its core. Indeed it has been described as replacing 'economic man' with 'contractual man' (Williamson (1985b)). Williamson and other TCE researchers recognise the existence of *ex ante* as well as *ex post* transaction costs and Williamson in his development of the framework recognises that the *atmosphere* surrounding a transaction will affect the likelihood of opportunistic behaviour. However, little of the subsequent analytical or empirical work appears to pay much attention to how search and screening activity or the social context of transactions (atmosphere) may remove or radically reduce opportunism. To be sure, some types of transactions may remain subject to it, but insufficient attention would appear to have been paid to how such factors impact on the mode by which a transaction is effected. For example, abstract consideration of the scope for opportunistic behaviour by (one party to a transaction where the other party has undertaken transaction-specific investment may suggest vertical integration in order to reduce transaction costs. Yet screening of potential partners or the availability of a partner who because of other connections of a social nature is unlikely to behave opportunistically might lead to the transaction taking place across a market interface. These considerations are not the same as reputation or 'cultural factors' that are addressed by Williamson.

The *positive theory of agency* (AT) is a third approach within the ambit of NIE. Following Jensen (1983), we distinguish AT from the more general and abstract mechanism

design literature. The latter is concerned with deriving constraints to be applied to an optimising problem, which will ensure that agents maximise the principal's utility. In contrast AT is concerned to explain observed institutional structures in terms of attempts to control the behaviour of agents (hence the adjective *positive*). The mechanism design literature does not have this positive focus and is more firmly placed within conventional microeconomic theory than the NIE. AR is the literature derived from the work of Jensen, and Meckling (1976), and Fama and Jensen (1983a), (1983b). In common with the other two strands of the New Institutional Economics, AT focuses on the individual economic agent as a utility maximiser. Organisations are composed of different agents each seeking to maximise his or her own utility subject to constraints. Managers in a shareholder owned corporation will make different decisions from those of the owner-manager in Alchian and Demsetz's classical capitalist firm. However, the managers will bring skills and knowledge to the firm, which the owners do not. The divorce between ownership and control is seen as an aspect of specialisation or the division of labour: owners specialise in the supply of capital; managers specialise in the supply of management skills. The cost of this specialisation is the agency problem: as utility maximisers managers will not necessarily operate a company in the interests of the shareholders.

The positive theory of agency literature is concerned with exploring how different forms of organisation constrain (or not) such managerial behaviour. In the case of the corporation the constraints come from the stock market in its role as the market for corporate control and the market for managers themselves. An essential feature of this approach is that it is assumed that in valuing a company the stock market will discount its value given the potential for managers to divert resources to maximise their utility rather than that of the shareholders. However, managers will incur bonding costs to signal to shareholders that they will operate in the interest of the latter (Jensen and Meckling (1976), Fama and Jensen (1983)).

The three elements of the New Institutional Economics each contribute an element to our conceptualisation of the problem of corporate governance:

- The property rights literature that property rights have a major influence in determining the distribution of the costs and benefits of economic activity;
- The transaction cost economics literature that transaction cost may attenuate the ability of shareholders to exercise their property rights;
- The positive theory of agency that different organizational forms will evolve to deal with the agency problems which arise from the attenuation of property rights.

The next section examines two systems of corporate governance which have received much attention in recent years. The Anglo-American model of outsider governance and the German-Japanese model of insider governance.

Insider and Outsider Models of Corporate Governance

The institutional arrangements in Western countries through which the control of managerial behaviour in a corporation is carried out can be grouped into two general types: the Anglo-American or 'outsider' system of corporate governance and the German-Japanese model of 'insider' corporate governance. Table 1 taken from Staykova (1996) and based on Corbet and Mayer (1991) and Nunnenkamp (1995) summarises the properties of insider and outsider systems of corporate governance.

Table 1

Properties of Insider and Outsider Systems

Outsider systems	Insider systems
Dispersed ownership	Concentrated ownership
Separation of ownership and control	Association of ownership with control
Low debt/equity ratio and low ratio of bank credits to total liabilities	High debt/equity ratio and high ratio of bank credits to total liabilities
Highly sophisticated and diversified financial markets	Low level of sophistication and low opportunities for diversification of financial markets
Little incentive for outside investors to participate in corporate control	Control by interested parties (banks, related firms, and employees)
Hostile take-overs that are costly and antagonistic	Absence of hostile take-overs
Interests of other stakeholders are not represented	Other stakeholders are represented
Low commitment of outside investors to long-term strategies of firms	Intervention by outside investors limited to periods of clear financial failure
Take-overs may create monopolies	Insider systems may encourage collusion

Source: Corbet and Mayer (1991) and Nunnenkamp (1995)

In Germany and Japan the stock market does not operate as a market for corporate control. The major financial institutions, which control around 60% of German market equity (Prodhon (1990)), perform the supervisory function associated with the stock market in the Anglo-American system. The banks themselves only own around 10% of the equity (Baums (1994)) but control a significant proportion of other shares by holding shares of their own depositors. However there is evidence that the performance of German companies is a function of the size of the shareholding owned by the banks rather than those controlled by them (Gorton and Schmid (1994)). There are also significant shareholdings held by companies. It is usually argued that a small

number of shareholders with significant shareholdings will be more active in monitoring managerial *performance* than a *large* number of small shareholders. The latter group generate a free riding problem: the gains to individual shareholders are small relative the costs of active monitoring therefore it is better to free ride on others monitoring efforts. Where shareholdings are concentrated the gains to the shareholder are greater and active monitoring more likely. The, generally, low level of individual shareholder's stake, it has been argued, limits the possibility of take-overs (Jackson (1994)).

The financing of firms is performed mostly by banks instead of by outside equity. The banks because of their position as insiders are likely to be better informed about company prospects than outside lenders or an atomistic stock market. However, collusion between insiders (managers and bank representatives) may produce a bias towards the *status quo* and resistance to change which might improve the wealth position of small shareholders. The two-tier board system is considered by some economists like Prodhon (1993) as one of the reasons of Germany's post-war prosperity. The separation of duties between the Managing Board of the senior management and the Supervisory Board representing the interests of the stakeholders in the company ensures a clear cut division in roles with respect to day-to-day management and long-run planning. However, it has recently come under criticism because increasingly key supervisory board members are seen to be members of a number of such boards and are alleged to maintain only their own interests. See Prodhon (1993), Kaplan (1994). However, it has been argued also that this system with the greater access to information on the part of banks reduces transaction costs and increases efficiency.

A similar argument has been made on behalf of the Japanese system based on the cultural features and information sharing through the group bank system. Monitoring of managerial behaviour is carried out through close bank involvement, cross-shareholding (by suppliers, distributors and creditors) and dispersed information. Consequently the stock market is less important in constraining managerial behaviour.

The ownership concentration of this model may reduce principal-agent problems. There is a stronger incentive to monitor because the marginal benefits from efficient monitoring are much higher than in the case of dispersed ownership. On the other hand, the inside collusion between banks, managers and employees that have common interest in increasing the level of employment and output, may undermine the minor shareholders' profit-maximising concern (Nunnenkamp (1995)).

The Anglo-American system does not afford banks a major role in corporate control and even specific restrictions on stock ownership by them (Prodhon (1993)). The main role in corporate control is carried out by the stock market. The take-over (or bankruptcy) is the main instrument for disciplining managerial behaviour. A low rate of return on capital will lower a firm's share value until a predator takes advantage of the low value of the company to acquire it with the intention of reaping the benefit from higher share value after take-over and better management. The low value of the firm

prior to take-over will also lower the value of the firm's managers in the market for managerial talent. However, some empirical evidence suggests that leveraged buy-outs and hostile take-overs may cause reduction in long-term investment (Shleifer and Vishny (1990)). That is, firms adopt a short-term strategy directed towards high dividends and high share price thus protecting managers against the threat of take-over and displacement. This displaces a long-term investment strategy. The empirical evidence is on the whole mixed on this question.

Shareholders prefer free riding or to sell rather than being engaged in improvement of corporate governance given the high information costs of monitoring relative to the individual returns from such activity. Institutional investors (pension funds, life insurance companies, mutual funds) could play an important role in corporate governance, but particularly in the UK, tend to adopt a passive role. When a company's performance is poor institutions are more likely to exit selling share than try actively to improve managerial performance.

The growth of international capital markets may lead to a process of convergence of the two systems. Some commentators have pointed out, for example, that the structure of financing companies in Britain and Germany is quite similar. Investment in physical and financial assets are financed primarily by issuing debt rather than equity. However, for the present they represent alternative models from which to draw on in the transition process.

Corporate Governance in the Transition Economies

What are the implications of this analysis of 'insider' and 'outsider' models of corporate governance for the transition economies of Central and Eastern Europe? In particular, what are the implications for those sectors of the transition economies where schemes of mass-privatisation are being used as the vehicle for the privatisation of industry?

The Anglo-American 'outsider' system relies on a well functioning capital market in which information is rapidly spread throughout the market. It is this which ensures that the stock-market valuation of a company represents the true value of its future profit stream i.e. its value to its owners. Similarly the dissemination of informed comment on a company's prospects and performance is necessary to inform owners and potential owners whether a company's current valuation is can be improved upon or not. It is only with such information that the market for corporate control can be expected to work in the way which is assumed in the Anglo-American model. In most of the transition economies these conditions are far from being met at the present time. Trading on stock markets where they exist is relatively thin with relatively few companies being registered for trading on the stock market. In such conditions share prices will not reflect the 'true' value of the companies concerned. Similarly, reliable information and comment may be scarce thus reducing the ability of owners and potential owners to monitor company performance.

In circumstances such as these the costs of owners exercising their property rights are increased. Consequently, the attenuation of property rights of shareholders is likely to be greater, *ceteris paribus*, than in the U.S. or the U.K. Thus for a given dispersion of ownership it is less likely that the Anglo-American system if applied in Central and Eastern Europe will achieve its theoretical potential. A much more concentrated distribution of ownership than applies in these western economies may be necessary for an outsider system of corporate governance to function effectively.

The German system of 'insider' corporate governance relies heavily on financial institutions exercising a supervisory role over management and making use of the information they have as insiders. This requires that the financial institutions themselves have the appropriate incentives to exercise this function in the interests of efficiency. In a relatively competitive banking system this is probably true since the banks will have to manage their affairs in such a way as to maintain at competitive levels their own share levels and interest paid to depositors. However, to the extent that many financial institutions in Central and Eastern Europe remain state-owned their incentive to exercise their supervisory functions may be greatly reduced. As was argued earlier there is an inherent danger in an insider system that there will be collusion between management and financial institutions performing the monitoring role. Where the management of an enterprise is carried over from the former state-bureaucratic system and financial institutions remain in state hands this danger is heightened. Whilst competitive product markets may limit the extent to which such collusion pays in the German case the high degrees of concentration in many product markets increase the danger.

Applying either of these two systems uncritically to the conditions of Eastern and Central Europe may fail to achieve the projected benefits of either because their necessary conditions for success are absent.

Synopsis of the Country Studies *Mass Privatisation and Corporate Governance in Bulgaria*

Abstract

After very unstable transition period of almost 7 years Bulgaria started to carry out mass privatisation programme only in 1996 as a political answer to criticisms on the slow pace of case-by-case approach with the continuous bad management of state companies. Nevertheless, economic policy requirements were not the whole reason for launching mass privatisation but the fact that its opponents - powerful economic groups - finally found a way for benefiting from its existence.

Only about a half of all eligible citizens took part in the sale of investment bonds ('vouchers') books which means that actually demand was set initially less than supply.¹⁵ In many cases the mass privatisation stake in a company was combined with cash (or case-by-case) sale¹⁶ and varied from 10% to 90% with as much as 10% of all company's

assets reserved for free distribution to employees. Voucher holders had the opportunity to convert them either in companies' shares or in shares of privatisation funds (PFs). The requirement was the price of shares one has bid for to be both higher than the government set minimum one and higher than the last satisfied order. After the first auction 81 licensed funds acquired 81.56% of total voucher capital which proved the information asymmetry disadvantage of individual players on the best share price to be offered.

Privatisation Funds

Regulated by general rules for investment companies PFs (founded as joint-stock companies) can be distinguished from the latter by the existing opportunity to change their legal status post-privatisation to a holding company or investment company.¹⁷ A diversification of their portfolio is required, namely 70% of the capital to be acquired from the population in vouchers (i.e. investment bonds).

The legislation allows either two- or one-tier board system¹⁸ but following the clearer distinction between executive and control functions some 80% of PFs chose the former one. In majority of cases funds' governance is dominated by founders' representatives, particularly when targeted companies' managers are among founders of funds. There is no legislative rule on the correlation between fund's performance and management fee, therefore the principal-agent problem arises and an application of the modern incomplete contractual practice could be expected. No fund made use of the possibility to hire outside managers. The state control over funds is exercised by the Commission on Securities and has a limited scope - no government representatives are to be appointed in funds' boards. PFs' investment portfolio include not only privatisation shares but also treasury bonds,¹⁹ real estate, stock exchange securities, etc. under the restrictions no one of a single security to exceed 10% of funds' own capital and no more than 34% of shares of a single privatised company to be bought.

The objectives of PFs cover the following main directions: (i) strategic investment consisting of immediate restructuring programme and active control over corporate activities. In this case a presence of a strategic buyer for the stake offered for case-by- case privatisation could provide funds with lacking technical and governance know-how but they are to cease part of corporate control and could prefer free-riding; (ii) earnings maximising investment indicating funds' preferences mainly in dividends distribution as a special part of their portfolio which is clearly consistent with minor shareholders' interests; (iii) investments 'for sale' consisting of stock acquired for diversification reasons characterised by a high liquidity or low prices and which is to be sold within 12 months. Most of PFs favour the strategic orientation and engagement in corporate governance is of primary importance for them.²⁰ The high level of risk in the current economic status of Bulgaria forced PFs to adopt a balanced portfolio structure investing in very few industries with different hazard base and diversifying the residual capital in profitable or interrelated industries. Undoubtedly, risk-averseness of funds and therefore their portfolio structure depends also on their size.

The level of PFs involvement in companies' corporate governance and their future policy is influenced to a great degree by the small but powerful group of shareholders- founders. In trying to categorise them one should emphasise on the dominant group of former and present managers of state firms together with public officials disposing of both insider information and the shoulder of organised voucher holders. According to the new institutional economics, a change in the property rights' pattern will definitely cause limitations of former decision-makers' power and possessions and the first question to be considered by them, even before initiating the transformation, is whether the net expected gains are positive. It is clear, therefore, that preceding bureaucrats found at last the advantage in mass privatisation programme and cease the opposition against this idea. Block shareholdings are particularly attractive to them with a consequent direction towards post-privatisation transformation of their funds in holding companies (as an alternative to investment companies) and monopoly formations. The rest groups of founders include state financial institutions, private companies (industry-based, finance-based or with complex activities) and physical persons.²¹ Still, almost half of funds in terms of capital are controlled indirectly through their founders by the state.

The legislation imposes certain restrictions on fund founders largely presented in PFs boards. One of them concerns the direct relationship between shareholder's investment and his representatives in fund's management body. However, the lack of legal rules on proxy voting presumably assigns an unfavourable control position to the huge amount of small shareholders²² in a fund even if they want to be engaged in monitoring (nothing to say about the monitoring costs incurred). Thus, the principal-agent problem in corporate governance will be multiplied in a transition economy like Bulgaria from the very beginning of funds operation and accordingly will confound enterprises' control.

Financial Institutions

The fact that privatisation of state financial institution has not been announced yet suggests an unlikely outcome of banks' cross-ownership as we observed in Czech Republic.²³ As was already mentioned, state financial institutions, though controlling a large amount of funds' capital, do not possess a fixed strategy and their role in corporate governance is supposed to be passive. This sounds doubtful enough since banks are still the only credit institution capable to ensure the post-privatisation restructuring capital, moreover they already own through a complex set of intermediaries large stakes in their debtors. The bad debt problem still needs a solution in Bulgaria. Banks interests will contradict logically with the one of minority shareholders in terms of profit distribution and debt-equity ratio.

Stock Exchange

During the period between 1992-95 some 20 stock markets have been created in Bulgaria within the institutional framework of no legislative rules. Not after 1995 came into force the Law on Securities Trade, Stock Markets and Investment Companies.

Currently, approximately 90% of the trade (the rest are mainly treasury bonds) is done through over the counter market since no institution is registered in accordance to the above-mentioned Law and on the other hand, the inflation rate jump eliminates trade.²⁴

The Czech experience showed undoubtedly the significant importance of mass privatisation for stock market development. Yet, some possible negative effects should be taken into account, too. For example, reorganisation activities (split or mergers) of PFs might weaken the trade for the more convenient for large blocks of shares negotiations practice. Investors' departure from the stock market could be observed after an abandonment of PFs' promises to distribute dividends without considerable delays. Additionally, the restriction on trade during the first 6 months after the last auction forced funds to establish an Association of Privatisation Funds with the only objective of abolishing this rule the logic of which simply preserves the market from initial oversupply disorder.

State influence on corporate governance

In fact, the future investment strategy of funds and individual shareholders in the mass scheme has been constructed at first by the government as oppose to Czech model. Enterprises to be privatised using this programme and the exact percentage of their shares to be offered were set by the Council of Ministries with regard to the possible strategic investor (to be involved in the process through case-by-case privatisation) and/or the key national position of the company, etc.²⁵

Government interests could be clearly seen in the successful attempt to increase the capital of some listed companies by attracting private investors in the last possible moment before the start of mass privatisation thus undermining the investment strategy of (other) mass players. The refuse of ceasing its corporate control in listed companies was expressed through the change of their Articles of Association in terms of not allowing the major decisions²⁶ to be taken without an agreement of % of shareholders.²⁷ Theoretically, around 2/3 of offered for mass privatisation companies may turn out to be privatised by 67% after the first wave of auctions. In other words, any decision could be voted only if the state supports it; even if there are two main investment funds controlling more than 60% of the firm. In addition, the free share-transferability is limited: every shareholder is obliged first to offer his/her shares to the other shareholders. The correct question here is whether the state will wither away from the corporate control at all. Nevertheless, the negotiations among funds on a future coalition in ensuring stronger corporate control have already started.²⁸

In addition, there are a lot of enterprises where the remaining stake not offered for mass privatisation is considerable. Moreover, if some stock failed to be sold, only under certain limitations²⁹ is it to be offered to the successful bidders - otherwise, state keeps these shares either exercising its control functions through the ministries or through a special institution. There is an initiative³⁰ on creation of appointed by government Post- Privatisation Fund who is supposed to deal with privatised firms' reconstruction by, say,

increasing their capital and who will have the opportunity to attract institutional investors (PFs and banks as well) as its shareholders.

Conclusion

Some of privatisation funds - the major mass privatisation players - intend to adopt a pure investment strategy in firms of their portfolio which is inconsistent with the active involvement if corporate control. This role could be exercised by a large outside strategic investor who may become an owner of the block stake through a cash privatisation deal or even by the government who reserved a substantial percentage of shares in many firms. Another very probable expectation that allows funds to execute their governance functions is a coalition among them. Even the last could threaten individual shareholders' interest since within the current legislation their influence is limited. Despite of banks' large potential only after their following privatisation is possible to argue on their corporate commitment. The Stock Exchange control over some companies depends on the efficient regulation and financial knowledge which will allow a proficient securities trade and development of corresponding markets as well.

Thus, corporate shareholders, namely PFs, are presumed to be the future active corporate governors in Bulgaria after the state withers away. Their actions will be defined mainly from their founders, the branch they are investing in and investment scope, and could be hamper by problems with funds' own corporate governance and ineffective state regulation.

Mass Privatisation and Corporate Governance in Czech Republic

Mass privatisation initiative is seen as an answer to the necessity of accelerating the socially painful transition process of former socialist countries. The swift ownership reform in Czechoslovakia was intended by the government to be implemented together with the whole set of adjustment measures such as bankruptcy and anti-monopoly laws, restructuring of the banking system and trade in order to correct corporate management, pricing system, industrial structure and capital allocation. Analyses of the so-called Czech privatisation miracle as the only example of workable and prosperous privatisation model could be used as an effective foundation for another transition countries' strategies. Not only an acceleration of the transfer of ownership was to be achieved through the Czech mass scheme but also resolving the capital deficit problem together with assured national support and involvement. The success of voucher scheme guaranteed political stability of the country and convinced both strategic and institutional foreign investors on the possibility of using rapidly developing stock exchange.

The beginning

Using three main approaches: restitution, small-scale and large-scale privatisation, Czech government transferred more than 80% of its state ownership into private hands. The principal part of the large scale privatisation³¹ was mass or voucher programme

launched in the beginning of 1991: after 2 waves, each of them consisting of 5 and 6 rounds respectively, it was officially concluded in the end of 1994 with property sold of about \$ 11 bln. representing 40% of all large-scale privatisation deals.

Privatisation projects submitted by managers and/or their rivals started the process. These proposals consisting of a combination of one or more privatisation methods and detailed information on the company's activities were to be evaluated and enforced by the branch Ministry and the Ministry of Privatisation. There was no strict program to be followed and the unplanned result was shares from 988 firms out of 2,404 allocated for voucher scheme which was equal to 7.5% of country's capital assets. The residual shares was to be offered to the securities market or bought by a strategic investor. The next step was selling to all citizens vouchers books for a minimum price which entitled them to participate in the bidding process for as much as 10 subjects (companies or investment funds) thus diversifying their shareholdings.

Investment Privatisation Funds

The dispersed ownership that follows voucher sales creates vacuum of control to be filled by financial intermediaries. Funds establishment was left to the market, there was no government intervention, and the result was 265 (I wave) + 349 (II wave) registered IPFs. Thus, one of concerns of Frydman and Rapaczynski (1991) - increased barriers to entry into the mutual fund market caused by insufficient competence - was not justified by the practice. Founded as independent joint-stock companies during the first wave (very similar to Western closed-end funds) later IPFs were allowed to establish standard mutual and open-end funds: a rational sequence having in mind the initial low liquidity of funds. The type of founder - whether it is a manufacturing company or financial institution - formed the competitive advantage and the strategy of the fund. Besides, although the connection between the fund founder and the fund itself had to be loose according to the legislation,³² usually some implicit links remained interfering with the independent behaviour of fund management.

The process

A decentralisation of the process was observed. Funds were left to compete in attracting voucher points, even the price of shares offered for privatisation was only initially set by government, the following increase or decrease in shares' price was dictated by the market afterwards³³ (although political goals influenced decisions of Price Commission as well). The participation of eligible residents reached 75% and more than 80% respectively during each wave. The information asymmetry of citizens in choosing the correct fund was said to be overcome by widely spread detailed information on funds' strategy, however IPFs' advertisement campaign and promises played more important role in attracting voucher points. Providing participants with professional knowledge and risk diversification IPFs managed approximately two third of investment points in the first wave, this number was reduced however during the second wave showing the increased confidence and experience of individual players. The impressive stake of

individual investors (28% of points and later 36% of points) emphasises the lack of adequate protection of minor shareholders' interests in Czech legislation (e.g. legal rules for proxy voting).

IPFs and the Privatised Company

The two-tier board system of a privatised company reminding of the successful German model reflects the ownership post-privatisation structure: IPFs, state and individual minor shareholders. Mladek (1994) states that in the Czech case the secure way of becoming an active owner is a coalition formation with the other co-owners funds which is to take control over the executive board of the company (as more important than the supervisory board for its still limited control functions.³⁴ This coalition might be endangered one day, i.e. minority shareholders are actually not shielded from hostile take-over, moreover there is no legal regulation of take-overs in Czech Republic. On the other hand, investment fund boards include both government officials and managers of the privatised companies. A conflict of interest or insider collusion against minor shareholders' interests can be easily expected supported by the information asymmetry and the lack of clear rules for funds' actions. Finally, the narrow professional knowledge of funds reveals their inability to ensure an adequate control over the management in more than a few firms in one or two sectors. Nevertheless, funds portfolio is still diversified because of the risk-averseness within them, the 20% ownership ceiling³⁵ and the absence of legal rule for proxy voting of minority shareholders.

PFs ' Objectives

Management and employment reorganisations are among the goals of funds.³⁶ Most of them consider hiring external managers as an effective measure against former managers' opportunistic behaviour and low qualifications with a consequent diminished agency problem together with developing of a managerial market. However, this might not be enough to boost efficiency at once especially when dealing with loss-making companies; that raises the question with the trade-off between the promised distribution of dividends and profit reinvestment. A lot of funds announced the latest because of the fierce need of recapitalising. The problem with the working capital assurance remains and will have a direct reflection on the market price when shares start to be traded leading to massive bankruptcy of small funds.

Banks

The inclination of corporate governance pattern achieved towards bank-based German-Japanese type of control could be identified after considering the severe concentration of ownership rights among the 14 biggest investment groups³⁷ and the fact that most of them were controlled by banks.³⁸ Vouchers could be used for participation in bank privatisation and banks went round legal restrictions on buying other banks' shares by establishing their daughter company's fund. The outcome was severe cross-ownership

of the banking sector (some banks even became indirect owners of themselves). In addition, one should keep in mind the strong credit function of banks and the bad debt problem which adds more debtors' collateral to banks' scope of ownership, therefore more control on firms to be exercised.

The government

In view of the above-mentioned, the role of the government is not to be underestimated, too - from the 14 major investment groups referred to, 8 were state financial institutions whose shares were sold during the first wave using the same vouchers (and other means) but government kept a controlling stake in most of them (most of them above 40%). Same is the case with only partially privatised companies where a substantial stake (an average of 51%) belongs to the state without a clear understanding of whether the state should remain a passive owner or should pursue its own interests.

The Stock Exchange

Some authors consider the resulting dispersed ownership after mass privatisation auctions as a problem in a transition economy. On the contrary, fast developing stock exchange³⁹ is a source of future capital concentration in privatised companies. In addition, the huge incumbent costs of establishing financial institutions (like investment companies, funds, stock exchange, etc.) are covered in a great degree by the proceeds of voucher privatisation. The process itself ensured the demand for new institutions and decreased the number and influence of groups that benefit from their deficiency.

Conclusion

According to Schmognerova (1994), the emerging model of corporate governance in the Czech and Slovak Republics combines characteristics of the outsider (US-UK) model with the insider (Germany-Japan) one and is still in flux. Mass privatisation creates dispersed ownership and institutional investors as in the US-UK type but it still lacks ensured liquidity together with capital market and market for corporate control development. The weaknesses of the outsider model such as difficult management monitoring, free-rider tendency, company's restructuring left aside, etc., could be avoided either with appropriate legislation to support interests of block-holders (e.g. from individual shareholders) or to rely openly on the insider model of bank control. The strengths of Czech experience can be easily seen in the depoliticisation of ownership transfer, boosting the financial infrastructure, and swiftly generating huge amount of shareholders with understandable interest in intensifying, the process. Of course, complementary reforms are needed in order to ensure a proper regulation of financial agents and natural monopolies together with shielding minority shareholders interests.

Analysing the Czech approach to voucher privatisation round by round, some interesting features not so often mentioned by economists are to be observed. The bidding information asymmetry not only generally between insiders and outsiders to a

privatising company but also among outsiders themselves is biased in favour of IPFs than of individual buyers. On the contrary, if demand exceeds slightly supply individual players' bids are openly treated preferentially in comparison to prorated IPFs' placements. And even talking about rounds themselves they do not have an uniform base: demand defines whether any shares will be sold at all. Considering the fact that administered prices are checked by market, (me could easily perceive that shares sold in the case of less demand than supply are simply overpaid. Nevertheless, after these two waves of sequential rounds at the end of the day the share price is not only diminished but also approaches the market value of the company. Hence, firms economic performance does not influence decisions of individual mass privatisation players but funds' behaviour and learning-by-waiting pattern (Hanousek. and Kroch (1995)). Reflecting one of the main problems: the information asymmetry both for the citizens in investing and for government officials in defining rules of the game, Hanousek (1997) proves that outsiders could win more if relying on wait-and-see strategy.

Mass Privatisation and Corporate Governance in Poland

Abstract

One of the distinctive features of Polish mass privatisation approach or so-called Programme of National Investment Funds (NIF) relates to its supply side: only 10% of state-owned companies were offered for privatisation through a widespread participation of the population. The first presumption that follows concerns the possible ways to be privatised the remaining 90% of the state property. It seems likely, of course, that if the National Investment Funds Programme succeeds its scope could be naturally extended.

On the other hand, the Polish mass method was the most carefully prepared privatisation process in the former socialist countries with the active involvement of foreign advisors since its conceptual start in 1991. However, only after April 1993 was the Law on National Investment Funds approved by the Sejm (the Polish Parliament) which raised understandable doubts on the speed of Polish privatisation. As an answer to this, Szyber states that Polish state companies are in some way peculiar in comparison to another transition country - they are independent bodies dominated mainly by their workers' councils and the initiative for taking part in mass privatisation scheme has had to come from the enterprises themselves not "from above". The last limited the scope and speed of the process.

The Process

The transformation of chosen state-owned enterprises into joint-stock companies with a sole shareholder the State Treasury complemented the establishment of National Privatisation Funds (NIFs) which ensure the important connection between listed companies and all citizens. The last was completed until April 1995. 15 NIFs were founded as joint-stock companies with two-tier board system and the State Treasury as a

sole shareholder. A specially appointed Selection Commission chose through a competitive process the members of the Supervisory Boards and through an open international tender 14 management companies.⁴⁰ Only one fund made use of the opportunity to elect a usual Management Board without entering into a contract with a management company. The supply side of the programme consisting of 512 firms was prepared not until September 1995 after 4 different rounds of selecting⁴¹ enterprises to be corporatised afterwards. In July 1995 NIFs became shareholders of selected companies so that each of the funds received 33% controlling interest in 32-34 firms and minority stake of 1.93%⁴² in all remaining companies. The other shareholders in a firm include the State Treasury with 25% reserved stake⁴³ and employees of this firm with 15%. All citizens were entitled to buy participation certificates⁴⁴ (PC) for a price of ~ USD 7, to trade with them as a bearer security and/or to transfer them to shares in NIFs⁴⁵ (each PC equals to 5 shares, one in each fund). The first quotation of PCs on the public regulated market began in December 1996 whereas NIFs' shares are expected to start to be quoted on the stock market in the middle of 1997.

National Investment Fund and its Outside Management Body

General Meeting,⁴⁶ Supervisory Board and Management Board govern a NIF. The Supervisory Board possesses among all the right to appoint the Management Board (for up to 2 years) and to choose the outside management firm. The last may represent consortia of different members such as Polish commercial or foreign investment banks, consulting or lawyers firms. The independent outside management reminds of Chandler's managerial capitalism where the governance is left in the hands of directors who are full time managerial employees which leads to economies of scale and scope (Jackson et al. (1994)). It is clear however, that in the absence of enough products market competition and within widely dispersed fund ownership the agency problem is multiplied. On the other hand, the outside management body might play an additional control function and its relationship with the investment fund is regulated by the provision of forbidden shareholding of the management company in the fund.⁴⁷

The advantages of the governance system of outside management comprise of management, marketing and financial know-how provided by the consortia in order to strengthen the international good will and attractiveness of the controlled company to strategic investors as well as to facilitate the entry of the fund in the financial market. In particular, the management firm obligations should cover such an areas as strategy and policy of the fund, assets management and exercising shareholder's rights of the fund.

The control cm them is carried out by the Supervisory Board and an interesting clause stipulated in the contract deals with the damages' expenditures (to be reimbursed after that) caused by the intentional behaviour of the outside management firm. This is a clear case of bounding costs⁴⁸ of an agent supplemented with the necessary monitoring costs of the principal. The arm length control is ensured also through the compensation system of the management firm consisting of fixed part and performance related one as well as a final performance fee.⁴⁹

Funds and Portfolio Companies

The main NIFs' objective includes rising of the market value of their shares through various means of restructuring and development of their portfolio enterprises, though there are no legal sanctions if the objective is not fulfilled. The restructuring is considered as a priority for up to 5 years after which NIFs will start to undertake a 'pure' institutional strategy.

The selection of portfolio companies was based on equal opportunity grounds and generally satisfied NIFs. Typical indicators to be taken into account include assets value, gross and net profits, assets and sales profitability, etc., and a higher grade was attached to the good state of equipment or professional management but particularly to the availability of strategic investor. The actual NIFs' share in the chosen companies reached 60%⁵⁰ in every company and allow them to implement their strategic goals through, if necessary, a displacement of Management Boards. The last undermines the former strong independence of these Polish companies and could cause collisions if fund's or management firm's interests oppose those of the company itself.⁵¹

Investment Strategy of Funds

The investment strategy of funds is designed by the Supervisory Board. Some NIFs' medium-term strategy is aimed in companies' restructuring through ensurance first of all of the additional capital needed. The proceeds of shares sale of minority fund's holdings are to be used for the key⁵² portfolio companies only if there is a high level of demand and consequently supply together with effective management. Otherwise, if there is a need of technological innovation or new market entry a strategic investor's take-over is preferred.

In regard to minority packages that discard an active corporate governance and allow a passive investment strategy, the minority Fund enjoys free-riding at the expense of the block owner and expects that the well known goal of maximising shares' value will increase its own welfare as well. According to Szyber, dispersed shareholding may lead to adverse effects on the stock exchange quotations of such a company deterring possible strategic investors. Presumed by some Funds of being rather negative than positive, the dispersion of minority holdings started to decrease by initiated share consolidation in order to increase funds' smallest packages through acquisitions from another fund or from employees.

The contrasting objective of NIFs with highly diversified portfolio relates to the assurance of high liquidity of their shares. Frequent sales cover not only minority stakes but also the block-holdings⁵³ and the proceeds are invested out of the mass privatisation scheme leading to considerable alteration of fund's ownership pattern. Finally, it is worth to be mentioned that the final word for NIFs' portfolio structure will have the Stock Exchange.

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The capital market

Mass programme ensures an immense support for capital market development especially in the Polish case when grounds for the stock exchange already exists. Both supply and demand side of the capital market will be enhanced together with increased turnover and diversification as well as launched securities' public trade outside the stock exchange. An interesting observation on the delayed timetable of Polish mass scheme states that this 'wasted' time was used instead for establishment of the legal and institutional background of capital market development.

The official listing of companies on the stock market did not start yet,⁵⁴ but it is already clear that the regulated public market outside the stock exchange⁵⁵ could enjoy better turnover for its low requirements and costs. The negative impact of the oversupply after all NIFs' shares are listed might be overcome by consequent enlargement of demand (i.e. increasing the limited number of institutional investors). However, only 8 months after the introduction of PCs in October 1996 their sales were reality and because of that swift reaction the price margin (buying/selling) was very low. Six million from all 26 million issued PCs are traded in the secondary market allowing a market concentration of their owners and providing the highest rate of profitability among all other investment means.⁵⁶ Soon their single price will be substituted by price differentiation of each fund's shares based on their market performance.

Conclusion

Speaking about funds' corporate governance, its actual tendencies are to be revealed only after the transfer of PCs into NIFs' shares. Not only the new shareholders will ensure the adequate control over funds but also the ruthless power of the stock exchange and managerial market, the last being already created through the usage of the 14 management firms in funds. The state control over funds' activity is secured through the close monitoring of the State Treasury and the Commission of Property Transformation within the Sejm.

It is difficult to predict alterations in companies' ownership pattern caused by the stock exchange trade of participation certificates, companies' shares and then funds' shares. The shares trade will be influenced not exactly by the number of shares to be obtained but mainly by the number of votes these shares represent in the general meeting in accordance to the legal limitations. The expected concentration of ownership rights will incline probably in the direction of Polish financial firms as well as Western institutional investors who will take advantage of developing capital market and will play the major role in corporate governance of privatised companies. Banks' participation in corporate control seems to be shielded by the efficient involvement of funds in debt clearance of portfolio companies or equity/debt swaps. It is obvious that if the last increases its scope banks could become active shareholders pursuing their own goals that usually confront with the profit maximising concern of small shareholders.

Provisions in protecting minority shareholders' interests and antimonopoly stipulations exist but are not adequate.

Undoubtedly, Polish mass privatisation programme boosts severely financial markets development in the country and their favourable influence on companies' corporate control. And last but not least, the positive balance resulting from mass programme implementation will support the budget with around PLN 300 million after considering the programme costs.

Mass Privatisation and Corporate Governance in Romania

*Introduction*⁵⁷

A widespread perception exists on the too moderate transition process of Romania. The reasons include among all the inadequate conception about the nature of the desired economic system and the essential institutional environment to support it after eliminating the old institutions.⁵⁸ In the absence of legislative and institutional background economic units could not respond properly to the property rights alteration. Therefore, government intentions to privatise have to be supplemented by a legible definition of property rights as well as guarantees for their protection and enforcement.

The mass privatisation initiative

Privatisation legal framework was introduced by Law 15 in 1990 which stipulated the basic principles for privatisation introduction and was supplemented by Law 31 to deal with inside governance of firms and Law 5 in 1991 to define privatisation techniques including mass privatisation method. One of the initial steps was that barriers to market entry of new domestic and foreign firms were reduced substantially which created a favourable business environment for privatisation. Most of the state-owned companies were changed either into 'corporatised' business entities⁵⁹ with an independent board of directors or to autonomous state enterprises⁶⁰ (*régies autonomes*). The next stage was the establishment of five private funds to own 30% of corporatised companies and become mutual funds in the future. The remaining stake of 70% was allocated to a state-ownership fund to be privatised itself within a period of seven years through selling 10% of its shares every year. Thus, corporate governance of each and every state-owned company was to be exercised not directly by the state and its institutions but by these funds as only shareholders.

The distinctive features of Romanian mass scheme were the gratuitous distribution of vouchers means and the unchallenged state control over all privatisation funds. By the end of 1992 five ownership certificates (OC), one in each private ownership fund (POF), were offered free of charge to each citizen. The owner of these certificates may choose: to retain them for five-years period (no dividends during the first 3 years) after which the OC is automatically transformed into shares of the private mutual fund; to exchange them to shares of any commercial company to be privatised within 5 years; to

buy up to 30% of commercial companies' shares offered by the state ownership fund (SOF), or finally to trade them. The last began through Romanian Foreign Trade Bank and private channels initially at very low prices (~\$6). Later the management of POFs assigned a nominal value of their COs (between \$30 and \$37).

After introduction of Law 55 in 1995 the mass privatisation programme was substantially speeded up. This time the value of OC was set up (Lei 25000 for the whole stock consisting of 5 shares) and all citizens were entitled to receive new OCs together with nominal privatisation vouchers equal to 39 OCs. They could be converted either to shares of a commercial company (up to 60% of the shares, i.e. doubled the offered stake in comparison to 1992) or to shares in POFs.⁶¹ Under the condition of equal to supply demand the free shares of any citizen will be 40 in exchange of one nominal voucher and one OC stock. The participation of the population was impressive: 95.5% of all eligible citizens took part in the second distribution of vouchers, however the subscription for shares itself was surprisingly low. Supply⁶² included 51% of the *régies* and 40% of companies under the SOF's authority and alternative sale methods for the residual stakes were considered (such as a transaction with a strategic investor). If a company becomes more than 51% private, a General Meeting of Shareholders (GMS) was to be shortly announced in order to modify the Articles of Association and appoint new managerial body depending to the respective stake of each shareholder. The problem with the fierce need of restructuring capital was going to be resolved by the SOF through reinvesting in certain bad performing companies 60% of the proceeds from selling the residual stock. Lately, another approach to this question was found by establishing the Romanian Post-Privatisation Fund with the main task to provide credits on favourable terms and a limited period of its legal existence, namely 10 years.

Until the end of 1995 1508 companies from SOF portfolio were privatised mainly through management or employees buy-out technique - in some cases using case-by- case approach or mass privatisation programme. The application of MEBO privatisation has a direct influence on future corporate governance pattern if this method is combined with mass privatisation in a certain firm. Employees interests in managing sometimes inefficient employment and wage level contradict with the profit-oriented minor shareholder. On the other hand, the new ownership role of managers could naturally persuade them to act in direction of maximising shareholders' welfare.

Private Ownership Funds

SOF and POFs began operation in 1993 when POFs received 30% of all 6,400 state- owned companies and SOF - the residual. Each POF's portfolio is defined by: geographical principle; concentration in certain industries; and diffusion among the five funds in order to reduce the level of risk when investing in financial or insurance companies as well as in some 'distressed' sectors (like chemicals, petrochemicals, metallurgical, and machine building).

The management of funds as opposed to Bulgarian or Czech experience is appointed by the government and approved by the Parliament (7-member administrative council), i.e. funds' activity is under close state control. A conflict of interests may occur between the agent: the government pursuing its own social and political goals (and perpetuating their own power), and the principal: citizens-shareholders with a profit-maximising concern.

POFs will appoint their representatives in the General Assemblies of the companies in their portfolio. The interesting point here is that under the contract a premium on representatives' remuneration will be paid only if dividends are distributed. This could be identified as an attempt to engage POFs' members of the General Assembly in better corporate control over companies with a target of increasing fund's shareholders welfare. However, even if there are dividends they might be used for reinvesting in another fund's companies, in foreign firms or real estate, especially considering the announced in 1993 statement of not distributing any dividends for the first 3 years. In addition, there is a problem with the promised distribution of dividends even after the 3- year period based on the fact that some companies from funds' portfolio could not be enforced to fulfil their own dividends' obligations which reveals once again the weak corporate control over them.

In November 1996 all of POFs were transformed into joint-stock investment companies with capital size determined by the shares already obtained in exchange to transferred to them OCs. Their structure is close to the Western closed-end funds (i.e. funds with fixed capitalisation and not required to buy back their own shares) based on their initial low liquidity.

State Ownership Fund

SOF's administrative council consisting of 17 members is also appointed by government. The main functions of this fund include exercising of its ownership and control rights on 70% of shares in any commercial company, privatisation of 10% of its shareholdings annually, companies' restructuring, and liquidation of bad performing firms. SOF's representatives in GMS basically do not obey to the same as POFs contracts - the dividends incentive is missing.

Actually, state did not cease its control over the enterprises (even after the privatisation) but started to exercise it through two different legal entities under its close supervision: POFs and SOF. On the other hand, there could be an effective result coming from the very fact that the government separated its ownership functions as a main shareholder in commercial firms (now split between SOF and POFs) from its functions of regulator and policy-maker (concentrated in the relevant ministries).

Companies' Corporate Governance

Decentralisation of decision-making through corporatisation of state-owned companies and establishment of SOF and POFs led to a higher autonomy of firms' managers, thus however highlighting the principal-agent problems. At the expense of company's

efficiency and other shareholders' well-being managers could pursue their own goals leading to decapitalisation of the company. An alternative control mechanism against this behaviour are employees, yet their own interests could harm long-term profitability of the firm. On the other hand, managers' opportunistic behaviour is possible not only because of the agent's nature as such but also for the lack of governance knowledge and even enough control staff from the two main stockholders - SOF and POFs. Speaking about them, an effective coordination of their responsibilities is a necessity, but with difficult implementation, e.g. because of the different incentives for their General Assembly representatives. Furthermore, as an outcome of this co-ordination a possible collusion could be expected supported by the lack of antitrust regulation.

As an answer to the above-mentioned later a Shareholders Agreement has been entered into by the two main shareholders in order to ensure their co-ordination and, additionally, to entrust POFs with certain rights to implement privatisation of some companies within the scope of SOF.

A conceivable picture of post-privatisation shareholdings reveals the following main groups: (i) small shareholders who are granted basic voting rights usually neglected at the GMS since their shares are few; (ii) holders of more than 5% stake who are bestowed additional control rights such as initiating an extraordinary GMS or outside inspection of the management effectiveness;⁶³ (iii) strategic investors upholding more than 30% of shares with a long term commitment to firm's strategy and governance; (iv) block-shareholders that control at least 1/3 of the voting rights including a veto claim, issuing of new stock or changing the field of company's business activity; and (v) majority stockholder with rights to conduct management displacement.

After the mixture of privatisation methods applied the created shareholders' pattern may include individual citizens - owners of free shares,⁶⁴ POFs, private or foreign investor, i.e. the buyer of a block of residual shares, and SOF as a state stake representative. One of concerns on the effective corporate control in the postprivatisation period is built up on the fact that many shareholders will prefer selling for cash their certificates rather than being engaged in active monitoring of the firm's management. The last may lead to concentration of ownership with a consequent better control but a developed stock market is a prerequisite for such a result.

There are no legal rules for proxy voting of small shareholders, however an important development in this direction is the establishment of Shareholders Employees Association to protect employees rights in the GMS when the company was privatised through management-and-employees-buy-out technique. In fact, Articles of Association's provisions obstruct this possibility by a limitation of the possible voting rights to be represented by one shareholder at the GMS (namely 30). Obviously, the last supports interests of large shareholders - in this case the managers.

Banks

Although Law 15 stipulated that subsidies had to be gradually abolished, government continued to provide credits to commercial companies⁶⁵ (especially in transport, communications and industry) at interest rates considerably below the market rate. The problem with inter-enterprise credits forced the National Bank to inject new credits in order to support payment chains among enterprises. Even the introduction of the Bankruptcy Law (Law 76) in 1992 did not resolve the bad debt issue.⁶⁶

State Ownership Fund is a sole shareholder also in the main banks (through which 2/3 of all credits are provided) but they are not included into the scope of mass privatisation programme. After 1994 banks began to exercise a better control over their debtors and to be more strict in providing credits for state companies taking into account their performance. Unfortunately, a liquidation of a company (together with a replacement of incompetent or opportunistic management) is hardly observed despite of the adoption of the Bankruptcy Law and the presence of firms with huge amounts of bad debts.

The Capital Markets

Romanian stock exchange was set up as late as 1995 and later on the Romanian Shareholders Register was created. Still, capital market development is to be expected in the near future supported by the understanding of economic agents on its importance for the corporate success. It is worth being mentioned here that trade with privatised shares in Romania is limited only through the stock exchange and the stock market is one of the main sources for restructuring capital as well.

*Conclusion*⁶⁷

Despite of the dispersed ownership created by the long and complicated Romanian approach to mass privatisation, privatised firms are still far away from US-UK corporate governance type mainly because financial markets are unreliable, nothing to say about their sophistication and diversification. On the other hand, the high debt/equity ratio of firms (continuously provided with subsidies and low interest credits) does not automatically turn the type of control into German-Japanese direction, although the widely spread method of MEBO privatisation reveals the strong insiders influence on the corporate activities. A proof to the inclination towards bank-based system of governance could serve also the inter-enterprise credits routine which actually shows a pattern of hidden horizontal cross-dependence and control. One of the most important problems relates to the centralisation of the process. Even after the privatisation of a company government continues to take part in its corporate governance through: SOF ownership of the (usually substantial) unsold shares; control over the POFs' board of directors; and control over credit institutions - the main banks (SOF is their sole shareholder) together with the continuing tendency for provision of subsidies. Supplemented by the deficiency of legislative framework supporting the

interests of minor shareholders, finally we may approach the conclusion of ‘state-based’ system of corporate control in Romania.

Mass Privatisation and Corporate Governance in Slovakia

Abstract

Privatisation affects resource allocation and property rights structure, hence the model of corporate governance to be achieved. Relative to the case-by-case approach mass privatisation saves transaction costs, however the secondary reallocation of property rights, i.e. the concentration of initially dispersed ownership, is a costly process and might be prone to market failures. The understanding of governments of Central and Eastern European countries on the process of property rights change followed the assumption of zero transactions costs involved. On the contrary, transaction costs do matter in the process of privatisation in transition countries based on the existence of imperfect market, asset-specific investment, imperfect information, bounded rationality and incompetent thus ineffective state institutions.

In regard to the above, transactions costs involved in mass scheme are but two types: generally, costs of the initial ownership transfer as well as costs arising from the inefficient allocation and post-privatisation realignment of property rights. Part of the latter include expenses associated with the re-sale of a majority stake. They could be substantial because of the adverse selection problem and the access of the majority holder to the inside information on company’s business. On the other hand, if the initial ownership is widely dispersed, almost no information is available to the small shareholders - therefore, transaction costs of reselling are minimal but governance- restructuring expenses are high.

The mass privatisation process

The first wave of the privatisation technique with widespread participation of the population was introduced in 1992 in the former Czechoslovakia - exactly before the general elections in order to ensure the irreversibility of the mass process independently of the future party on power as well as to assure voters’ support to the process. Later it was revealed that voters took part in the voucher privatisation without considering their political preferences and were driven mainly by the possibility to exchange their vouchers for cash.

After the preparation of privatisation projects⁶⁸ by the former Ministry of Economy in co-operation with respective enterprises’ management 751 state firms were approved for the first wave (from which 503 for the mass privatisation target). The speed of the approval (120 days) and the limited number of bureaucrats dealing with projects indicates the kind of lottery game used in this situation. The following stage was corporatisation⁶⁹ of the approved enterprises. In Slovakian case the most attractive companies were not offered 100% for the mass privatisation scheme - a considerable

share was retained for future sales which supports the hypothesis of the sheltered power and cross-connections between managers and the state. After the break up of Czechoslovakia an important issue to be considered was that Czech or Slovak voucher holders had the opportunity to reserve their already invested voucher points even though these organisations could already belong to a different country. 74% of voucher points in Slovakia were placed in Investment Privatisation Funds (IPFs).⁷⁰ Citizens were attracted by banks' involvement in the process and as a result more than 60% of all voucher points were obtained by banks' founded investment funds. Not surprisingly, the group of former managers and union members founders was the second best in voucher points collection. After five different rounds these points were converted into shares in the listed joint-stock companies. The results in Slovakia were: 98 companies completely sold, majority share (above 50%) privatised in 456 companies and less than 33% private share in 7 firms. Slovak IPFs acquired shareholdings in 196 companies, which was lower than the achievement of Czech funds.

The first wave of voucher privatisation in Slovak Republic was completed in the middle of 1993 and then it was virtually terminated. Its next stage - in the end of 1994 - was associated with the extended rights⁷¹ of the Fund of National Property (FNP) in all direct privatisation deals. The second wave of mass privatisation was announced in 1994 and 3.4 million voucher holders were registered. However, an amendment to the Privatisation Law in 1995 cancelled the second wave and all registered voucher holders (3.39 mln.) were entitled to a compensation of 5-year bonds with a nominal value of around USD 330 issued by the FNP. Bonds could be used for health insurance, housing expenditures, acquisition of FNP shares or sold to banks and potential buyers of privatising companies. Otherwise, these bonds will be exchanged by the National Bank in 2001 together with the interest due.

The second wave privatisation projects submitted by 600 enterprises were used by FNP for direct privatisation sales and around 80% of these 600 companies were privatised until the end of 1996. Moreover, the remaining after the first wave of voucher privatisation stakes were offered, too. Thus, it becomes clear that in contrast to Czech approach Slovakian privatisation was diverse: during the first wave the proportion voucher scheme/direct sales scheme was 58.6/26.6, whereas during the second wave only direct sales (or other standard techniques) were used. The question arises of what is peculiar in corporate governance inclination caused by these alternative techniques.

The Fund of National Property and its present rights

Bonds were introduced on the stock exchange⁷² in August 1996. Since then their supply is much more higher than demand and the rights they represent are firmly controlled by FNP. Namely, FNP rights and obligations consist of: (i) the subjects to be bought using bonds means; (ii) selecting and announcing FNP debtors to use bonds as a repayment means; (iii) privatising through a direct sale technique state-owned companies and allowing bonds to be used as a payment means; (iv) representing state interest in Supervisory

Boards of the privatised companies (where FNP usually votes against IPFs' decisions using different approaches and even the 'golden share'⁷³ right to veto).

The picture of post-privatisation corporate governance achieved clarifies that the FNP (the major present privatisation player and only seemingly independent from the government legal body) coexist in collusion with insiders at the expense of the other shareholders. As oppose to Czech experience, outsiders, i.e. IPFs that became shareholders after the first wave voucher privatisation as well as state financial institutions being funds' founders and major creditors, are shielded from the corporate control. Strangely enough, a social support to the above governance model is brought about.

Investment Funds after 1995

Slovak investment funds are regulated as closed-end funds. Any new fund establishment or merger are subject to the Ministry of Finance approval. Members of Supervisory Board and Board of Directors of a fund cannot become members of portfolio company management body. Besides, the Ministry of Finance must approve the statutory body of a fund and the Supervisory Office of Capital Markets has the right to change its members or to take back fund's license.

Originally, fund ownership (alone or jointly with its founder) in a joint-stock company was restricted to 20% limit similarly to Czech regulations. However, after the amendment of the Investment Companies and Investment Funds Act this limit was reduced to 10% shareholding which represents a minority stake (depending on shareholders dispersion, of course) and cannot ensure efficient corporate control. Moreover, costs associated with close monitoring are undertaken by the fund itself whereas its benefits are marginal even if we assume an absence of managers' opportunistic behaviour and FNP opposition.

It is clear that the unfavourable legislation cannot ensure an effective incentive for investment funds to be engaged in active corporate governance. Moreover, the shock of the second mass wave cancellation on IFs' business operations was immense. Based on the very high level of interest in participation in the second wave, some of funds had even started to acquire voucher points prior to the actual beginning of the first round and to pay in advance dividends.⁷⁴ The last undoubtedly increased the amount of bad debts of Slovak banks. Another outcome of the terminated second wave was the outflow of foreign investors especially considering the fact that some of them were IPF founders during the first wave.

Based on the above reasons, after 1995 many funds (as well as investment companies) were forced to close down or to change their legal status to stock-holding company - excluding the biggest funds supported by a collusion with government officials and companies' managers. During this transitional for IFs period insiders will reap the benefits of reduced control in portfolio companies in order to strengthen substantially their positions.

The sale of majority holdings by FNP to a strategic investor in only partially privatised companies reduced the share price on the capital market of minority stakes owned mainly by IFs. This way IFs' interest in a direct involvement in corporate restructuring was diminished even more supplemented by the hazardous alternative the future controlling shareholder to conduct a different mode of control.

Moreover, many small funds' shareholders disappointed by the outcome of their investment strategy will prefer selling back to IFs their shares at a very large discount.⁷⁵ This time the well-informed insiders within IFs indirectly will take advantage of the unclear situation with the repurchase of funds' shares and will probably assure through banks (the providers of loans for the repurchase) better control positions over the transformed already IFs.

Why was the process terminated?

The official reasons for the mass process termination are based on the following: (i) the dispersed ownership (consisting of small shareholders with no interest and relevant knowledge in corporate control as well as newly formed investment funds with unqualified in this field of activity management) is not an alternative to better governance of a privatised company, (ii) IPFs themselves cannot provide portfolio companies with the required for their restructuring capital; (iii) the underdeveloped capital market cannot be relied upon to discipline companies' managers; (iv) the applicability of mass privatisation on the formation of strong entrepreneurs in Slovak Republic is doubtful.

Conclusion

The dynamics of Slovak market structure influence the privatisation in the following way: (i) a rent-seeking behaviour is observed not only in political bargaining but mostly expressed by the present managers (often retaining their positions post-privatisation) claiming their abnormal rate of profits; (ii) therefore, any realignment costs will be undertaken by these managers. The main goal of insiders in terms of concentration of the dispersed ownership is achieved through political lobbying in order to be acquired the remaining state shareholdings and illegal deals on the capital market. Of course, these realignment costs should not exceed future gains related to future cash flow expectations. Vitkovic concludes that the present economic conditions in Slovak Republic are marked by the resistant involvement of the powerful, rent-seeking economic groups and are biased in favour of highly concentrated ownership by insiders within a limited perspective for capital market external corporate control.

Analysis of the Case Studies

On the basis of the theoretical work outlined above, a set of fifty questions had been derived which was sent out to the authors of the case studies. These were then discussed in great detail with the authors and the results have been condensed in the table and set of remarks following each particular question. The purpose of the exercise is to arrive at

a market compatibility index for each privatisation program. The result is given in the following table:

Table 2

Q. No:	Poland	Czech Rep.	Slovakia	Romania	Bulgaria	Q. No:	Poland	Czech Rep.	Slovakia	Romania	Bulgaria
1	3	4	3	2,5	3	26	2	1	1	1	2
2	3	3	3	4	2	27	1	1	2	1	1
3	2	1,5	2,5	2	1	28	3	3	3	3	3
4	2	2	3	1	2	29	4	4	4	3	3
5	3	3	2	1,5	2,5	30	2	2	2	2	2
6	3	4	2,5	2	3	31	3	2	3	2	4
7	2	4	3,5	3	3	32	4	3	4	(2)	2
8	2,5	3,5	3	3	4	33	4	3	3	2	1
9	4	5	4	2	4	34	4	3	4	3	3
10	4	4	3	2	2	35	4	4	4	5	4
11	3	3	5	2	3	36	2	2	3	2	3
12	3	3	3	1	2	37	2	2	2	2	2
13	2	5	3	2	1	38	3	3	3	4	4
14	3	5	5	1	1	39	5	4	4	4	4
15	1	4	4	1	1	40	4	4	4,5	4	3
16	1	4	3	2	2	41	5	(3)	3	3	3
17	3	3	3	2	2	42	3	2	2	3	3
18	2	3	2	1	2	43	3	4	2	2	2
19	2	2	3	1	1	44	3	4	3	4	2
20	1	4	3	1	2	45	2	3	3	3	2
21	1	4	4	1	1	46	2	4	3	4	2
22	3	3	4	2	2	47	3	4	3	3	3
23	2	5	2	2	3	48	3	(3)	3	3	2
24	3	3	2	2	2	49	3	5	3	3	2
25	3	3	2	2	2	50	5	1	3	3	2

The table rests on answers to the fifty questions, which we here for purposes of documentation, repeat in abbreviated form (a protocol of the long hand answers is available).

1. Who has a claim and how is this claim being translated into structures?

P1: The minister operates as the owner and management is automatically reappointed. The labor force is protected, there is some flexibility in pricing. The system is akin to co-determination.

C1: There is automatic re-appointment of management. Hiring and firing is partly restricted. There is free choice of the product mix, pricing and some codetermination.

S1: Due to management buy out there is automatic re-appointment of management. On the board there is 1/3 employee representation. There is restricted ownership, no majority of shares can be attained from outside. Although the work force according to statistics is being reduced, there is an obligation to retain the work force and some amount of investment (to be deducted from the purchase price). Determination of the product mix is free.

R1: In all probability, there is automatic re-appointment of management. There are objective performance criteria in management contracts. They call for the stability of the work force for a period of at least ten years and some investment. Prices are regulated and there are restrictions, in particular in the area of public utilities.

B1: Management is automatically re-appointed. Management buyouts prevail, employees get access to free shares, sometimes there is replacement of management by initiative of the funds. Stability of the work force is an objective and a fact. Initially there is an administered pricing that is slowly being liberalised. There is little change in the production structures.

2. Which is the institutional landscape in which property rights can be exercised?

P2: There were three cases of bankruptcy initiated by fraud.. Generally contracts will require restructuring before liquidation.

C2: Ownership through banks effectively prevents liquidation.

S2: The situation is similar to the Czech case.

R2: Two cases out of some 2,000 led to liquidation. New management may change legal forms. Bankruptcies and liquidations do happen.

B2: Liquidation is in principle possible, but unlikely due to large government stakes still held.

3. Are there political constraints, which have shaped the specific structure of property rights in institutions relating to mass privatisation?

P3: Management contracts are the rule. Government holdings are still extensive.

C3: In controlling a majority, residual claimancy can be turned into claiming the entire profit.

S3: No dividends are really being paid. Management can appropriate profits and more; there is strong management participation in revenues.

R3: No dividends are being paid.

B3: There are attenuated property rights for all types of ownership forms; shareholder certificates hold the shareholder rights in limbo. The structure of funds makes payments of dividends unlikely.

4. Which causes or considerations have weighed in favour of mass privatisations?

P4: 512 enterprises represent very large segments of total industry and of the instead of using a piece meal case by case approach; population that is affected by privatisation; also, avoiding foreign investment played a role.

C4: The speed in getting rid of the responsibility for the state public sector was the determining cause.

S4: Important was the lack of domestic cash capital; also mass privatisation assured management of its influence.

R4: Before the mass privatisation program was launched, only 21% of industry could be privatised; hence, the speed of privatisation was an important argument, social justice was an important argument as well.

B4: The lack of domestic capital, the speed of privatisation and the size of the entities to be privatised were the important arguments.

5. What have been the different criteria deciding which industries to put together:

- a. sector
- b. corporate form
- c. their export/import orientation or else their home base orientation?

P5: An algorithm was developed in order to ensure equal opportunities of the different funds; industries were ordered by sector.

C5: There was an emphasis on sectors and the strategic industries were left out of the program.

S5: Natural monopolies were excluded from privatisation, also the weapons industry was excluded.

R5: Natural monopolies were being excluded, likewise mining, defence, even transport; geographical and sectoral aspects played a role in grouping companies together; sensitive industries were equally distributed over the different funds.

B5: Strategic companies were excluded or only a small part was made subject to the privatisation program, this was particularly true for profitable companies.

6. What is the legislative ideal of a privatisation fund, or how was it described or supposed to work?

P6: Mass privatisation was largely seen as an experiment, an exercise in developing capital markets.

C6: Funds were seen as acting as the final owners expected to introduce an American type management.

S6: Restrictions were imposed on funds of owning assets (10%) in order to help strengthening a domestic class of managers.

R6: The goal is the ultimate transformation of funds into financial institutions.

B6: Ideally, there should be a shakeout process, holding companies and financial investment institutions have been encouraged to develop.

7. How have the assets been found and determined as being subject to mass privatisation?
P7: Determination took place on a case by case basis for the big assets such as land. C7: The state retained property in the national property fund.
S7: Low asset enterprises have been privatised; the second wave includes higher asset firms. There is a self-selection of poor firms into the mass privatisation program.
R7: A sectoral approach was taken, giving priority to attractive firms, but only in industry; there is restitution in agriculture.
B7: Good firms wanted to be left out of mass privatisation in order to realise management buyouts.
8. How were capable owners of assets supposed to be found?
P8: Still 85% is controlled by the Treasury. Capable owners were supposed to include small investors, banks, foreign firms, but management firms also had to play an important role. Some rights were given to the employees.
C8: Funds were supposed to either be or to identify viable owners, but this did not really work out.
S8: A new political and commercial class has emerged. There is little transparency and little supervision.
R8: Identifying private owners with little regard to state revenue is now in emphasis, but the political will is divided; a corporate commercial elite is already formed instead of a middle class.
B8: There is the wish to create capable owners through the funds; but the state also wishes to keep a finger in the pie. ING and Postbank have become involved.
9. Were owners supposed to be motivated by owners' rents,
P9: Yes
C9: For the first tier this is correct, less so for the second tier.
S9: This is correct for the first and second wave. Yet, 20% of GDP can be looked at as rent seeking.
R9: Management contracts are widely used, the reporters are sceptical about the overall benefit.
B9: The emphasis here is not on creating private owners but institutional owners. Institutional rent seeking is present.
10. and wherein do these rents consist?
P10: Management contracts give stock options and bonuses.
CIO: Republic rents consist in return on equities.
S10: Direct sales are often made at 10% of market value, transferring large rents. RIO: Rent seeking is happening through management buyouts.
BIO: There is an emphasis on institutional assets.

11. Have effective privatisation packages been combined from scattered assets?
P11: Funds pursue different strategies, some restructuring does occur, but it does not explain the entire pattern to be observed under mass privatisation.
C11: Some re-packaging has occurred.
S11: A Japanese system has been used as a guideline, banks and big export oriented companies received most of the focus.
R11: As a goal some re-packaging has been envisioned, but it has not really occurred in terms of formulating a clear cut strategy.
B11: By way of intention, there has been an effective strategy.
12. Are the resulting portfolio's in some sense meaningful?
PI2: Asset values have recently risen.
C12: Recently there has been some weeding out of portfolios. This can be shown empirically as well. The portfolios can be said to be variagated.
S12: Asset values are rising, yet the undervaluation of the Slovak crown should also be considered in this context.
R12: No economic reason can be suggested for the composition of portfolios.
B12: Some attempt at creating meaningful portfolios can be discerned.
13. In the case of joint stock companies, do their shares trade?
P13: Not many stocks are actually trading, but some do.
C13: They do trade.
S13: 40 out of 160 listed stocks do trade publicly, more than 80% are, however, subject to direct trade.
R13: The trading volume is low, at most 30%.
B13: The stock exchange is closed.
14. Where do they trade?
P14: Direct trade in some cases of consideration.
C14: Direct trade that is very active.
S14: Direct active trade.
R14: Probably very little trade.
B14: Only bonds trade.
15. Who appoints the board or boards?
P15: Appointment is handled through the national investment fund with one third representation of labour.
C15: Shareholders do appoint.
S15: Shareholders appoint one third.
R15: In principle shareholders should trade.
B15: No corporate control through trade.

16. Who appoints the board or boards of funds?
PI6: This is handled through management firms.
CI6: Shareholders do the appointing.
S16: Shareholders appoint with regulatory approval.
R16: There is involvement of the president, the parliament, government and the privatisation agency.
B16: Sometimes management companies are involved.
17. Who appoints members of regulatory commission(s)?
P17: The Council of Ministers does the appointing.
C17: The security and exchange commission to be, ministries and public tender.
S17: Informal forms with cabinet involvement.
R17: This is done through the anti-trust authority and the commission for transferable securities.
B17: The important issue is whether one is on the list for mass privatisation or not, primarily in the context of management buyouts.
18. How can the rent from privatisation be measured?
P18: The most important issue is job security.
C18: Rent seeking does occur, it may be 25% of the social product.
S18: The Harburger type rent may be a .7%, but there is at least 20% of the Tullock rent in addition.
R18: Rent seeking takes the form of foreign deposit.
B18: Rent takes the form of manager's perks, members of boards may benefit.
19. How can the rent from privatisation be captured?
P19: The rent can be captured through job security and management contracts.
CI9: Creativity in the tender process is the most important element.
S19: Capture occurs through the regulatory process. The privatisation process itself and money derived from the privatisation transactions; this may be about 25%. In addition, income tax legislation, the revitalisation act and easy credit need to be considered.
R19: There was disagreement between the Romanian specialists on this point.
B19: Cumulative appointments are important.
20. Who has an interest in setting up a privatisation fund?
P20: Only the state treasury has an interest.
C20: Certification happens through a selection commission. The initiative is generated by "sniffing profit"; approval is required by the ministry.
S20: Private banks, state banks and state insurance companies are involved; revenues from state insurance companies are important.

R20: Various political interests are involved, mostly in stabilising the status quo. B20: The political and economic elite are dominant.

21. Who has an interest in liquidating such a fund?

P21: By statute; nobody.

C21: The fund owners.

S21: Completion of transformation into joint stock companies.

R21: The state may end the privatisation process, the private ownership funds are supposed to be transformed into financial institutions.

B21: The main elements are hereby back of fund vouchers, likely inside a trading and speculation.

22. How does the fund make itself obsolete, thereby fulfilling its function?

P22: Funds pursue different strategies.

C22: A fund turns itself into an investment fund.

S22: Funds are already holding companies. Owners can often not exercise their rights.

R22: Turning themselves into regional investment funds.

B22: There are essentially two legal forms available, the holding company and the investment funds. Yet “some of the funds are happy with what they are”.

23. Is enabling legislation clear or vague?

P23: Legislation is vague.

C23: Legislation is clear.

S23: A high extent of regulatory uncertainty is effected through the treasury itself. R23: Legislation is not sufficiently clear it is actually, perturbing the perception of foreign investors and there is substantial litigation.

B23: Legislation is basically clear, although some doubts remain. Self regulation is non-existent and government influence still very strong.

24. Is there a capable judicial venue for dispute resolution?

P24: Cost of litigation is high.

C24: Dispute resolution is inefficient for the existing set of problems.

S24: Dispute resolution is inefficient and very time consuming, waiting periods exceed one year.

R24: There is now a commission of transferable securities.

B24: Dispute resolution is in the hands of the security commission.

25. Who has standing in such cases?

P25: Employees may have standing against the treasury and unions do have standing.

C25: Unions do not have standing.

S25: The second wave of voucher privatisations was cancelled, there are many cases depending on the parliament are majority, government and the fund of national property can block litigation.

R25: Regents can interfere.

B25: The commission can intervene.

26. Who bears the risk and associated cost of incomplete legislation?

P26: The cost is borne by society at large.

C26: The losing party and small shareholders.

S26: The small shareholders.

R26: Society at large, there is extensive litigation.

B26: Funds can guard their interests through the political process. Losers are the small shareholders.

27. Who bears the risk and associated cost of incomplete regulation?

P27: There is no liability of regulating bodies.

C27: The regulatory intensity is low. There is only a minimal role for the treasury. S27: The small shareholders are the losers, the treasury is also the regulatory authority. Litigation is costly and inefficient.

R27: Society at large.

B27: Funds guard their interests through the political process and small shareholders loose out.

28. Who benefits from minimum and maximum holding limits?

P28: Employees benefit being protected with 15%, the state treasury retains 25%. C28: The company as a going concern; management.

S28: Management benefits, so does the fund of national property.

R28: The 30% stake can be relevant depending on the distribution of shares.

B28: The limits are important in order to maintain the privatisation process.

29. What are the sanctioning instruments available to the regulatory commission?

P29: Suspending the exercise of the rights of shares.

C29: There are penalties, assets can be frozen.

S29: Sanctions include change of custody or liquidation.

R29: Compulsory administration through the commission of transferrable securities is possible, so are penalties and de-certifications.

B29: Penalties and special interference, but no de-certification.

30. Can former commission members become managers/board members and vice versa? P30:

Yes they can. There are some limited restrictions of conflicts of interest.

C30: Same.

S30: Same.

R30: Same.

B30: No, but past contacts are relevant.

31. In case of holding restrictions, can funds co-ordinate their activities in board caucuses or similar forms of understanding?

P31 : Some consolidation is possible.

C31 : This strategy is limited by law, but it partially happens.

S31: There are no relevant restrictions to this strategy, although some are officially on the books. Small funds are practically passive.

R31 : No co-ordination possible.

B31 : This is possible through trustee contracts.

32. Are there limits to such co-ordination? (If no, what is the point of having the restrictions in the first place?)

P32: The restriction is 33%.

C32: The restriction is 20%.

S32: The restriction is 10%. A second company can be created to hold all the remain shares.

R32: ?

B32: -

33. Who benefits from holding restrictions?

P33: Employees and the state treasury. The restrictions are 80 and 60% respectively. C33: Managers.

S33: Managers.

R33: ?

B33: The general public.

34. Can different funds have interlocking directorates?

P34: Interlocking directorates are forbidden, but exemptions are granted.

C34: They are not prohibited.

S34: No restrictions.

R34: An administrative corporation can serve as a bracket.

B34: Funds can have interlocking directorates in this sense that one founder can establish more than one fund.

35. Can banks exercise stock voting rights and delegate representatives to supervisory boards of companies and funds?

P35: Yes, they can. They also play a role in appointing and supervising management.

C35: Yes.

S35: Yes, under certain restrictions, however.

R35: Yes, if they own the stock and if anti-trust restrictions are not violated.

B35: State banks cannot, and private banks can.

36. Are funds free to take different corporate forms, e.g. that of a charitable foundation?

P36: No.

C36: No. •

S36: No, but some old regulations can be by-passed.

R36: No.

B36: No.

37. Can funds be operated for not for profit purposes, e.g. by a church or institution of learning?

P37: No.

C37: No.

S37: No.

R37: No.

B37: No.

38. Are the funds restricted in terms of holding preferred or common stock?

P38: In principle no, but voting rights on treasury shares are not exercised.

C38: No.

S38: No preferred stock.

R38: No legislation in existence on this matter.

B38: Different classes of stock cannot be issued by funds, private companies have common stock.

39. What is the tax treatment of fund earnings, with respect to individuals?

P39: Capital gains, but revenues are tax free.

C39: 25% capital gains tax.

S39: Dividends are taxed at 15%.

R39: Foreign re-invested income is tax free.

B39: The individuals receiving the dividends by funds are subject to income taxation at 15%. The same is applicable, if they receive the dividend directly from the privatised enterprises.

40.... and corporations?

P40: 40% corporate income tax.

C40: 40%.

S40: 40%, no tax is paid in fact.

R40: 38%, dividends 10%.

B40: The funds are subject to 25 or 35% corporate tax on their profit depending on the size of the turnover. The limit for applying the second rate is two million in turnover. However, the part of the profit which goes to payments of the dividend to the shareholders of the fund is exempt from corporate taxation.

- 41.** Can the corporation income tax be deducted from individual income tax owed by holders of shares or certificates?

P41: No.

C41: -

S41: There is double taxation possible.

R41: Double taxation possible.

B41: See the answer to question 40.

- 42.** Can several privatisation funds be held in one holding?

P42: No, subject to a limit of 5% of net asset value.

C42: Clearly prohibited.

S42: Clearly prohibited.

R42: No regulation.

B42: Yes.

- 43.** Can we, quite generally, identify political forces in your country that aim at opening markets either regionally, nationally, or intra-professionally?

P43: EU membership is the driving force. Agriculture is a strong restraining interest group.

C43: The pro-market coalition is growing in the polity.

S43: The nationalist populist movement is prevalent. It is tied to the weapons' industrial complex and in this sense against market forces. Pro-market forces may, however, grow in time.

R43: Forces include outside forces, they suggest the World Bank and the IMF, but the concept of the market economy needs clarification.

B43: There is only one political party that is pro-market, there are few other political pro-market forces.

- 44.** Can foreign trained professionals freely practice in your country? For instance, attorneys, accountants, surveyors, notaries public, civil engineers, medical doctors, university professors?

P44: Yes, under restrictions.

C44: Yes.

S44: Yes, under restrictions.

R44: Yes.

B44: Under severe restrictions.

- 45.** How many steps does it take to establish a workable firm with at least five people on the payroll, an industrial production site, and international connections?
P45: About 10 for a Polish citizen; no foreign nationals can do this.
C45: About 3 steps.
S45: Less than 15 steps.
R45: Precisely 9 steps.
B45: Although the real process is not difficult and there are thousands of five person companies, obstacles are indeed very substantial.
- 46.** Is it possible for a new company with a business plan and only outside credit to open a company in your country?
P46: No.
C46: Yes.
S46: Yes, but there are substantial credit barriers.
R46: Yes.
B46: Yes, but very substantial credit barriers.
- 47.** Is it possible for this company to hire qualified personnel and contribute to the social security fund?
P47: Only in the form of a Polish company.
C47: Yes.
S47: Registration is required.
R47: As in Poland.
B47: Yes, but in practice it would be very difficult.
- 48.** Can IOU's bills of credit issued by predominantly foreign companies operating primarily in your country be deposited for discount with a) either a leading bank or b) the Central Bank?
P48: This requires a Polish account.
C48: Unsure.
S48: It requires a Slovak account.
R48: It requires a Romanian account.
B48: It depends on various circumstances.
- 49.** Can foreign entrepreneurs acquire real estate on their own?
P49: This requires approval from the Ministry of Foreign Affairs and is possible under some specific conditions.
C49: Yes.
S49: This requires registration and cannot be done with physical persons.
R49: Yes, but only land.
B49: Yes, but not land.

50. Does the privatisation initiative developed by your country include a plan for giving a haven to domestic black market capital?

P50: Not officially, but it clearly happens.

C50: For the case of mass privatisations, the answer is clearly no.

S50: It happens, the shadow economy now stands at about 25%.

R50: The shadow economy stands at between 40 and 50%.

B50: Requirements to disclose sources make this difficult.

This exercise allows us to arrive at the following set of market compatibility indexes:

Poland	Czech Rep.	Slovakia	Romania	Bulgaria
0,562	0,648	0,608	0,468	0,47

Interpretation of the Results

Although great care has been taken, the questionnaire results aiming at defining a clear market compatibility index cannot be regarded as a clear success. Although some countries clearly have market based mass privatisations which can serve as an impulse for the establishment of a well functioning market economy, they do not rank significantly different from those countries such as Romania and Bulgaria that use mass privatisations as a subterfuge to prevent the establishment of a market economy. As the indices clearly show, from the point of view of transition to a market economy, each country experiences a series of deficiencies, as all the results are significantly different from one. However, the deficiencies are widely scattered, and the results can be used for a further in depth analysis, as weaknesses point to improvement strategies. In this sense, the empirical exercise has been met with success.

Summary and Conclusions

The in depth analysis of five mass privatisation programs in Central and Southern Europe, in particular those in Poland, the Czech Republic, Slovakia, Romania and Bulgaria has resulted in one rather tangible result. They all remain far from ideal in the sense of the market compatibility index derived as the empirical contribution to this study. All programs significantly differ from one, but they also differ substantially among themselves. The index is an aggregate measure, and it covers up much variation which can only be discerned through going into the results more extensively. Specific follow up studies will be needed in order to focus on the specific deficiencies identified in the five country studies.

Notes

¹ "Madison replied in 1816, after an interval of five years, courteously refusing and understandably softening the blow with a number of vague phrases. To this reply Bentham replied, subjecting to microscopic examination every evasive word used by Madison. In 1817, he published a circular to all the governors of all the states in the Union and finally a vast collection of eight letters addressed to the citizens of the American United States. In these, at enormous length and with remorseless detail, he defined and expounded the cardinal virtues of a properly drafted code of law. These were 'aptitude for notoriety', 'completeness' and 'justifiedness' or support by adequate reasons." (Hart, 1982, pp. 76-77).

² See the Symposium issues of the *Journal of Legal Studies* (1980) "Change in the Common Law: Legal and Economic Perspectives." *Journal of Legal Studies* 9; and Symposium on "Efficiency as a Legal Concern." (1980). *Hofstra Law Review* 8, 3-4.

³ See the Symposium "Evolutionary Models in Economics and Law." (1982). *Research in Law and economics* 4.

⁴ See in particular the contributions by Pejovich and Posner cited in this essay.

⁵ A description of the legal provisions of the 1976 mass privatisation law as well earlier legislation is available in English: Der Bundesminister für Arbeit und Sozialordnung, Mass privatisation in the Federal Republic of Germany. Bonn 1978.

⁶ We are in particular referring to the contributions by Hayek and Lachmann; Furubotn, Pejovich and North.

⁷ There is an American translation by Paul Streeten, (1934). *The Political Element in the Development of Economic Theory*, Cambridge: Harvard University Press.

⁸ We use the term "political economy" synonymously with "theory of economic policy" as opposed to economic policy practice or the art thereof. When referring to that aspect of economic policy which involves the legal order we use the term "legal economic policy". This has always been a concern of political economy, so there is no need for a distinctive term for the theory of this type of economic policy.

⁹ And ideological elements may even be a driving force in their development. See Schumpeter (1949).

¹⁰ Even if he remains politically without influence, the economic contributions made in seeking political influence may be long lasting, as Walras' example can teach us.

¹¹ Notably Cossa (1876), Ricca-Salemo (1888), Antonio de Vitti de Marco (1890), Ugo Mazzola (1890, 1895), Mañeo Pantaleoni (1882, 1886), Flora (1893), Graziani (1897). See a survey in Einaudi (1931).

¹² Notably in the Limits of Liberty (1975).

¹³ Of course, the topic is not new to economics, as the writings of i.a. Wagner, Veblen and Sombart demonstrate.

¹⁴ The following citations refer to North (1981). There is a long Review (1983) in *The Wall Street Review of Books* 11,3.

¹⁵ Demand = Investment Leva 75 bln. Supply = Leva 86 bln. companies' assets book value.

¹⁶ Usually a majority share sale to a strategic buyer through negotiations technique.

¹⁷ According to relevant regulations the choice on which business entity is to be converted the PF should be done in advance.

¹⁸ Executive and Supervisory Boards or Board of Directors controlled by the General Assembly.

¹⁹ No more than 25% of funds capital.

²⁰ 23 funds chose first objective against 17 upholding the other two objectives (31% of all PFs capital against 25% respectively).

²¹ State-owned financial institutions (banks, insurance companies and financial brokerage houses) control 20% of the total capital of all funds, whereas the prevailing type of founder in terms of the number of established funds is private industry-based one. The reason for the former is the higher credit of trust state banks were granted during the last bank crisis.

²² Legal measures include only general protections from fraud when converting vouchers but no future regulations on minor shareholders' economic interests.

²³ The complex cross-ownership in Czech Republic and insiders' control in Russia are to be avoided by not allowing depository banks or companies with more than 50% state ownership to become a founder or fund's shareholder whereas funds' purchases of other funds' shares are possible only after state approval.

²⁴ About 20 financial brokerage houses offer a stock from 40 companies.

²⁵ There is no apparent link between sector profitability and state divestment of control except in tourism and trade. Thus, other factors than profitability influence government strategy.

²⁶ Such as changes and amendments in the Article of Association, increasing of the capital, issuing of new shares, decisions on the number of board representatives, composition of the board and dismissal of board representatives (Capital, 29 July 1996).

²⁷ Capital (5 August 1996) as well as Capital (29 July 1996).

²⁸ Cash (18 July 1996).

²⁹ The unsold stock should be less than 5% (but no more than Leva 25 mln) from all the stock offered and the company's capital is less than Leva 500 mln.

³⁰ A joint project with EBRD.

³¹ Initially, large enterprises were divided into four groups: within the perimeter of the first and the second mass auction, firms to be privatised after 5 years and enterprises for liquidation.

¹⁴ The founder's compensation was limited to 2% of nominal value of vouchers' shares, 3% of assets and 20% of fund's profit.

¹⁵ Speaking about price determination procedure, the first round showed whether the identical price set for all shares was consistent with market demand. If demand was less than supply, the price for residual shares offered in the next round was to be reduced, whereas in the opposite case individual investors' preferences were satisfied first, IPFs' demand proportionally reduced and all shares sold. Still, the reduction of IPFs' bids should not exceed 20%, otherwise all shares were placed for the next round at a higher price. After these two waves of sequential rounds at the end of the day the share price was not only diminished but also approached the market value of the company. Hence, firms economic performance did not influence investment decisions of individual mass privatisation players but funds' behaviour and learning-by-waiting pattern (Hanousek (1997)).

¹⁶ The supervisory board of Czech companies consisting of 30% employees and 70% shareholders had limited influence on the actual effective body: the Board of Directors.

¹⁷ Funds could acquire even more than 20% of one privatised company only if the excess is sold 6 months after the beginning of stock market trading of this company.

¹⁸ E.g. Harvard Capital fund stated that management in 30% of its companies will be displaced together with 30% reduction of employment level (Schmognerova, 1994).

¹⁹ An investment company was allowed to found more than one fund (Mladek, (1995)).

²⁰ Nine of these 14 Investment Groups were banks (OECD, 1995).

²¹ Shortly after the distribution of the first wave shares to all participants the Prague Stock Exchange and RM-System started to list both privatised companies' and IPFs' shares. However, the tendency of trading mainly large blocks of shares reveals the power of 'off-market'.

²² After the tender with offers from 33 consortias submitted, there were 19 shortlisted consortias among which 14 were drawn by lots.

²³ Some of enterprises were chosen on voluntary basis, others were offered to join the Programme with the alternative to justifiably reject the offer within 45 days.

²⁴ It means that the remaining 27% of each company in the list was divided among all funds.

²⁵ Free shares from the State Treasury package were provided also individual suppliers (farmers, etc.) of the same former state-owned enterprises (lately transformed into joint-stock companies) in exchange for a not less than 2-year supply of raw materials.

²⁶ According to the Law on National Investment Funds the certificates are 2 types: universal shares and compensation shares.

⁴⁵ Until November 1996 25 675 citizens received PCs.

⁴⁶ The broad competence of General Meeting covers: change of statute; issuance of new shares; merger with another company; dissolution of the fund.

⁴⁷ The paragraph is based on my thesis. The next footnote as well.

⁴⁸ It is not possible the agent to act as maximiser of principal's utility at nil costs. Sometimes even the agent enters into expenses, i.e. bonding costs, in order to guarantee his loyalty or, if necessary, to provide compensation for actions against principal's interest (Jensen and Meckling (1976)).

⁴⁹ Nevertheless, these new organisational structures was prone to conflicts, too. It happened the Supervisory Board to break up the contract with the management company or in another fund even the Supervisory Board itself to be replaced.

⁵⁰ The actual figure is 51% funds' ownership (equal to PLN 7.2 billion) in every company because only 85% of funds' shares were exchanged for PC - the management firm's payment is connected with the rest 15%.

⁵¹ For example, when the Fund introduces a strategic investor.

⁵² Companies where the funds has a controlling interest.

⁵³ Of course, state interests are shielded at least through the relevant legislation such as antimonopoly provisions but on the other hand, extreme shares diversifications affecting the block position of a fund are controlled, too. It means a fund may sell its minority stakes in one firm but if the decision is to sell its stake as a major shareholder this should be done only through a block sale of the whole stake.

⁵⁴ Only 3 companies from the scope of the mass programme were listed until December 1996.

⁵⁵ The regulated public market outside the stock exchange is to be opened in December 1996.

⁵⁶ Revenues from the PCs sale are not laid on an income tax (Art. 42 of the Law on Investment Funds). Same applies to sales of funds' shares under certain limitations.

⁵⁷ Some of the information is based on: Avner and Montias (1994).

⁵⁸ It is necessary not to forget that institutional change brings about unavoidable transaction costs.

⁵⁹ Commercial joint-stock or limited liability companies with the state being a sole shareholder.

⁶⁰ These are enterprises in the strategic sectors, such as armaments, electric power, mines, natural gas, the post office, railway, etc. reminding of some French state- owned firms. They are controlled by the ministries in charge as oppose to the corporatised firms.

²⁷ OCs guarantee a 10% discount on the share price when SOF shares are to be sold by public offering. Only using nominal vouchers one could subscribe for shares in one and the same company without diversifying his holdings.

More than 4000 companies.

²⁸ Very positive action from the point of view of the effective control but a question arises of costs associated with this assessment and who will undertake them when benefits are marginal.

²⁹ However, citizens subscribed for shares using their mass privatisation means do not receive shares but shareholders certificates and their ownership rights may be exercised only after issuing of the shares themselves.

³⁰ Subsidies were 4.9% of GDP in 1995. SOF allocated to its companies Lei 514 bln in 1995, and Lei 167 bln in 1996.

³¹ When there were several creditors it was difficult to satisfy all of them by selling the assets. In addition the court had limited power in resolving these disputes.

³² The conclusion is mine.

³³ As oppose to Czech experience, much smaller number of outsiders' projects for Slovakian state enterprises' privatisation ere submitted which can be explained by the information asymmetry.

⁶⁹ I.e. transformation into joint-stock companies.

⁷⁰ 169 investment funds and 68 investment companies.

⁷¹ In the period of 1991-1994 the government was approving every single direct sale of the Fund. After 1994 only the parliament could control FNP through the selection of its management body.

⁷² Precisely, bonds are traded in RM-System Slovakia which is one of the public capital markets - the other is over-the-counter market.

⁷³ The possible ways of retaining state control consist of either 33% blocking share or a 'golden share'. However, the Constitutional Court rejected the last as unconstitutional for impeding other shareholders' rights.

⁷⁴ As a result of the second wave invalidation investment companies being founders of 169 investment funds lost around SK 9 bln. (Vitkovic's own calculations show different figure of SK 6 bln.). No more than one half of this amount will be paid off by the relevant authorities as a lump compensation sum.

⁷⁵ More than 60% of a fund net assets value per share.

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Bulgarian Mass Privatisation Scheme. Implications on Corporate Governance

Plamen Tchipev*

Introduction

Bulgaria as many other CEE countries developed a Mass Privatisation Scheme (MPS). The Scheme is based upon specific financial intermediaries called Privatisation Funds (PFs). Beside the important functions they have to play in the mechanics of the process

- collection and exchange of vouchers against the acquired assets from the privatised companies, those institutions are expected to perform another, even more important role
- to establish an effective system for corporate governance over the privatised companies.

The main questions associated with the implementation of MPS emerge at that point - is it justifiable to expect those institutions capable and willing to exert control and monitoring over the enterprises they hold stakes in, if they do not normally perform that function in the developed market economies. Could one hope that given the specifics in transforming economies those institutions would change their behaviour and what kind this change would be? Is it possible to guide the institutions' activity in a targeted direction by a special regulation and what type it should be?

Those kinds of problems are familiar to the researchers dealing with the problems of transforming economies and particularly, with the problems of Central and Eastern Europe privatisation. Carlin and Mayer (1992), Coffee Jr. (1994), A. Thorn, Stiglitz (1991), van Vijnbergen (1992), Frydman et al. (1993) point out them and propose solutions, emphasising mostly the temporary and auxiliary role of privatisation intermediaries and recommending orientation of the financial systems toward a more traditional models for corporate control.

Recognising the vast complexity of the problem, the following study presents extensively the Bulgarian Mass Privatisation Scheme with its relevant legal framework and some of its first results concerning exclusively the Privatisation Funds, their organisation, objectives, resulting portfolios and interaction with the government and the stock market. First section presents the overall process. Second part deals with the legal regulations of PFs and the third section reveals some of the first results. Section 4 offers the conclusions.

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The transition toward market economy in Bulgaria, which started in 1989, has developed on very unstable political background. Practically, all the governments ruled during the period were unable to finish their mandate urged by sharpening political struggle and frequently not without the intervention of trade unions. The consequential replacement of radically opposing each other political forces was not beneficial for establishing of common or close understanding on the ways, scale and pace of the process of transition.

After first inflation shock in 1990 and temporary partial financial stabilisation in the following two years, the macroeconomic situation deteriorated again. Emancipated from totalitarian state control, but within underdeveloped market framework, at first place proper legislation, the state-owned enterprises became primary source for uninterruptedly rising budget deficit and inflation.

From the other hand, the loose control at any level of national economy eased rapid enlargement of shadow business which benefited from Yugoslavia embargo, was employed in suspicious or openly illegal operations, and which feeling free from paying taxes formed in very short time a powerful, though narrow group of new-rich. The latter joined and in some cases initiated the abroad-based capital with unclear origin, related to various 'circles of friends' of former politicians and socialist top-managers.

As a result, powerful economic groups emerged which claimed to be the national- responsible large capital. Their deals were able to put overwhelming impact on some economic sectors aggravating and catalysing the overall macroeconomic instability. Those economic groups not only created mighty political lobbies, but also were able to use the influence of trade unions in achievement of their goals.

After a weak rise of GDP in 1995, a new fall-down occurred from the beginning of 1996 perplexed with an unprecedented financial crisis and culminating in the early 1996 hyperinflation. In several waves, seventeen banks both state- and private ones were put on a special regime by the Central Bank, and many of them went bankrupt, while some are still on trial. All those banks have had very high credit expositions toward bad debtors including not privatised state enterprises and many firms of the banks' major shareholders. Trying to compensate the thousands of citizens who deposited their money in the non-performing banks, the government undertook their debt pushing up the inflation higher and higher.

Several sharp jumps of the exchange ratio of foreign currencies against Bulgarian Leva (BGL) devaluated national money erased the credibility of the latter almost completely.

The drop of production and the negative balance of payments made the country unable to service its foreign debt without continuous support from the international financial

institutions, which become more and more reluctant on that. This was finalised with the proposal of the IMF Bulgaria to introduce Currency Board and to suspend the functions of the Central Bank. Endangered by the possibility of second moratorium on the service of the national debt, the political class of the country accepted the proposal and the Currency Board was implemented in the middle of 1997.

The Discussion on Mass Privatisation Program started in 1993, but the lack of political consensus on almost every of its aspects delayed the process up to beginning of 1996. This way, the objectives of the process were set out before the current financial crises, but they certainly are exposed on its increasing pressure.

Mass Privatisation Objectives

The most popular reason for mass privatisation has always been the willingness to speed up the privatisation. In fact, the first privatisation model, called later 'cash privatisation' was designed with a lot of deficiencies in the procedure, based on wrong expectations, as quick development of the stock market etc. Although, its main problem seems to be unnecessary concentration of deals; e.g. any deal above 70 mln BGL £350 after the last amendment of the Privatisation Law, October, 1997) is reserved for the Agency for Privatisation (AP) and below this line are mostly shops, restaurants etc. If one consider the fact, that utmost privatisation technique is 'negotiations with the potential buyers' - a time consuming one, it seems apparent the slow pace of the process.

Compared to cash privatisation results - about 32 bln BGL direct payments for almost four years - mass privatisation scheme seems really promising - more than 80 bln BGL companies' assets only for one wave. Bearing in mind that financial situation in the state enterprises deteriorates virtually day after day this objective seems most justified.

The second goal stated before the MPS is to change the way for managing the companies. While the poor management of great deal of state enterprises is out of question practically for everybody, it is not clear why this particular way is the most preferable one. There are expectations, that the change in the ownership of the selected enterprises will have a strong positive effect on the way the enterprises are managed, but there was no going debate - which way the thousands of small new shareholders will initiate this radical change; are the privatisation funds able to perform a governing role and, if yes way should one see them as investment institutions?

Both of the publicly raised goals have a common underlying impetus and. that is the **presence of an effective mechanism for continuous erosion** of the state-owned enterprises, a mechanism which includes tools for transferring the consequences of that practice to the macroeconomic level, i.e. to the all economic subjects. The mechanism includes a non-economically based outflow of capital from the state owned enterprises, which at their turn, in an environment of soft budget constrains, borrow more and more loans, vast majority of which is not even intended to be serviced.

At their turn the banks providing those loans, the state-, but also the private ones, require (and receive easily) refinancing from the Central Bank eventually at the cost of continuous devaluation of the national currency and riding inflation, i.e. at the cost of falling living standard and financial instability. The main points in this chain are: *the blocked cash privatisation; the uncontrolled management, the presence of informal networks between the different links of the chain enabling co-ordination of described mechanism at meso- and macro-levels}*

Apart of the main two objectives, some others were launched, as getting social effects from mass privatisation, stimulating the development of the middle class and so. A more careful look at the proposed scheme does not allow to classify those statements other way than as a demagogy.

It makes sense to repeat, that none of pointed goals was not analysed in whole, within the context of complex concept for economic policy - a policy encompassing the privatisation as unavoidable means for achieving those goals. Just the opposite, in a very long period of accepting the process, it became clear that it has almost no supporters, but has a very powerful opponents, gradually lowering their rejection against it. And if mass privatisation did started, it should be assigned to the fact that the opponents of the mass privatisation find out promising ways for achieving their interests through it. And of course, to the support provided by the international financial institutions.

Conversion of Privatisation Vouchers

The amendments of the Privatisation Act adopted in the middle of 1994 have introduced that variant of mass privatisation which has its first wave finished recently. Later, further determination of the process was made in the Law on Privatisation Funds (LPF, 1996) and other government acts.

According to that scheme, every matured citizen receive the 25 000 (roughly 500 USD) investment bonds (vouchers) at a symbolic price covering the organisation of the process, but having no connection with the price of the assets, which could be appropriated by the bonds. The nominal value of one investment bond was determined by the law at one investment Leva for one bond. Since, there were not bonds with different value, it was just a confusing perplexity for many of the citizens.

The possible number of participants has been estimated at 6.5 millions people. In fact, about 3 millions people took up the opportunity. Created this way, the demand of about 75 billions investment Leva was opposed by a supply of state-companies' assets, with a balance value of about 86 billions BGL. The full value of the assets of state enterprises was estimated at 201.85 bln BGL but all of them have been included in the Scheme only partially, the average share of a company put on sale was about 42%. Actually, this share vary strongly among the companies - from 10% to 90%. The problem what to be the share for any specific company was a major one during the pre-privatisation

period, but it never became clear, what is the criteria one share to be preferred to another. About 10% of offered assets of any company had been given to its employees without any payment.

The voucher-holders would be provided with the opportunity to convert them in the shares of the enterprises offered for sale or in the shares of one or more privatisation intermediaries (funds). In the latter case one investment Leva is set to be equal of one Leva of a Privatisation Fund's stock. This way, this is a *par excellence* process of primary subscription of PFs shares at their nominal value.

In the former case, the scheme had two specifics of the conversion of investment bonds against companies' stock:

competitiveness - each participant bids for the stock proposing a price and a volume of the shares desired by him;

and acceptability - the auction commission sets a minimal acceptable level for the price of any company's stock and the orders below this level are not considered at all.

All orders, of citizens and of PFs are satisfying in descending order to the end of the available stock. When the supply becomes insufficient, the orders are being satisfied to the last possible one, if more than one order is at the last feasible price, a scale down of orders takes place.

If there is still unsold stock after fulfilment of all the orders, the remaining stock is subject to distribution between the bidders proportionally to their orders, provided it does not exceed 5% or 25 millions of the stock of privatised company. When the remaining stock is above the limits, it is proposed to go under jurisdiction of a special government body.

This mechanism of voucher conversion bears a very strong advantage for the PFs since the citizens who compete with them does not have a proper information what is the real price for the desired shares and how to calculate it in order to win the auction. Conversely, the relatively small number of competing funds allows them to expect that the price they will offer will dominate the auction and they will have their orders completed at best price.

The initial, or minimal acceptable price is calculated by the Auction Commission in accordance with the net value of the capital, more precisely the balance value is corrected with the loss accumulated during the past periods of a company's operation. Keeping in mind the bad financial situation in many enterprises, it is not surprising the presence of some enterprises in the list with the initial auction price at 1 BGL. Although, there are some companies with the initial price several times higher than the nominal one.

The actual problem here is, that the initial prices are calculated on the basis of the value of company capital as registered in the court, i.e. calculated in various time periods.

This way, they encompass different levels of inflation and since it is too high some of the initial prices are underestimated and others are overestimated, which again, is out of possibilities to be detected by the small investors.

According to the two mechanisms the Bulgarian Mass Privatisation Scheme has been shaped in two forms of participation:

direct - citizens compete for shares from privatised companies right at the auctions bidding the price and the volume they want to acquire;

indirect - citizens buy shares from Privatisation Funds (PF), which then bid at the auctions for the companies stock;

The reasoning for the latter form is the general presumption for diversification of the risk ensured by the institutions pooling the investments of large groups of investors. In fact, the relation between the participants and privatised company is torn under this form of participation, since the funds increase the fund's own capital and investors lose the control over the investment decisions. What is more serious, becoming PFs' shareholders they share the future of the funds, which is not necessarily that of an investment institution.

Theoretically, there is one more form of participation - one may authorise a proxy to stand for his/her interests, but this process is regulated as any other legal process of authorisation and does not cause any specific privatisation consequences.

During the process of establishing the model some opportunities for regulation of the two forms of privatisation have been considered, but they have been abandoned and in the current model the development of each form depends exclusively on the independent will of participants, i.e. on the abilities of the PFs to advertise. As a result, the indirect participation dominate almost completely: the funds acquired four times more vouchers than those presented by the direct participating citizens.

Scales of the Process

The Mass privatisation scheme ensures equal right for every mature citizen over 18 to take part in the process. These are about six and a half millions voucher books for Bulgaria. The actual number of participants was about 3 millions presenting an investment capital of a 75 billions investment Leva.

From the supply side, they were 1050 with total capital of 201.85 billions Leva, 1040 of which actually have taken part in the process, with an actual capital of 84.8 billions Leva. This was the average privatised stake is only 41.8% from a company's assets. 82% of those assets (70 bln BGL) have been transferred and 15 bln left unsold with the government.

Mass Privatisation Statistics

Potential Participants 6.5 mln		
Actual Participants 3.0 mln 3.1 with 75 bln Inv. Leva	Individual Participants About 0.5 mln With 12.5 bln. Inv. Leva	Licensed Priv. Funds 81 with about 62.5 bln BGL
Total Voucher Resource Spent 71.5 Wasted 3.5	Resource Spent by the Individuals 9.1 Wasted 3.4 bln Inv. Leva	Inv. Resource Spent by the PFs 62.4 Wasted 0.1 bln Inv. Leva
Offered Companies 1040 with 84.8 bln shares		
Total Shares Transferred 69.1 bln	Shares Acquired by the Individuals 9.0 mln.	Shares Acquired by the PFs Above 60 mln
Total Shares Left Unsold 14.7 mln		

Source: Centre for Mass Privatisation

The funds attained above 62.4 billions Leva, which is the capital of about 2.5 mln. voucher books; in fact more people became shareholders of PF, since some of them entrusted only part of their voucher books to the funds. This way, the funds acquired 83.2 % of the total volume envisaged for investment in privatised companies. This figure becomes bigger (above 87%) if we consider the actual placed vouchers; 62.2 bln investment Leva have been placed by funds against 9.1 bln by individuals. This way the individuals wasted about 25% of their resource.

81 PF have been licensed and 11 others failed to get that permission because they did not reach the minimum level of voucher capital. The investors in unsuccessful funds (about 13 thousands) had the opportunity to invest them again directly or indirectly.

To compare the Mass Privatisation Scheme to the General or 'Cash' Privatisation, which started in Bulgaria in 1993. The latter encompasses about ten different privatisation methods, including public offers on Stock Exchange, sales to potential investors, auctions etc. Through all those methods for six years about 35.8 billions of government enterprises' assets were sold, i.e. less than half the assets approved for the first wave of Mass Privatisation.

Privatisation Funds

Legal Status

Privatisation funds regulation goes under the special Law of Privatisation Funds (LPF). According to it privatisation funds (PFs) are subject to a set of rules which follow closely the general regulation of investment companies changing only some specific points. Namely, constitution of privatisation funds is subject to approval of Commission on Securities and Stock Exchange (The Commission or CSSE). It grants a license for privatisation fund to act, following the special procedure with key point in publishing a prospectus for capital rise. The prospectus contents an information which does not differ from the analogous information concerning an investment company, including projected investment strategy. Later, the funds are allowed to register and trade their stock on stock markets as any other investment company. The management, control, accountability and information disclosure is also within general investment framework.

Specifics of PFs' regulation include the requirement for a minimal level and structure of capital, restrictions on their portfolio structure and prohibition for buy back of their stock for a 5 years period. Contrary to investment institutions funds are allowed to acquire much higher stacks in the companies from their portfolios.

The main difference is in the opportunity provided for PF; it may change its functional role after privatisation registering itself as a holding company.

The privatisation funds in Bulgaria are shaped exclusively as joint-stock companies targeted on acquisition, management and trade of shares against the investment bonds in the process of mass privatisation. The funds are obliged to issue nominated shares with voting rights, securing this way a classical set of rights for their investors on dividend and capital gains. This way, each act of acquiring any sum of bonds from a holder corresponds with the relative rise of the funds' own capital.

Six months after the last auction round the privatisation fund may change its legal status to either an investment company acting upon the Law on Securities, Stock Exchange and Investment Companies (Securities Law) or to a holding-company acting upon the Commercial Code. Since the former are allowed to keep holdings up to 10 percents of any company's assets and the holdings of latter should not fall below 25 percents, this regulation seems as direct attempt to force privatisation funds to make a certain choice from the very beginning of their existence. This choice is supposed to keep the fund away from the embarrassing situation to find itself with the holdings whose scale lays in the gap between the required values for the two different business entities. Finding themselves in a such situation, they should take an emergent action to get in line with the legislation incurring all the unfavourable results of that situation. It should not be forgotten, that there is a prohibition for transfer of the shares acquired in mass privatisation lasting for the same period of six months after the end of the last privatisation auction. Unfortunately, the point whether this norm is obligatory or not is

not clear as well as what will happen with the institution which do not comply with this requirement - a classical case of leaving a gate in the law.

There are no restrictions on the subjects establishing privatisation funds, but there is a lot of specifics in defining the capital structure. A minimum size of capital is required, about 70 ml Bulgarian Leva (BGL), at least 10 ml of which in cash or in securities, and not less than 70 per cent of the capital must be acquired in form of investment bonds received from the population. This requirement seeks to ensure that funds will be able to complete a minimum diversified portfolio securing a higher level for investor's protection.

Practically, this requirement became a heavy barrier preventing 11 funds from further participation in the process, i.e. about 12 percent of the total number of funds bidding for vouchers at the first round. The investment Leva they acquired in competition have been restored on the accounts of their original holders. This resulted in an urgent need for about 13 000 people to find another fund to invest their vouchers within a few days. Logically, a lot of them failed to resolve this problem. As an attempt to prevent further delay of the process funds have been granted an opportunity to continue acquirement of the vouchers from citizens between the auction rounds.

Apparently, this requirement is not applicable, if a PF changes its legal form, i.e. ceases to be privatisation fund. This is another evidence of developing privatisation framework in a way to ensure that privatisation funds will not perpetuate in their special legal status but will take a more standard form of their activity.

Management of the PFs'

Structure of the Management Bodies

Funds are organised as one- or two- tier management structures of, i.e. some have Board of Directors, controlled by the General Assembly and others Executive and Supervisory Boards. Both forms are regulated by the Bulgarian Commercial Code and follow the world-wide applied patterns.

The two-tier system gives more clear distinction between the executive and governance function and this may be the reason to be more preferred in a case with still not clearly defined property rights as the Bulgarian one. About 80% of total number of registered funds have chosen the two-tiered management structure.

There is no evidence that this organisation of the management has been chosen with connection of the size or the portfolio structure of the funds. Funds from all the scale groups are represented among those choose the one-tier system.

At this point of the process, it was not possible to investigate the managing bodies of all the funds, but the preliminary data show that in almost all the cases the majorities in the managing bodies are contingent on the structure of founders. It means, that the

members appointed by the dominant founders are elected in overwhelming majority of cases by the general assemblies of shareholders without serious obstructions.

This connection is particularly strong within the group of funds founded by the incumbent management. In almost all the cases when one finds specially designed companies functioning as a fund-founders and being controlled by currently acting CEO of the companies from the privatisation list one may predict with great probability, that those CEOs are also the top managers or supervisors of the privatisation funds. Moreover, even in some cases when the founders work in one or more privatised enterprises, but act just as a group of physical persons and not as a business entity, even in those cases the privatisation funds are controlled by the state managers. Just for example, the Nikotiana fund has been established by 3969 persons with the goal to acquire a substantial stack in the tobacco companies and 3 out of 5 members of its supervisory board are CEOs in the state tobacco holding and its subsidiaries.

The members of funds' managing bodies are required to match a number of preliminary conditions, mostly general. For example they are expected to have a suitable professional qualification, but without any specific restrictions. Type and Size of Managers Remuneration

This problem is not treated in an explicit way by the regulatory framework which leaves the decision within the competence of each fund's own ruling bodies. The problem is essential since having in mind what is the level of market knowledge and behaviour of the thousands of "investors" created by scratch, it is not striking to predict insufficient correlation between managers remuneration and fund's performance.

The only regulated situation is when the fund is being managed by a specially contracted investment intermediary. In this case the upper level of intermediary's commission has been set out at 5% of actual fund's assets in the balance sheet.

Outside Management

The law provides for privatisation funds to hire outside managers (investment companies) to deal with its portfolio. Those kind of institutions are also under jurisdiction of Law on securities. Moreover, their functioning as fund managers is regulated more strictly than that of the PFs. Apart of rules on capital structure an investment intermediary must hold special reserves aimed to cover more risks etc.

Engagement of an intermediary as a fund manager is guided by specific contract containing a number of economical indices which are to be met in a certain period as the scale of projected gains, management responsibilities etc. The main point is the condition, that the contract is subject of termination by the PF in any time (after a short notice) during the first five years after its establishment. The intermediary's commission is also contractual but the law does not permit it to go higher than 5 percents of the real assets value in the fund's balance sheet, incl. the costs for the management of the fund.

The general slow-down of the development of the investment framework had its negative impact on investment intermediaries as well. While, the institutions which carried on this business had been obliged to rearrange it according to the Law on Securities, they continued operating postponing the change of legal form. This way, the actual beginning of establishment of the investment intermediaries coincided or if said other way, was forced by the ban on trade in securities.

That is certainly one of the reasons that none of the funds did not announced a hired manager of its portfolio, but it does not seem explanatory of way many of funds declared, that they will never use this opportunity in its operation. A better reason seems the above analysed fact that dominant founders got almost complete control over the management and they do not need to secure additionally their position by hiring outside managers.

Moreover, under situation where the investment as a mass process practically has never existed before, the funds' are being legitimated namely as assets managers as well as a number of fund founders. This means, that they are seen as last instance of investment process and this way they could not pass their most important function to any other agent.

This situation barely represent the actual abilities of many of the funds and one may expect it to change rapidly in short time.

Control Over the Management

The control over the funds activities is organised in two forms - internal and external. The internal control is fund's own problem and it is provided by General Assembly, respectively Supervisory Board, who observe management obedience of the funds goals and strategy, and how much successive they are; do they provide for shareholders interests etc.

The external control is offered by the government through the Commission on Securities, which licenses the funds and watch their compliance of the Law of Privatisation Funds. The Commission members are neither allowed to sit on any managing or supervising board of privatisation fund or intermediary company, nor to hold stakes in them.

The Commission carry out its functions through six-monthly and annual reports prepared by funds and containing large scope of information about the deals and gains from securities, changes in managing bodies, legal or physical persons obtained more than 5 per cent from funds stock etc.

Those reports are open for the large public and funds are obliged to provide free entry to the information for any one interested in them. The most important index in those reports is that, showing the accounting value of funds shares.

The disciplining measures assigned to the Commission are penalties and property sanctions, as well as interventions for deposition of a member from governing body of the fund. The Commission has reserved for itself the right for suspending the trade in a certain securities, but it has no right to take -back the fund license.

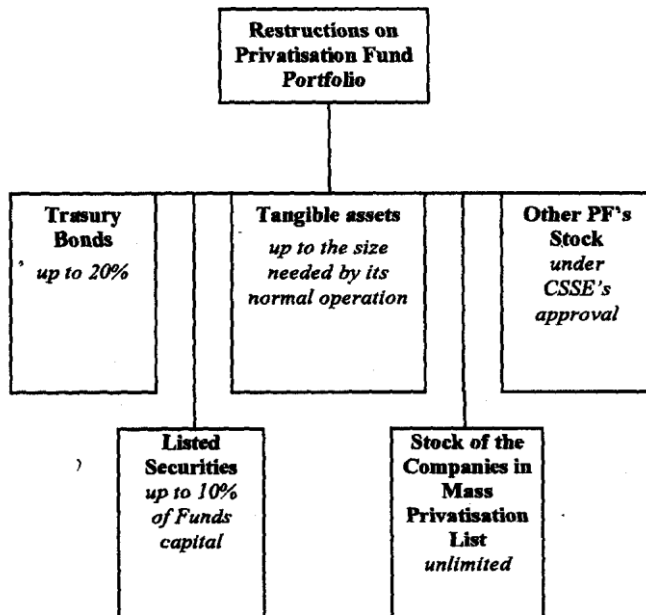
PFs' Portfolios

Regulation

Privatisation funds are special institutions with a range of particularities in their creation, objectives and functioning. This is recognised by the legislator and it resulted in a number of restrictions which were imposed on their activities during the period of their existence.

The specific legal regime of functioning of PFs has its most impact of construction and maintaining their portfolios.

Chart 1



First of all, the PFs are restricted on the types of assets they may invest in. Funds may invest in mass privatised companies' stock, treasury bonds, moveable assets and real estates, under certain restrictions. They are free to invest in privatised companies as much as they wish, provided an investment in securities of any single

issuer does not exceed 10% of fund's own capital. This is a general restriction and it applies to any possible issuer of securities, unless it is a company from privatisation list.

PF cannot invest more than 10 per cent of their capital in securities listed on Stock Exchange (issued by companies out of Mass Privatisation Scheme) and not more than 25 per cent of their capital in treasury bonds. Funds may acquire real estates only up to the size absolutely necessary for carrying out their activities.

From the other side, that of the capital of a targeted company, PF are also restricted. They cannot buy more than 34% of company's voting stock.

Apart of that a privatisation fund is prevented from investing in other privatisation fund's securities, unless there is a Commission on Securities' permission. Fund is banned to invest in securities of its depository, as well as in those issued by persons taking part in management or supervision of the fund.

The objectives on portfolio structures have been one of the main characteristics emphasised by PFs, (and used by the investors), to distinguish themselves during the campaign for acquirement of investment vouchers. This section presents some of the first results after the three auctions of the first mass privatisation wave. We analyse them in two aspects — the orientation of a particular fund toward a certain behavioural strategy and the extend of concentration of its investments. The first aspect concerns the strategic policy a fund is going to follow - to get stock in a certain company or companies, to maximise its earnings or other. The second aspect of PFs' objectives considers which industries are of interest for them.

Strategy Orientation

The basic question of a privatisation scheme in which some economic agents receive property for nothing concerns their post-privatisation behaviour; what are the stakes they acquire in the enterprises and what are their intentions as regards to those stakes. Are they going to exercise control over them, are they trying to use their stock in terms of normal investing process or they just want to 'squeeze' any feasible income from the companies abandoning the 'nutshell'.

Our preliminary observation on the PFs' prospectuses fra: rising of capital allows to identify a few different structures of the portfolios resulting from the process. These are - strategic portfolio, earnings maximising portfolio and portfolio "for sale".

Strategic Investments

Almost all of the funds acquired the maximal share allowed by the law (34% of a company's total stock) in a number of enterprises. Some of them declared that this type of investments will enable them to play active governance role in the privatised companies, and that seems the goal for the others too. The funds intend to restructure them and increase their long-term profitability. Selection criteria for an enterprise to be aimed as a goal for strategic investing are rather different. The funds point out the

economic position of enterprises as well as their importance in sector. The definition of the "strategic" interest, however, often entails some additional criteria, such as:

- availability of a potential buyer or strategic investor;
- relation to founders' business;
- formation of a closed production cycle;
- size of the enterprise;
- size of the share which is being offered in mass privatisation and combination with cash privatisation;
- region.

Apparently, the presence of "another" strategic investor and potential buyer hardly eases the governance task of the bidding fund, but it seems reasonable behaviour, if counted their almost full lack of experience with this kind of business. Acquiring relatively large stack in the enterprise which had been already sold by cash privatisation or which is targeted by other strong investor may be a good guarantee for a secure choice. Although the strategic investment reasoned this way should be judged very carefully from the governance point of view. This kind of behaviour suggests rather passive free riding, but it also may indicate the willingness to form a "governance coalition" at a later stage.

This funds' goal is considered as the main one and because of its importance our attempt to classify funds is based heavily on it. According to the law a fund is allowed to acquire in the bidding process up to 34% in any company's stock. If we consider such kind of investments as *strategic ones*, we may define a PF's portfolio according to the deal of it. If their share is above 60% of the total funds investments we consider this portfolio as a strategic one. This seems even more justified if one consider that the ban on the trade with privatised stock expired. So those 34% appear in many case just as a intermediary step in acquiring a majority packages by a PF. This is the reason also, every resulting stack above 25% to be included in the group of *strategic investments*.

Earnings Maximising Investment

This kind of aimed package is seen by funds as a main source for dividends in the medium-term, a kind of "cash cow" within the portfolio. Although, funds evaluate a certain stock highly, from their point of view they will not be able or they find it costly to acquire a large enough stack to engage in active shareholders' role. The reasons here may be either the relatively small available fund capital, or the small size of the privatised part from the targeted company.

Among the selection criteria for such packages are stability, and market potential of offered companies, their size as well as, in certain cases, their relation to the "strategic" group. The last one is just a different interpretation of the case above when there is another strategic investor.

According to the above criterion, a portfolio which contains a share of its strategic investments between 40 and 60% should be considered as *earnings oriented one*.

Investments “For-Sale”

This is the most incoherent group. Here may be included the shares acquired for diversification reasons, as well as the already “contracted” enterprises. Because of the specificity of transitional privatisations there are a lot of investors which prefer not to engage directly but rather to use an intermediary. Here also fall the so called underestimated stock, which may be acquired for bargain but must be sold as quickly as possible. Shares of that group are envisaged to be released within 12 months. As a selection criteria may be used also high liquidity of some stock. Finally, in this group are all the shares which the large and very large funds will buy simply because they must use all their investment potential within a determined privatisation wave but they will be not able to manage effectively.

We define those portfolios which contain a relatively small share (less than 40%) of strategic packages as a *trade oriented ones*.

Results

Table 2 represents the distribution of privatisation funds between the possible strategies grouped by size of their capital. The minimum size of PF’s capital is determined by law at the level of 70 mln BGL, and the maximum was reached by PF Doverie Ltd. - above 6 bln BGL.

Table 2

PFs’ Portfolios (in aspect of strategy)

Size-of-Capital Groups	Number of Funds	Number of Shares	Number of Funds	Number of Shares	Number of Funds	Number of Shares
Extra Large (over 2.0 bln BGL)	1	4 221 146	5	17 278 381	5	14 921 949
Large (0.5-2.0 bln)	4	3 466 817	4	4 345 304	7	5 004 664
Medium (0.2- 0.5bln BGL)	6	1 728 087	7	1 673 856	8	3 199 805
Small (0.07- 0.2bln BGL)	10	1 193 487	13	1 943 707	11	1 092 997
Total	21	10 609 537	29	25 241 248	31	24 219 415

Source: Own Calculations based on Centre for Mass Privatisation October 1997 Data.

There are several important fact about the resulted PFs' portfolio.

1. First of all the there is considerably less funds with the preferences on larger participation in a company's stock. Even when one consider that almost all of the funds will enlarge later their stakes it should be kept in mind that PFs have a very low starting base. More than 40% of them have less than 40% of their portfolios placed in bigger than 25% of a company's stock.
2. It seems slightly surprising that the biggest number of funds whit strategic portfolios belong to the smallest group, those with registered capital less than 200 billions BGL, (slightly over 100 000 USD). In fact this is due not only to their bigger absolute number. Those funds are 42% of all funds, and the absolute number of their shares have in the strategic group -1.2 mln, is 4 times less than the shares owned by the extra large funds placed in strategic portfolios.

Although, there is another more substantial reason for their behaviour — while they own a limited number of assets which will hardly allow them to have sufficient portfolio diversification for active and profitable trade in securities, they own a good enough set of participations (on average 15) to ensure them an active governing strategy.

At the same time the two smallest groups of funds are relatively equally distributed among the different strategies which may refer to the other inexplicit goals or may be not enough clear perception for their future development. It seems strange for a fund with 600 000 USD capital to have stakes in more than 60 enterprises only 5 of which are above 1%.

3. The more surprising is another fact - relatively few PFs inside the groups of large and extra large funds have chosen overwhelming predominance of strategic packages in their portfolio. Partially that may be assigned to their origin - as shown on *Table 5* most of them were created by persons and institutions which were able to manage and attractive for investors because of their specific positions in the economy. Such were some state banks and financial institutions which avoided the banking crisis relatively safe, and some managers of the big privatised state enterprises who inspired thrust and respect in their employees etc.

The same idea of predominance of 'trading' strategy may be observed in the second largest group - that of the funds over 500 mln BGL (more than 280 000 USD). Those portfolios are almost twice more than strategic portfolios. In the last two groups the distribution of the funds between the three options is much more equal.

A good explanation of those facts might be that, an optimal size for constructing a 'manageable' portfolio is somewhere about the size of our medium size funds - 100 - 280 thousand dollars, of course given the current supply of the assets and the condition of the stock market.

It is good idea to compare the current results as regards to the strategy with the intentions which we observed in the prospectuses. The strategic oriented portfolios were declared twice more than the others. True more than half of all funds did not expressed

any clear strategy in the beginning of the process. Apparently, the outstanding advantages offered to them initiated an Olympic feelings in many of PF founders, making them to involve in the process without clear plans for its development.

Concentration of the Investments

We analyse PFs' portfolio concentration by two criteria. First, it is possible to distinguish several types of PFs' portfolio depending how they allocate their capital among the economic sectors and second, it might be estimated by the size of a single stake.

Branch Concentration

The criteria for the definition of these types are amount of capital invested in a sector and total number of industries to invest in.

highly concentrated portfolios - more than 60% of fund's capital is concentrated in one industry or 40-60% of the capital is concentrated in one industry, but the total number of industries to invest in is not more than five;

concentrated portfolios - where, outside the above cases, 40-60% of the capital is concentrated in one industry, but 60-80% of the capital is invested in not more than five industries;

balanced - where only up to 40% investments in a sector, but the sectors planned to invest in are between 5 and 10;

diversified - where there are investments of 20-40% in a sector but the number of industries to invest in is more than 10;

highly diversified portfolios - where there is no sector with investment of more than 20%.

We distributed the fund according to their industry concentration at the preliminary stage trying to add an additional criterion for outlining a possible fund behaviour.

Here we want to add one more dimension for studying of portfolio concentration pointing out the different size of a PF's single stake in a company.

Portfolio Concentration Measured by the Average Size of a Single Comnanv's Stake

In order to classify PF, we distinguish several ranges of size of that characteristic. They do not have an absolute value and play role just for comparing the different fund groups.

That distribution of funds is heavily dependant on the available capital of the fund and on the average price a particular fund paid for its own set of shares. Though the lower price the bigger available capital, and the more the shares in a single company, that relation should not be overestimated. Those funds which want to keep their portfolio diversified still may do so. And vice versa even small funds which want to concentrate their portfolio in less participations could always do it raising this way the size of a single stake.

Results

The Table 3 criteria represents an *a priori* situation when the PFs announced their striven objectives on investment by industries.

Table 3

PFs' Portfolio Concentration (by Branch Diversification)

Type of Portfolio:	Highly Diversified	Diversified	Balanced	Concentrated	Highly Concentrated
Number of Funds: Of which:	14	15	24'	11	17
Extra Large (over 2.0 bln BGL)	3	3	1	1	3
Large (0.5-2.0 bln BGL)	2	2	6	2	3
Medium (0.2-0.5bln BGL)	4	4	6	2	4
Small (0.07-0.2bln BGL)	5	6	11	6	7

Source: Capital Rise Prospectus of Privatisation Funds

Among the five branch strategies identified above, the balanced portfolios seems to be most attractive for the funds. Nearly as many funds have adopted this strategy as funds that have adopted highly concentrated/concentrated or highly diversified/diversified ones. On the whole, more funds have opted for less concentration, thus, less risk, investing in industries with different risk specificity rather than for the management of the portfolios on the basis of active involvement in a limited number of sectors. Thus, more funds have decided to invest up to 40%, or less, in a limited number of industries spreading the other part of their capital in traditionally profitable or interrelated industries in order to additionally lower the risk.

All branch strategies seem to be attractive for funds of all size-groups in an almost equal distribution with strong preference to the balanced portfolio, i.e. portfolio which include up to 40% of a funds' capital in a single branch, but the total number of branches do not exceed 10. A striking exception, however, is the relatively unsuitability of the concentrated and balanced portfolios for extra large funds. This distribution seems random proving once again the unclear strategy for the actual objectives of the funds.

The a posteriori results shown in the next Table 4 Table 4 are much more definite. The bigger funds keep much bigger stakes than the average, which is 19 406 shares per stake. Moreover the extra large do not have stakes less than 20 000 shares per share, and the large ones - less than 10 000.

Table 4

Portfolio Concentration measured by the Size of a Single Package

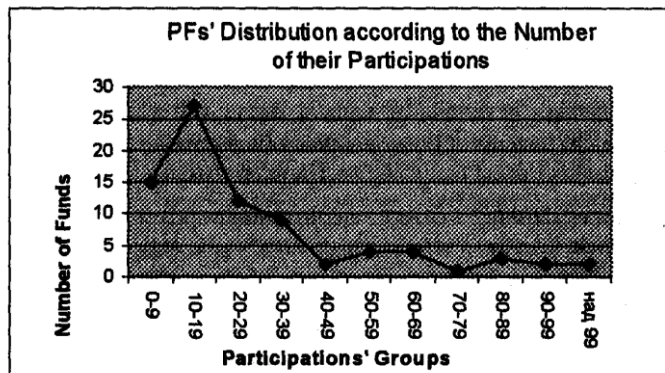
Size of the Package:	up to 10000 shares	10 000- 20 000	20 000- 30 000	30 000- 40 000	over 40 000 shares
Number of funds: Of which:	18	37	11	9	6
Extra Large (over 2.0 bln BGL)	0	0	2	5	5
Large (0.5-2.0 bln)	0	8	5	2	0
Medium (0.2-0.5 bln BGL)	3	13	3	2	0
Small (0.07-0.2 bln BGL)	15	16	1	0	1

Source: Own Calculations based on Centre for Mass Privatisation October 1997 Data.

Just the opposite, the smallest funds are almost completely gathered together in two lower size groups. The only exception with a brilliant high concentration is a fund which was specially created by an enterprise management to privatise its own company and they succeeded completely in that.

If one consider that at the same time the average number of participations rises steadily from 20 for the group of smallest funds to the 82 for the extra large, (Chart 2) we can make the straightforward close - on the average the PFs did follow the natural policy when built their portfolio determined by their size.

Chart 2



Unfortunately, that conclusion does not allow us to make a more concrete statement on their possible behaviour since this normal distribution does not mean that the small funds are less concentrated than the big ones. This situation is confirmed further by the average price of one share acquired by any group. Roughly, it favours more the bigger funds than the smaller — 1002 BGL for the extra large 1426 for the large, 1159 for the medium ones and 1370 BGL for the smallest. This way the price of the shares additionally enlarged the concentration of the single stake of the bigger funds without relation to their intended behaviour.

Mergers, Acquisitions and Cross-Ownership among the PFs

As long as the process of bidding for enterprise stock is still in progress the only possible source of information of this aspect of PFs behaviour is an indirect one. According to LPF, privatisation funds may invest in each other assets only upon the CSSE approval. Apparently, the competing character of the process of acquiring capital will make their portfolios random to the large extend. From the other hand, the large variety between the size of the funds - about 100 times between biggest and smallest, will impose also certain requirements on their portfolios.

Both those features will put pressure on PF to restructure in order to fulfil their investment objectives. With limited opportunities for investment out of the scheme the funds will attempt to restructure among each other. A possible direction of this kind of restructuring has been already announced. Some of the big funds assured, that they consider split of the three strategic groups of investments in three different funds.

They are two main regulators of the process in Bulgarian Mass Scheme. First of all, Bulgarian state-owned financial institutions are not included in the list of privatised companies by now. They have the opportunity to establish privatisation funds, but not to be privatised itself by this programme. Secondly, they are not allowed to invest in companies out of the privatisation list more than 10%. This way the Bulgarian Scheme does not encourage establishment of cross-ownership between the funds and their founders.

It seems possible, the institute of financial intermediaries managing the funds to play a certain role in this process, but they still do not develop considerably.

The only way for establishing a cross connections seems to be establishing more than one fund by a single investor, a process which already took some place. By incomplete data there are 1 case of a single founder of four funds, 3 cases of three funds with a single common participant and about 10 cases of two funds with a common founder. The problem is very interested and important but it is too complicated because the contacts between the different founders are not always apparent and need a special investigation by special methodology.

Privatisation Funds' Shareholders

Logically, this scheme of the Bulgarian mass privatisation outlined two different groups of shareholders. First one is the group of shareholders-founders of the fund. This group play the leading role in setting up the funds. It determine the goals of the funds, their desired portfolio structure, the dividend policy and most important, they are expected to make the strategic choice about the involvement of PFs in corporate governance.

The second group is that of the millions of voucher holders who, granting their thrust to the founders constitute the funds scale and ability to strive their goals. Just for example, more than half of the launched funds decreased their initially announced capital, some of them did it several times, changing each time their projected portfolio and its expected performance.

The different positions of the groups within the funds motivate us to investigate them separately emphasising the opportunities for conflicts of the interests.

Shareholders-Founders of the Funds

Types of the Founders

Among the great variety of privatisation funds emerged under the Bulgarian mass privatisation scheme, there are five groups of founders which can be distinguished:

Type I: State controlled financial institutions - banks and insurance companies

The PFs falling within this group are organised around a majority state owned financial institution- bank or insurance company. Such institution holds the majority of the founders' stock in the portfolio of the PF.

It is important to form this group because it allows to distinguish the PFs originating on the basis of national financial institutions, aggregating capital in the form of savings. Such PFs are likely to be the biggest funds reflecting the credibility in the state financial system in a time of unstable private banking. The funds in such a group are also likely to show a specific investment and governance behaviour. The latter could reflect the closer link of the dominant founders to the state, which can be an impediment for active, decisive restructuring of the acquired enterprises, or an advantage because of possibilities for co-operation with relevant regulatory bodies. On the whole, it is difficult to speculate on the likely strategy of such PFs.

Type II: Legal entities controlled by managers of companies under privatisation or public officials

This is the second most spread type of found founders revealing the state of the art in Bulgaria current economy. The most active economic group dominating in many industry branches the enterprising initiative. If one add here the PF formed by former managers the group will certainly take the largest place among the funds. It is distinct with the strong personal, but not formal relations between its members, which will play more important role for the intrafund governance power then formal holdings, at least during the first stages. As a strategy, the group does not show clear preferences and its behaviour is difficult to predict.

Type III: Private industry-based companies

The largest group as a number of companies within it, but not as a capital raised in the group. To some extent covers the above mentioned group of former state managers and government officials, who started already successful business. Their private companies operating in a specific branch are in many case the core around which will be formed or attempted to form the PF's portfolio.

Type IV: Private finance-based companies

This is the type of founders which has the clearest ideas about the investment business. In many cases they have well established financial business and the PF may play the role of structuring unit allowing them to diversify their investments in the real sector of the economy.

Type V: Private financial-economic groups with more or less complex activities

That type of founders have already economical structures including various activities in several sectors of the economy. They have a strong incentive to form holdings enhancing their positions in more sectors.

Type VI: Physical persons and small firms

A type of founders entering the recently business. It is probable that they may be representing larger investors staying aside at the first steps of privatisation. The prevailing type of founders of PFs is clearly the private industry-based ones (type III) - 23 funds, followed by those controlled managers and public officials (tjpe II) -19 funds. In terms of the capital of the PFs, as well, the managers/public officials and the private industry-based companies control 53% of the total capital of all funds (See Table 5). The number of funds with private complex founders (type V) and state-owned financial founders (type I) *is the* least. The latter become much more important as a group when looking at the capital they control (20% of the total capital of all funds). Then, the smallest group of founders proves to be that of the physical persons and small private entities, which stands for only 4% of the total capital.

In addition to the numerical analysis of the importance of the various groups of founders as identified further above, it is possible to see that, firstly, the industry-based founders, regardless of the type of ownership or their size, have taken a bigger part in the MP programme than the finance-based founders. Secondly, nearly half of the capital (although less of the number) of the PFs will be controlled by founders related in some way or another to the state-owned economy (see the chart below).

Table 5

Source: Own **Distribution of PFs Capital by Type of Founder** calculations based on PFs' prospectus

Size of Capital Grouping	State-owned Financial Founders		Management/ Officials' Controlled Founders		Private Industry- based Founders		Private Finance based Founders		Private Complex Founders		Physical Persons/ Small Private Founders	
	Number	Capital	Number	Capital	Number	Capital	Number	Capital	Number	Capital	Number	Capital
Extra Large (over 2.0 bln BGL)	2	10,444.100	4	13,018.800	2	4,895.220	1	2,108.060	2	4,868.590	0	0
Large (0.5-2.0 bln BGL)	2	1,266.370	3	3,005.690	4	4,915.180	2	1,798.670	4	3,727.860	0	0
Medium (0.2-0.5 bln BGL)	0	0	7	2,260.430	7	2,402.720	3	1,052.930	1	214.08	3	870.538
Small (0.07-0.2 bln BGL)	3	402.908	5	632.483	10	1,135.121	4	515.325	0	0	n	1,655.712
Total	7	12,113.378	19	18,937.403	23	13,348.241	10	5,474.985	7	8,810.530	15	2,526.25

The state-owned financial institutions have created funds of extra large, large and small sizes. They have visibly concentrated their investments in extra large funds. The participation in the small funds is of a very little importance, it represents cm of the smallest figures in the whole table. This observation, on the one hand, points at the ability of these institutions to achieve such levels of concentration of capital, and on the other hand, at the fact that such institutional forms will suit best their intentions.

The managers and the public officials have established funds of all sizes, but there are more smaller than larger funds. Nevertheless, their investment in extra large funds is most substantial. Like the previous group, the contrast between investment in extra large PFs and in the other funds is really sharp. The private industry-based founders have evaluated medium- and small-size funds as most appropriate for their strategy. Again although not with such a definite distinction, they have aggregated their capital in a limited number of large and extra large funds.

The private finance - based founders follow the above trend in terms of numbers of as well as capital of funds. There is, however, a more equal distribution across size groups.

The private complex founders clearly concentrate on the large and extra large funds. There is no participation in funds with a small amount of capital and the figure of the medium funds is the lowest in the whole table. Obviously, such funds can not serve the objectives stemming from a complex and already developed economic structure.

The physical persons and small firms, as expected, have not been able to mobilise big amounts of capital to form large and extra large funds. In the largest number of cases they will follow their strategies through small PFs.

In all sizes of funds there are dominating types. The extra large funds are characterised by state-owned financial founders, able to mobilise large masses of savings, and management and officials' controlled founders, enjoying the advantage of insider information and the support of organised voucher holders. The large funds will be controlled in their majority by private complex and private industry based founders; the medium - by private industry based and managers again; the small - by physical persons and small firms.

It is also possible to see that, unlike the larger PFs, the founders of small and medium funds hold more than 5% of the total funds' capital, in some cases up to 35% of it.

Restrictions on Founders' Rights in the Funds' Management;

The initial analysis of PFs' functioning outlined above shows clearly the strong position of the fund founders. Most of the funds are established by coalitions of entities more or less well-established in various kinds of businesses. Those coalitions are largely presented in the management bodies of the funds and they are in the position to dominate all the functioning of the PF. Presumably, envisaging this situation, the legislator imposed certain restrictions on the founders and managers of the funds.

An exclusive prohibition prevents the fund-founders from preserving any special advantages for themselves against the other shareholders and from issuing privileged shares or bonds. It provides the opportunity of determination each

shareholder's influence in the fund management depending on the amount of his/her investment. The latter may be done in investment bonds (vouchers) and cash. Though, cash investments may not be obligatory. The practice by now shows that the only cash or treasury bonds investments have been donated again by the founders. While this was the obvious case for establishing the fund, they have been few more cases when some cash was donated in the last moment to match the requirements for minimal fund capital. Actually, the latter are the cases when the founder shareholder have more or less significant share in the fund capital. In the others this share is about one percent.

Another set of regulations is imposed on the way PFs' are managed. During all the period of their operation, PFs are banned from any commercial activities, differing from securities trade. The LPF explicitly prevents PFs from participation in commercial and civil unlimited partnerships, issuing debt, securing or providing loans.

The funds may undertake loans for its own business in very few cases and under strict rules; if the loan is not higher than 10% of its net assets value; if not longer than three months or if for tangible assets necessary for its operation. PFs cannot pay dividends in advance or deal in securities which are not their property.

Another aspect of regulation concerns prohibition for taking legal obligations of managing other privatisation funds or acting as citizens' representatives in investment . Any decision on reorganisation and liquidation of a privatisation fund should be taken under Commission on Securities and Stock Exchange approval.

The Type of PFs ' Founders and Their Strategy

The analysis of the strategies of the different categories of funds if combined with an analysis of the types of their founders will give an important information for their explicit goals. The Table 6 presents the results of such a grouping based on the announced strategy.

Not surprisingly the funds founded by state financial institutions did not have a clear orientation on their strategic goals. One may guess that they had been created to balance the situation, if the private funds are not very active or if their activities begin to threaten the success of the scheme. Although, the coincidence of the banking crisis, which affected strongly the private ones gave to those funds a great chance to acquire a lot of vouchers. The so-called trade orientation had been regarded by the most of the funds as save strategy, which provides them with better liquidity at the first stages of their operation and allows them to get rid of the most unwanted enterprises, mainly acquired for their low price. Such a goal does not seem very productive for the group of funds, which holds over 12 billions BGL investment capital (about 20% of all investment vouchers), and which has more than 50% of its funds determined as large and extra large.

Table 6

PFs grouped by the Type of Founder and the Orientation of the Portfolio

Strategy Type of Founders	Funds with Strategically oriented Potfolios		Funds with Earnings oriented Potfolios		Funds with Trade oriented Potfolios		Funds with - Unexpressed Potfolios	
	Number	Capital	Number	Capital	Number	Capital	Number	Capital
State-owned Financial Founders	0	0	0	0	2	7018.28	5	5003.9
Management/ Officials' Controlled Founders	8	8440.78	1	890.294	0	0	10	9606.286
Private Industry based Founders	6	4852.71	2	499.986	1	289.866	13	7568.738
Private Finance- based- Founders	1	242.648	2	1066.35	3	2840.38	6	1325.6
Private Complex Founders	4	4883.73	1	664.193	1	1049.01	1	2213.605

Mln BGL

Source: Own calculations based on PFs' prospectuses

More intriguing were strategic goals expressed by the PF founded by institutions under the control of state managers and government officials. They clearly emphasised an orientation toward portfolio with more than sixty percents of their vouchers invested as a block shareholdings. That seemed justifiable since those founders had good positions in specific industry branches and they tried to ensure that their funds will form holding companies. Those intentions were quit feasible keeping in mind the opportunities offered by the scheme. A look on the Table 7 proves that they were available a lot of enterprises which allow assembling of large stacks. (The column controllability shows not only the share of the branch for mass privatisation but also the share, which has been already sold by other techniques.)

Privatised Enterprises Indices*Table 7*

Industry Branches	Controllability	Weighted Profitability
Energy	78.50	-1.40
Ferrous Metallurgy	64.00	-2.11
Non-ferrous Metallurgy	55.75	15.40
Machinery	70.13	-3.43
Electronics	67.13	-3.73
Chemistry	51.39	-0.33
Wood	76.07	-0.02
Paper	66.45	3.84
Glass/China	60.09	6.25
Light industry	72.12	-0.32
Science	65.26	-0.57
Construction	67.45	-1.22
Food	58.71	-16.66
Agriculture	53.67	-fl.59
Transport	58.40	1.22
Commerce	34.95	10.70
Tourism	41.92	10.70
Other Industries	81.00	-0.21

Source: Own calculations based on Club Economica 2000 survey.

Similar was the picture for those private founders based on a specific industry branch. They also tried to create industry groups, but differently from the managers' group they were more restricted because of the smaller average size of their funds. The latter fact may be explained with the advantages, which have the management of state enterprises to attract the people employed in their enterprises, promising to keep their jobs or to secure other privileges.

Different were strategic goals of the private founders basing their business on financial structures. They relied more on investments for maximisation of the earnings, which resembles much more the normal strategy of an investment institution. They also intended to keep a sufficiently large part of their portfolios for sale to overcome the overall bad performance of many enterprises. In general, their strategies were clarified in higher proportion than those of the other groups of founders.

Logically, the group of complex private founders presented a strong interest in pursuing the strategy associated with large stacks in targeted companies and probably with more serious engagement in the restructuring of the enterprises. By its characteristic, the founders of that group match the perception for diversified well structured business in several branches of economy and they may be expected to try to firm further these characteristics in mass privatisation.

Table 8 shows some important features of privatised enterprises grouped by industry branches. The controllability of the branch (or enterprise) shows the formal opportunity for a fund to obtain the wanted size of its participation in an enterprise. It is based on the information for all the shares which are released already (or offered for release) from the domain of the state. The industry indices aggregate the companies' ones weighted by the number of companies with the same share.

Table 8

Bulgarian Stock Markets 93-95

	1993	1994	1995
Number of traded securities	105 640	1 267 781	1 187 447
Turnover (mln BGL)	25.506	525.766	413.590
GDP (mln BGL)	298 934	555 474	852 000
Liquidity of the market (turnover/GDP, %)	0,009	0,097	0,049

Source: Reuters Bulgaria.

The probability is a standard index showing the profit earned on 100 BGL of a companies' capital in a pre-privatisation period. The industry indices are weighted by the capital of the enterprises in the branch.

Nearly two thirds of all sectors had a negative profitability. Among this group a clear negative extreme was the food processing. It was due mostly to state of meat, sugar, grains-processing industries and the production of tinned food. Somewhat in the middle stand the production of construction materials, the machine-building, the electronic, the energy-processing industries and the non-ferrous metallurgy.

The most attractive part in the group in terms of profitability represented the agriculture, the science, and the chemical, light, and wood-processing industries. The group of the sectors with a positive profitability was smaller, but also represented relatively wide disparities. Most of the service-oriented sectors - transport and tourism, were at the bottom of the list, offering some opportunities for earnings-oriented investment. The paper/pulp and the glass-making industries were suitable as well. The most profitable sectors were the trade and, especially non-ferrous metallurgy.

The analysis of the controllability of industrial sectors shows a largely varying range of values among the industries. In most of the sectors the state divested between 60 and 80% of its control. Less were the values in trade and tourism, and larger in the production of construction materials. In between were chemical industry, agriculture, non-ferrous metallurgy, transport and the food and beverage-making industry.

The state did not divest much of its control in trade and tourism, which are still highly profitable sectors. There is no apparent link between the profitability and the divestment of control with regard to the other sectors. Thus, other factors than profitability substantially defined the strategy of the state.

Apparently, the funds which stated in their prospectuses orientation toward strategic packages of shareholders were in good position to complete it. There were a lot of industries offering the opportunities for one or two funds to receive the packages of average size 34% in a particular industry, allowing them to engage seriously in restructuring of the company. Of course, these are aggregated indices and the situation is different for any particular company from the branch.

More serious seemed the situation with the earnings-maximising orientation. Very few companies offered good opportunities for secure profit earnings. If considered the precondition for such a policy - developed markets, i.e. companies large enough to be quoted on the Stock Exchange - the picture faded out much more.

The apparent conclusion, that even more of the funds which declared a strategic orientation of their portfolios will decline from the announced strategy and will undertake other behaviour more suitable to the real economic situation has been proven completely by the first results of the process. (See Table 2)

Voucher-Contributing ' Shareholders

The strong position of the founders is opposed by the great number of ordinary shareholders. In some cases it counts hundreds of thousands. Thus, by its economic characteristic the PFs are public companies and their attractiveness to regular shareholders may be based and should be based mainly on the income generated as a dividends and capital gains, which they are able to provide.

From the other hand, it was shown that a large number of them insist on strategies and objectives which hardly may be estimated as capable to match those requirements. Their interests in creating a holding companies with preferences in long term development, combined with the poor performance of the offered state enterprises rise the question of protection of the interests of their investors. If the sociological polls for the expectations of the small investors may be considered a justified tool for determining their incentives, the later should be considered as clearly oriented, against any kind of income. This is not surprising having in mind the deep shortfall of the living standard, which occurred in last years.

Unfortunately, the measures for protection of the interests of small shareholders are very limited by now. They include mostly general protection from fraud and manipulation during the process of converting the vouchers, but not envisage any special rules securing investor's specific economic interests as when their money are invested in and how they will be managed.

Of course, there is an obligation for the PFs to follow the strategy they showed in their prospectus, but the PF are not in the position to buy stock from the markets. They participate in a bidding process and not all of them will be able to acquire what they promised to their shareholders. What are the rights of the investors in this case is not clear. The Commission on Securities Trade may impose penalties in cases of mismatch between the projected and actual portfolio, but will that be justified? And what will investors benefit from that?

In that order is the problem for the voting rights of the small investors. In normal case they delegate their rights to an institutional investor, which manage them in favour of the people who trusted them.

Some steps in this direction were done in the process of acquirement of the investment bonds. In many cases people transferred their rights for the establishing general assemblies to the founders of the funds. Some steps were also done by the legislators to ensure a diminishing quorum of those assemblies. But this may not be the general case and hardly the founders of the funds are the right subjects to be transferred the voting rights to.

Another solution may be to entrust the voting rights to the depository banks. They are banned from any kind of business interests in the funds and may suit this function well. Although this seems difficult not only because of the general problem of expected low profitability of that stock but also from the decision to centralise all the stock in a Central Depository Institution, which will not be able to play this role.

Apparently, the problem with the rights and interests of small shareholders is not well resolved and the near future of the process will show interesting and important developments.

Development of Bulgarian Stock Markets

During the 92-95 period the trade in corporate stock had been performed on several stock markets in Bulgaria registered and functioning upon the Commercial Code. They do not have a proper legislative basis and the trade is regulated mostly by internal regulations. As a result of the lack of regulation about 20 markets had been created.

The biggest market - First Bulgarian Stock Exchange makes a lot of effort to comply with the European regulations in securities trade and became the member of Association Internationale des Bourses des Valeurs.

The volume of the trade shows a tendency of increase, but it never got any significant liquidity. If one consider the actual inflation rate, the trend will be rather negative. This is caused by the low dividends (or lack of dividends) paid on stock, *de jure* bankrupt of some companies traded and overall collapse in the economy.

Table 9

Strategies of Financial Institutions Founded PFs (capital mln BGL)

Financial Founders	Funds with Strategically oriented Portfolios	Funds with Earnings oriented Portfolios	Funds with Trade oriented Portfolios	Funds with Unexpressed Portfolios
State-owned	0	0	7018.28	5003.9
Private	242.648	1066.35	2840.38	1325.6
Total	242.648	1066.35	9858.66	6329.5

Source: Own calculations on the basis of PFs' prospectuses for capital rise.

In 1995 a Law on Securities Trade, Stock Markets and Investment companies has been adopted. Upon jurisdiction of this law started its functioning the Commission on Securities and Stock Exchange (CSSE) as a governmental body for regulation and control over the securities issues and deals.

According to the law, a stock market may be created with the capital not less than 100 mln BGL, which initiated a merger between the existing markets. The process has not yet finished. The state reserves a 25% share in the stock of First Bulgarian Stock Exchange. Another two thirds are reserved for financial institutions as banks, financial intermediaries etc., but the bankrupt wave endangers fulfilment of that ratio.

The functioning of the stock market will be helped by the Central Depository, which constitution resembles those of the Stock Exchange. By definition it will organise settlement and clearing of the trade and its capital must be above 30 mln BGL.

Last year twelve joint stock companies have registered some of their securities issues and another eight companies had been traded as unregistered stock. In the first group are companies with major private participation and among those of the second are many state controlled companies. This fact may be realised, if one consider that a lot of stock from state financial institutions had been allocated between different economic agents in 1987 as an attempt for a reform of financial system. A certain share of the trade is represented by different kinds of state bonds, which actually are the only stock traded last weeks, when the CSSE banned the trade in securities of those issuers and intermediaries which are not registered according to the new law. And since none of the institutions did not registered, practically all the trade went to the over the counter market. As a general reasons for such a weak trade are shown the high inflation rate, high interest rate and the government practice of financing the state budget mostly by treasury bonds.

According to expert opinions, the trade over-the-counter encompasses over 90% of whole market volume. The stock rates there are considerably lower, which proves that the trade on the Stock Exchange has mainly prestigious character. That trade is not considered as transparent and it is suspected to include a deal of manipulative contracts. The over the counter market is supposed to be computerised through the Automatic quoting system but the process is still in the beginning. Currently, about 20 Financial- Brokerage Houses operate on that market offering the stock of 40 companies.³

Influence of Mass Privatisation on the Trade

The overall development of the process of mass privatisation is expected to change radically existing markets.⁴ The potential stock of privatised companies is about 85 bln BGL and a part of it will be appreciated several times. Of course, some part will never go to the organised markets. The current opportunity for PF to split, merger and reorganise itself may be expected to have some slow down on the market trade because certainly they will find much more convenient to deal with considerable blocks of shares on the principles of negotiations.⁵

Another negative effect may be expected from the dividend policy - almost all of the funds envisage to start paying not sooner than in two years. This seems to be the crucial point of their functioning since, a great deal of their investors do not see their investments as a long term business. The social polls show more than 70% expecting to have some income in short time. The absence of dividends will diminish the interest of a lot of the investors in stock markets.

As a possible solution may be seen the projects for development of the parallel stock market based on the system for acquirement of vouchers and ordering the shares. This system is spread over the country and if its maintaining could be kept relatively cheap it may offer a good opportunity for all those thousands of shareholders who will try to exchange

their stock for some cash. Although that market also will depend on the development of the Stock Exchange as a major spot determining the price levels of the stock.

The PFs have seen the 6-month ban to trade with the companies' stock and funds own assets as a major impediment for development of the trade; their Association of Privatisation Funds put a lot of efforts to overcome this rule and eventually they succeeded; the last amendments of the Privatisation Law allowed an early trade of the privatised securities. To a certain extent this pushed the process, but the trade encountered soon a new set of barriers laid in the PFs' statutes.

Role of Financial Institutions

Financial institutions play an important role under Bulgarian Mass Privatisation Scheme. Being allowed by the Law on Privatisation Funds to take part in the process, the Bulgarian state-owned financial institutions developed a large programme of setting privatisation funds and acquired about 20% of the total available voucher capital. This is about 2.5 times more than capital attracted by the private founders based on financial institutions and will certainly impose a specific impact of the governance structures created by the scheme. The possible explanation of that phenomena should not be assigned only to their larger opportunities in terms of both advertising and larger capital basis, but certainly to the bigger credit of thrust they acquired in the financial crisis. In most cases those institutions are represented by the biggest and well- established institutions as State Insurance Institute, United Bulgarian Bank etc.

It is doubtful, was that situation envisaged in advance, since their future privatisation may rise a lot of problems, about the strategy they will follow, the scope and structure of the portfolio they will try to achieve? It is not even clear are they going to try forming of holding chains of enterprises or to devote their policy of pure portfolio management?

A lode on the Table 10 shows that as an overwhelming policy they did not expressed their intentions. To the limited extent they did it, they inclined toward a trade policy which hardly may be seen as a valid strategy for such a funds.

Table 10

Share Remaining at Government Disposal

Size-of-the Stakes Offered for Privatisation	Companies in the Group	Capital in the Group*	Capital Offered for Privatisation*	Capital Remaining in the Group*	Average remaining Share
13%-49%	178	109	29	80	73.4(%)
50%-67%	453	76	50	26	34.2(%)
70%-90%	419	17	13	4	23.5(%)

* bln BGL

Source: Centre for Mass Privatisation

Though with clearer position, the funds founded by private financial founders also have a great deal of ambiguity, half of them have left the question about their objectives to the future.

A good perceptions of the picture, one may have, if compare the above figures to the whole capital controlled by funds with a particular strategic orientation.

Although the financially based founders are in command of about 30% of all the funds capital, they control only 1.39% of the capital with strategic orientation and 6.09% of that with an orientation toward stable earnings. If those figures are proven after the first wave of privatisation, this will mean that financial institutions, as a general rule, avoid involvement in corporate governance. By now, such a conclusion seems too preliminary, and very probable is the answer that funds, especially those founded by the state entities have not yet realised in full the situation they fell in.

When estimating the importance of the financial institutions, one must consider the fact, that the figures above represent only this cases, when they have dominating position among the other founders. It does not mean majority of a single institution in the fund, but rather a joint majority of two or more institutions of a common type.

There are though, cases when participation of such an institution has not predominant importance and which have not been considered, but in those cases financial institutions will have also role to perform.

The passive at first glance position of financial institutions does not seem much justified considered in regard with another problem from the Bulgarian economic picture - the huge burden of non-performing debts, which they hold in privatised enterprises. It is the fact, that requires one to expect adverse behaviour from the funds at a later stage.

Another form of participation of financial institutions in the scheme is to be appointed as depositories of the funds. This form involved much more banks, but after creating the Central Depository responsible for registering and clearing of the transactions of the funds, it may be expected, that they will not be able to participate actively.

The structure of the financial institutions involved encompasses banks, insurance companies and financial brokerage houses. The latter is better represented among the private founders of the funds. There are also some foreign financial investors and banks, some of which participate in very large funds. This is the case of the Dutch ING - Bank, which established one of the biggest funds jointly with a big state-owned bank. While the type of the founder may be expected to matter in the future strategy of the PF, it is not possible to find clear differences in the policy they follow by now.

Government Implications on Corporate Governance Structures

Opportunities for Governmental Legal Influence on Corporate Governance

State control over the enterprises from the scheme is being performed in accordance with general rules for governing of state property. By Privatisation Law the Council of the Ministries passed the rights over the stocks and shares of the state companies and not incorporated enterprises over the branch ministries and comities. They include appointing of the half members of the managing and controlling bodies' plus one; decisions on the increase of the capital managing the assets; participation in other companies, decisions on changes in the company statutes, privatisation decisions etc. All the important decisions about the management of the company are subject on the approval of the particular ministry.

The governmental Agency for Privatisation has not been granted ownership rights over the privatised companies neither within the cash privatisation framework nor in mass privatisation. The Council of Ministries selects which enterprises to go private and what share to be placed, considering a lot of reasons as strategic position of the enterprise in the national economy, better opportunities for cash privatisation etc., which have not been discussed publicly. Actually, the construction of privatisation list was the crucial point over a long period characterised with inclusions, exclusions, rising or decreasing the privatised share of the companies and made very difficult the estimation of what is privatised right to the last moment.

Another way for involvement in the process has been found in the opportunity the governing ministries to set mixed companies or to enlarge the capital of the companies in the list by the attraction of private investors. In fact, this leads to diminishing of the state influence in the particular companies as a general process, but by last moment enforcement of its rights, once again not publicly, the government obstructed the investment strategy of those private investors, who relay on mass scheme. Since there are evidences, that this changes of the government shares are frequently major - over the 50% going to out-of-scheme investors, this may be seen as a privatisation, before the mass privatisation.

The large set of rights secured for the state or its bodies some times took very peculiar forms. There was evidence, that a lot of the companies had changed in their statutes the level of legal majority required by the Commercial Code for taking crucial decisions. This way for a great number of companies a majority of 75% from the voices was set as a rule for taking decisions on mergers, acquisitions and reorganisations. A look on privatisation list will show that a lot of companies participate with up to 67% of their assets. Thus, the state appointed managers still may keep their voice decisive in the management of the newly private company.

This process was seen as unacceptable even from the high state officials and they asserted that it has been stopped and the old situation will be reversed, but it may not be proved before the end of the auctions.

Opportunities for Influence through Still-State-Owned Stock;

The real problem of the government role is how large will be the remaining part, in which industries and enterprises it will stay, how and who will manage it and which way? What is available as an information is included in the Table

The size groups has been determined on the basis of general consideration of the possibility to find a potential private investor desiring to acquire the controlling block of shares in a particular company and the corresponding desire of the government to match these wishes. In general, it is supposed that for the enterprises from the first group there is an already expressed interest or a potential one. Here, as an example may be seen some big hotels and enterprises from the chemistry as Sodi, Devnia, which is the second world producer of calcinated soda and which is on cash sale now.

The enterprises of the second group are usually considered to be of interests for the management-employee coalitions which have been granted a large advantages in cash privatisation. The third group encompasses all the others. As mentioned above, there was no public discussion of the way the companies are classified among the groups.

What is remarkable in the table, it is that, even in the last group the share under the state disposal is enough large to allow exercising of strong influence over the companies. Here should be added the shares left after the third auction of the privatisation wave. According to the mass privatisation scheme, if there is unsold stock less than 5% from the offered one it is subject to redistribution among the successful bidders provided not more than 25 mln BGL and the company is bigger than 500 mln BGL. Outside of these cases, the remaining stock is back under state control and the question of its management raises again.

Currently, there are two possibilities which are under consideration - to bring it back under ministries' jurisdiction or to create a special institution for its governance. With the last amendments in Privatisation Law the latter opportunity was allowed and there was launched a project with the European Bank of Reconstruction and Development.

According to the project, this must be a classical case of portfolio management. Three types of strategy were announced - active, silent and passive; they are connected to the presence or absence of fund's representatives in the managing bodies of the companies, which shares are in the portfolio. The management of the fund is supposed to be appointed on a competitive basis by the EBRD, but more details are still not available. Oilier Forms for Government Control;

A second form of the influence of the government is the Post-Privatisation Fund. It is also planned as a joint project with the European bank for reconstruction and development, but its objectives are rather different. It is supposed to restructure the enterprises during the post privatisation period by increasing their capital. That fund is expected to attract another institutional investors as well, decreasing this way the government participation and becoming ever more a normal investment venture. The

most important feature of this fund is the opportunity to attract as its shareholders privatisation funds and banking institutions.

The project includes an investment policy based on strong minor blocks of shares and board representation in privatised companies. The investment cycle is envisaged for four years with the ten years horizon.

Government Agencies and Mass Privatisation

The Agency for Privatisation (AP) and the Centre for Mass Privatisation (CMP) are government bodies by definition. They play more or less technical role in the privatisation process, though the AP has some important functions on the choice of privatisation methods and attracting foreign investors. Its possibilities though to play more or less independent role decreased heavily with the last amendments of its statutes limiting the number of the members of its controlling board being appointed by the Parliament.

The Centre for Mass Privatisation had never been even partially independent from the government, which does not mean that its policy is perfectly co-ordinated with the AP. Adversely, they opposed and competed each other very strongly during the process of appointing the companies in the privatisation list. That imposed The Ministry for Economic Development to be granted specific functions on co-ordination between them.

Analogous is the position of the Commission for Securities and Stock Exchange, which has been created under a special law and is governed by the government.

The Central Depository was created as a central registry of deals with the securities including those of the mass privatisation and has as well the clearing and settlement functions. It is a joint stock company, which is planned to have financial institutions as major shareholders, which situates it more as independent body. Thus, it strongly resembles the Bulgarian Stock Exchange which is also not subordinated to the government.

Conclusions

There is a radical, far going process of changing the ownership structure and as a consequence corporate governance in progress. The major players in it are the privatisation funds, which strive different objectives. Contrary to the announced strategies only much less funds created portfolios with structures which will allow them to form holding companies more or less involved in the restructuring and governance of the enterprises. This is particularly true for the bigger funds which apparently felt unsure with the assets which overcome their initial intentions. Although, after removed ban on the trade with privatised stock, which also means removal of the 34% ceiling on the biggest stakes in a company we may expect a further concentration and consolidation of PFs' portfolio in order to acquire a larger control.

This way that goal seems feasible, though PFs will probably violate the expectations of the millions regular shareholders. The investor's rights of the latter are not clearly defined and are not firmly protected. A part of PFs will try to adopt pure investment strategy, which will not probably match the active involvement in corporate governance.

The change in the way enterprises are governed may be helped by large outside investors, which will be encouraged to participate in many privatised companies. The final word here is kept by the government, which is also in the strong position to delay the process.

There is a chance though for a few companies to be controlled by the Stock Exchange. The role of the latter will depend mainly from its ability to canalise the trade in securities by proper regulation. Its efforts will depend also on the development of the parallel markets and on their role in the trade.

The financial institutions, mainly the banks are in position to acquire great importance in the process of privatisation and later in the restructuring of the companies, but since the active ones are largely state-owned that opportunity is contingent on their privatisation.

While there may be found some evidence on self-regulation of the process, as a general practice, it is still dependant on the regulative framework and the government actions.

The influence of the individual shareholders is very limited and it may not be expected to increase in conceivable future.

Tough very preliminary and so uncertain it may be expected a gradual shift of the controlling functions from the government to the corporate shareholders, which seem to be the major agents of governing power during the next period. Their behaviour will be determined to the largest extend by their founders, especially their position in economic system and striven strategy. This behaviour seem to be strongly varying by branch and scale.

At least on the first stages the corporate entities will not be able to exercise their controlling functions exclusively and it is possible formation of close coalitions among the privatisation funds.

Notes

¹ Because of running inflation the figure limits in the privatisation legislation are frequently changed.

² After introduction of the Currency Board in July 1997, the inflationary process was stopped or at least slowed down, but it is still early to announce it's breakage.

³ The situation changed recently with unification of all markets in a single one called Bulgarian Stock Exchange ‘Sofia’ and with the new much more strict requirements for the traded securities.

⁴ The first sessions on the new Bulgarian Stock Exchange ‘Sofia’ in November 97 proved that statement partially. After few strong days a new set of bureaucratic impediments emerged.

⁵ In fact the Privatisation Law was changed and the Funds were allowed an early trade but only through the Stock Exchange. After their strong opposition a compromise was achieved, permitting so called block-trade the funds were allowed only to register deals which *de facto* were executed outside the floor of the Stock Exchange.

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The Impact of Czech Mass Privatisation on Corporate Governance

*Jan Hanousek and Evžen Kočenda**

In 1989 the former Czechoslovakia had one of the smallest private sectors in the communist world, employing only about 1.2% of the labor force and producing a negligible fraction of the national output. Often cited as one of the major success stories of the transition in Eastern Europe, the Czech privatization program resulted in almost 75% of productive capacity being transferred to the private sector by the first quarter of 1995 (for preceding overview see Aghion, Blanchard and Burgess (1994) and Blanchard et al. (1991). This is comprehensively captured by Table 1.

Table 1

Registered Corporations According to Ownership

Type of Company	1991	1992	1993	1994	1995
Number of incorporated individuals	891,872	982,075	1,044,635	856,509	1,000,375
Total number of	57,083	83,965	116,706	153,937	196,434
Privately owned	16,913	30,097	47,446	64,343	88,582
Cooperatives	4,031	4,148	4,638	5,227	6,172
State owned	16,762	14,125	11,113	9,733	9,432
Municip. owned	876,000	5,490	8,099	9,199	9,980
Foreign or joint ventures	6,349	8,780	13,970	22,715	33,687

Source: Ministry of Finance

Privatization in the Czech Republic¹ was carried out under three programs: restitution, small-scale privatization and large-scale (or mass) privatization. This comprehensive

* Centre for Economic Research and Graduate Education (CERGE) of Charles University Introduction.

privatization program resulted in a remarkably high share of the Gross Domestic Product (GDP) being eventually produced by the private sector. Table 2 compares the role of the private sector as a percentage share of the GDP in various Central European countries from 1990 to 1996.

Contribution of Private Sector to the GDP (in Percent)

Table 2

Years	Czech Republic	Bulgaria	Hungary	Poland	Romania
1990	12	9	25	31	16
1991	17	12	30	42	24
1992	28	18	42	45	26
1993	45	25	50	48	32
1994	56	30	60	70	39
1995	64	32	68	75	45
1996	74	34	75	78	50

Source: IMF

Large-scale privatization brought companies out of state ownership, but left them without proper management. This was due to the fact that shares in legally and newly created companies belonged to investment funds or banks, or were spread among numerous small shareholders. The interest of investment funds in increasing the net asset value of the shares on one side and the lack of power of small shareholders on the other created an extremely soft-management environment. Such a situation was not a suitable environment for the active management and necessary restructuring of non-competitive industries.

Over time, however, the situation changed considerably. The investment funds started to trim their portfolios to weed out non-productive companies or to create positions for eventual transformation into holding companies. Sales for the sake of sheer profit were also not uncommon. Of particular importance is that such a process enabled firms to affect a corporate governance since the majority shareholders in each company started to transform their firms while pursuing active management. Despite the fact that the issue of corporate governance was addressed by Aghion, Blanchard, and Carlin (1994), Coffee (1996), and Hanousek and Kočenda (1997), among others, literature on the corporate governance of companies in transition economies is still lacking.

Brief Overview of the Privatization Process

The Czech government pursued three major programs of privatization: property restitution's, small scale privatization and large scale privatization. The first two started in 1990 and were most important during the early years of transition. Table 3 shows this two-wave process translated into major numbers.

Table 3

Brief Overview of Voucher Privatisation

Subject	Wave 1	Wave 2
No. of State Enterprises Entering the Voucher Scheme	988	861
Book Value of Shares Allocated for Voucher in Particular Wave (billions of crowns)	212.5	155.0
Participating Citizens (in millions)	5.98	6.16
Average Accounting Value of Assets per Participating Citizen (crowns)	35,535	25,160
% of Voucher Points with IPFs	72.2%	63.5%

Source: Ministry of Finance, Ministry of Privatization.

Restitution restored assets to those from whom they had been nationalized by the communist regime after 1948. Estimates of the amount of property involved in restitution are sketchy since implementation was carried out by direct negotiation between current and former owners. There have been at least 200,000 claims for agricultural land. In addition, about 70,000 apartment buildings have been returned to their former owners. For our purposes, the most important feature of the restitution program is that owners of industrial property incorporated into larger enterprises (or expanded by new investment since nationalization) were entitled to receive a share of the enterprise when it was privatized. In addition, they could purchase an additional part of the enterprise on preferential terms (usually at book value and without having to compete with other potential buyers).

Small-scale privatization dealt primarily with small economic units such as shops, restaurants or smaller industrial enterprises that were sold at public auction. Bidding was restricted to Czech citizens or corporations formed by such citizens. Buyers were forbidden from transferring property to foreigners. By the end of 1992, over 22,000 units with a total sale price of about \$1 billion had been privatized through small-scale privatization. At least an additional 10,000 units were approved for later sale. Although there was no explicit limitation on the size of property which could be auctioned in

small-scale privatization, the program focused on small businesses engaged primarily in retail trade. By the end of 1993, when the program was officially terminated, 30.4 billions crowns worth of property had been sold to private owners.

In 1991, large-scale privatization was launched. Its evolution in nominal monetary units is presented in Table 4. Large-scale privatization allowed combinations of several privatization techniques: small businesses were typically auctioned or sold in tender, medium businesses were sold in tender or to a predetermined buyer (direct sales). The largest firms were transformed into joint stock companies, the shares of which were distributed within voucher privatization (almost one half of the total amount of all shares of all joint stock companies was privatized), sold for cash or transferred for free to municipalities. Municipalities also benefited from transfers of property, namely unused land within their territory.

Table 4

Large Scale Privatisation in the Czech Republic

	Property June 93 mil. CZK	Units June 93	Property June 94 mil. CZK	Units June 94	Property June 95 mil. CZK	Units June 95	Property June 96 mil. CZK	Units June 96
Total property	607,635	4,893	922,041	16,071	950,463	20,917	963,453	22,190
Auction	5,634	431	10,057	1,714	9,378	2,110	9,360	2,054
Tender	16,434	424	27,931	887,000	31,236	1,351	36,544	1,750
Direct sale	38,016	1,359	86,407	7,713	0,463	10,899	90,156	11,436
Joint Stock Como.	534,779	1,327	756,008	1,897	765,941	1,875	774,955	1,914
Free transfer	12,772	1,352	41,998	3,860	53,445	4,700	52,438	5,036

Source: Ministry of Finance

Large-scale Privatization

Mechanism of privatization

By far the most important privatization program in the Czech Republic was large-scale privatization. This process began in the spring of 1991. Enterprises not privatized through restitution or small-scale privatization were divided into four groups:

- firms to be privatized later (after five years);
- * firms to be liquidated.

Over 2,400 firms in the Czech Republic (about half of all firms eligible for large-scale privatization) were assigned to the first wave, which began in June, 1991. For each firm assigned to the first wave, the firm's management (under the supervision of its founding or supervising ministry) had to submit a proposal as to how the firm should be privatized by October 31, 1991 for how the firm would be privatized. This proposal could involve one or more methods of privatization, including direct sale to a domestic or foreign buyer, public auction, public tender offer, unpaid transfer to a municipality or other agent, transfer to workers, or participation in the voucher scheme. Shares not allocated to the voucher scheme could be sold directly to a chosen buyer or offered to the general public on the securities market. In addition to indicating the preferred method(s) of privatization, each firm's plan had to present basic financial and operational information, including employment, wages, capital, sales, costs, profit or loss and foreign trade during the period 1989-1991.

It was possible for anyone other than the firm management to submit a competing privatization plan for all or part of each enterprise. All told, the 2,404 enterprises involved in the first wave elicited 11,349 projects, an average 4.72 projects per firm. The founding ministry and the Ministry of Privatization decided among the competing projects, except in the case of a sale to a foreign buyer, which had to be approved by the government of the respective republic. Since a project could be for only part of a firm, the total number of approved projects was about 1.5 times the number of firms privatized. As might be expected, proposals from the management of firms were most likely to be approved. Management projects accounted for between 20 and 25 percent of all proposals, but over half of those were approved. Proposals to purchase all or part of a firm were the second most commonly approved group.

Although it may appear that the allocation of shares to the voucher scheme resulted from proposals generated "from the bottom," in fact the privatization authorities had rough goals regarding how much property they wanted to be included in the voucher program and indicated how the vouchers would be finally allocated. In the end, 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.²

Participation of citizens

The importance of the voucher program can be appreciated by examining the share of total assets placed in it. In 1990 the official book value of all capital in the Czech Republic was Kcs 2,604 billion³ (about USD 95 billion). Of this, about Kcs 1,000 billion was included in the first wave of large-scale privatization. Firms in the voucher

program had a book value of about Kcs 331 billion, of which slightly over 200 billion was allocated to vouchers. Thus, the first wave of the voucher program included about 7.5% of the country's capital assets.⁴

All Czech citizens over the age of 18 who resided in the Czech or Slovak Republics could participate in the voucher process. Each participant could purchase a book of 1,000 voucher points for a fee of Kcs 1,000 (a little over one week's wage for the average worker in 1992). Before the bidding process started, each voucher holder had the option of assigning all or part of his points to one or more Investment Privatization Fund (IPF). These IPFs had to provide basic information regarding their ownership and investment strategy. In addition, information regarding profitability, sales, growth rates, and extent of proposed foreign involvement for each firm was provided in a booklet available to all voucher holders. Anyone who brought a diskette to the privatization offices could obtain this information in a database designed to make analyses easy. A great number of citizens opted to put their stakes into these funds. Tables 5 and 6 show the most important fund groups that managed to gain more than 2% market-share and their relative position on the market.

Table 5

Position of the Major Funds on the Market: Wave 1

Founder	No. of Points Allocated	Market Share	Cumulative Market Share	No. of IPFs
Ceska statni spofitelna	950918800	15.494	15.494	1
Prvni investicni, a. s.	713837100	11.631	27.126	11
Harvard Capital and Consulting	565170000	9.209	36.334	6
V+B Invest, i.a.s.	500668100	8.158	44.492	1
IKS KB spol. s r.o.	465708300	7.588	52.081	1
Kapitdl. Invest, spoleinost, a. s.	334234900	5.446	57.527	1
Slovenske Investicie, s.r.o.	188041300	3.064	60.591	1
Creditanstalt, a.s.	138924800	2.264	62.854	1
Prva Slovenska Investicni, a.s	136348000	2.222	65.076	11

Source: Ministry of Finance, authors' computation.

Table 6

Position of the Major Funds on the Market: Wave 2

Founder	No. of Points Allocated	Market Share	Cumulative Market Share	No. of IPFs
A-Invest, investini spoleinost, a.s.	309243300	7.896	7.896	2
Investiini spoleinost Expandia, a. s.	306290600	7.820	15.716	3
Harvard Capital and Consulting investiini spoleinost, a.s.	292170900	7.460	23.176	23
O.B.Invest, investiini spoleinost, s.r.o.	198351200	5.064	28.240	3
KIS, a.s., Kapitalova investiini spoleinost Ceske pojiSt'ovny	186697800	4.767	33.007	3
Investiini spoleinost podnikatelu, a. s.	159263500	4.066	37.073	2
Investiini spoleinost Linh Art, s.r.o.	156432100	3.994	41.067	3
Czech Investment Company investiini spoleinost, spol. s r.o.	151666300	3.872	44.939	1
Spofitelni investiini spoleinost, a.s.	124161800	3.170	48.110	1
Investiini kapitalovd spoleinost KB, a.s.	124063500	3.168	51.277	1
PPF investiini spoleinost, a.s.	119703700	3.056	54.334	2
Prvni investiini akciovni spoleinost	97629000	2.493	56.826	5
C.S. Fond, a.s., investiini spoleinost	94007200	2.400	59.226	7
Moravska agrdmi potravinafska investiini spoleinost, akciovni spoleinost	89932800	2.296	61.523	1

Source: Ministry of Finance, authors' computation.

Management regulations

IPFs were subject to a number of regulations that made them resemble closed-end mutual funds in the West. Technically, funds for the first wave of voucher privatization were organized as "Legally Independent Joint Stock Companies" since the law that allowed more conventional mutual funds (including open-ended funds) did not come into effect until after the deadline for registering funds for the first round. Funds had to

be approved by the Ministry of Privatization and had to have at least Kcs 1 million in initial capital. The structure of the Joint Stock Companies that emerged out of privatization is conveniently presented in Table 7.

Table 7

Structure of Joint Stock Companies Privatized through Voucher Scheme

	No of units into which was privatized SOE divided				
	1	2-4	5-9	10	Total
Czech JSC	600	248	99	41	988
Slovak JSC	320	108	70	5	503
Total CSFR	920	356	169	46	1,491
Second Wave	324	160	74	118	676

Source: Database of the Center of Voucher Privatization.

For a fond to be approved, the founder had to submit a plan including the contract between the founder of the fond and the fond itself (which was required to be a separate legal entity). This plan was required to document:

- the management conditions of the fond;
- the number and qualifications of the administrators of the fund;
- information regarding the board of directors and supervisory board of the fond;⁵
- the fund's investment policy regarding risk taking and sectoral specialization.

Compensation to a fund's founder (operator) for managing the fond was limited to 2% of the nominal value of shares gained through voucher privatization plus up to 3% of assets and 20% of the fund's profits each year following privatization. Government officials were excluded from serving on the board of an IPF. Each IPF could not invest more than 10% of its points in a single company nor obtain more than 20% of any company.⁶ Since the most common situation was for the founder of a fund to be an already established financial institution, regulations also forbade funds founded by financial institutions from purchasing shares in financial institutions.⁷

Property outcomes of privatization

The first wave of voucher privatization started slowly. During the first two months citizens could buy voucher coupons, only a few hundred thousand did so. By January of 1992, official estimates were that only about 20% of eligible participants would

purchase books before the official deadline at the end of February. However, in the next two months demand soared, largely in response to advertisements by several of the IPFs guaranteeing returns of 1,000% in one year.⁸ In the end, 75% of those eligible to participate did so. About 72% of the voucher points were placed for bidding with one of the 264 IPFs in the Czech Republic, while 28% were retained by individuals. There was substantial concentration among the IPFs, with over 56% of the points given to the funds being controlled by the thirteen largest funds.

Once individuals who so desired had had an opportunity to place their points with an IPF, the actual bidding process began in May of 1992. Bidding was conducted in rounds. Each round involved a period of two to three weeks in which voucher holders could register their demands. There was a period of about a month between each round to allow the authorities to determine the outcome of the previous round and set the price for the following round. To avoid end-game problems, it was not announced in advance how many rounds would take place. In fact, there were five rounds, with the final round closing in December 1992.

In the first round an identical price was set for shares in all companies. Once this price was set, the number of shares to be issued was determined by dividing the book value of the capital to be privatized through the voucher process by the fixed price. Individuals and funds then indicated their demand for shares in each firm at the announced price. Shares were allocated according to the following procedure:

- a) if the demand for shares in a particular firm was less than or equal to the number of shares available, all bidders had their demand met. Any unsold shares were carried over to the next round and offered again at a lower price;
- b) if demand for a firm's shares exceeded supply by less than 25% and IPFs comprised a significant part of the demand, then individual investors had their demand met while IPFs were rationed in proportion to their bids. IPF participation was judged significant if their demand did not have to be reduced by more than 20% to equate demand and supply. In this case, all shares were sold and the firm was not available for purchase in the next round;
- c) if demand exceeded supply under conditions other than those in point b), then no shares were sold and the firm was offered in the following round at a higher price.

Overall, almost all voucher points were used and over 92% of the offered shares were sold. About 56% of the offered shares were sold in the first two rounds.

Price-setting mechanism

Of particular interest for our research is the price setting mechanism. Prices were adjusted between each round by a three-member Price Commission. According to the official publications of this commission, price adjustments were based on a complex

(and secret) algorithm involving up to 17 different factors. Econometric estimates of price changes suggest a much simpler process involving share price in the previous round, excess supply or demand in the previous round and the total supply of shares remaining to be sold.⁹

After a delay caused by complications arising from the split of Czechoslovakia in January of 1993, shares were distributed to citizens and IPFs in late May, 1993. Shortly thereafter, shares of both individual companies and IPFs began to be traded in the secondary market. There are two alternative markets for trading shares. Large investors (including institutions) tend to use the Prague Stock Exchange. Although only a minority of firms are officially "listed" on the PSE, all public firms, including non-listed ones, were traded there (a small number of firms was delisted from the PSE, but these firms are still traded on the alternative market described below). Official listing involves volume considerations as well as meeting the exchange's rules regarding disclosure and other conditions. The PSE began trading sessions once a week but gradually increased sessions as volume increased, so that by September, 1994 trading was conducted five days a week.

An alternative market called the RM-System developed out of the registration sites used in voucher privatization. Operated by the private firm that handled registration of voucher bids, the RM-System primarily serves small investors. It began with trading rounds of about three weeks in length during which it attempted to match supply and demand at a market clearing price. Recently, the RM-System has moved to a continuous computerized matching system, although volume remains small compared with the PSE. Despite the presence of two formal markets, estimates are that up to 80% of all shares traded are bought and sold in large blocks that move "off-market."

Corporate Governance

level of a fund's involvement. 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 investment and eventual restructuring. Naturally, such behavior indicates poor corporate governance.

Nevertheless, most of the conditions described above create a good starting point for strong corporate governance in the enterprises controlled by funds. However, at the time it was not possible to check any of the hypotheses on the presence of corporate governance by using data from the stock market and hence no empirical estimations were made. Even now, there is little data on the portfolio structures of the funds and it is extremely difficult to collect current information on funds' portfolios.

Conclusions

Since the mid 1990's, the majority of the nation's GDP has been formed in the private sector. This is a result of a massive privatization program, which was started in 1990 by returning some of the state's property to the former owners (restitution), followed by the auctioning of small businesses in 1991 (small privatization) and concluded by the privatization of the vast majority of large industrial, financial and other state owned enterprises by auctions, direct sales, tenders or by free distribution of shares within mass voucher privatization (large-scale privatization).

At the end of 1996, only a few important firms, such as railways, the postal service and national airlines remained fully state owned. Other firms in key industries, such as telecommunications, utilities and banking were at least partially privatized, while the state remained the controlling shareholder. Since 1995, investment funds started to reorganize their portfolios and more and more companies undertook the task of restructuring to become competitive. This was the beginning of a logical process toward an active management approach backed by the majority shareholders.

It can be concluded that the presence of privatization funds in the ownership structure of a company is desirable from the point of allocation and use of financial resources up to a certain level of a fund's involvement. 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 It has been pointed out in many discussions, see Lastovicka et al. (1995) among others, that from the very beginning investment privatization funds have controlled about 57% of the shares in 473 (out of 949) companies. Moreover, the individual investors represent a very disperse (and passive) ownership; even funds that are not majority shareholders are able to effectively control a company. Estimates of how strong the position of the funds must be to control the enterprise have varied over time. Lastovicka et al. (1995) concluded that the ownership in about 700 companies can be easily dominated by funds. Very often funds created alliances and dominated the other fragmented owners.

Table 8 presents the results regarding the profitability of large firms during 1992- 1995.

The different extent of improvement in financial performance illustrates in detail the level of restructuring of large firms in Central European Countries. The profitability of firms is divided into five categories where A denotes the best and E the worst state of financial affairs. So far the Czech Republic has recorded the most rapid adjustment. During the period 1992-1995, only 6% of Czech firms remained in the most troubled categories C-E with negative cash-flow. In 1995, 19% of firms incurred losses but kept positive cash-flow and 75% of them were simply profitable.

Table 8

Profitability of Large Firms

Country	Year	Profitable	Positive cash flow	Cannot service all debt	Cannot pay all wages	Cannot pay all suppliers	Total
Bulgaria	1995	45	13	17	22	4	100
(828 firms)	1994	43	11	29	13	4	100
	1993	22	18	23	32	5	100
	1992	28	10	31	27	4	100
Czech Republic	1995	75	19	6	0	0	100
(676 firms)	1994	71	20	6	3	0	100
	1993	63	25	10	2	0	100
	1992	60	11	15	13	0	100
Hungary	1995	-	-	-	-	-	-
(301 firms)	1994	68	12	8	11	2	100
	1993	66	8	9	12	5	100
	1992	59	6	15	14	6	100
Poland	1995	36	31	15	15	2	100
(940 firms)	1994	50	21	9	17	2	100
	1993	40	17	12	24	8	100
	1992	37	16	17	20	10	100
Russia	1995	46	27	5	21	1	100
(158 firms)	1994	27	37	21	11	4	100
	1993	-	-	-	-	-	-
	1992	-	-	-	-	-	-
Slovakia	1995	53	25	9	13	0	100
(905 firms)	1994	57	21	9	13	0	100
	1993	51	23	12	14	0	100
	1992	-	-	-	-	-	-
Slovenia	1995	64	17	9	8	2	100
(727 firms)	1994	67	14	13	6	0	100
	1993	67	13	15	5	0	100
	1992	65	13	17	5	0	100

Source: World Bank.

Other countries also recorded steady improvement in the financial health of their companies, though at a somewhat slower rate than the Czechs did. On average 80% of the firms in Slovakia, Slovenia, and Hungary are visibly in a positive cash-flow regime. Poland, on the other hand, recorded a disturbing worsening of financial conditions in 1995. The country had a large percentage of firms with negative cash-flows, and the portion of firms with positive cash flows actually decreased from a high of 67% the previous year. Bulgaria still had a large number of companies with negative cashflows, though 58% of firms managed to have positive cash-flows. This represents only marginal improvement in comparison with 1994. Russia showed a recent improvement due to reforms with 46% of firms being profitable.

Yet another view is provided by the figures in Table 9. It contains some important characteristics in terms of changes of operational profit and added value per unit of capital and labor for companies having different proportions of fund ownership.

Table 9.

**Changes in Economic Outcomes Between 1994-1995
Based on Structure of Ownership**

	Companies Where Funds Own Less than 15%	Companies Where Funds Own Less than 50%	Difference Between Them
	(1)	(2)	(D-(2))
Change in Operational Profit per Unit of Capital	-0.23	-0.68	0.45
Change in Operational Profit per Unit of Labor	17.39	-23.84	41.23
Change in Added Value per Unit of Capital	0.28	-0.09	0.37
Change in Added Value per Unit of Labor	143.64	68.86	74.78

Source: Weiss, A. "Effects of Capital Market Regulation on Economic Growth."
International Conference, Prague, May 6, 1997.

It is evident that the firms with less than 15% fund involvement behaved much like a typical portfolio investor. The funds here could have put some pressure on management; however, they were not strong enough to extract profit from the company. In the case of firms where the fund was a majority owner, the profits were extracted and moved out of the company. In this situation funds acted counterproductively.

Quite interesting results are presented by Claessens, Djankov, and Pohl (1997), who argue that the (mass) voucher privatization scheme improved the management of privatized firms by concentrating ownership. They also claim that, contrary to expectations, banks with an indirect equity stake in a privatized firm have a positive influence on the firm's corporate governance. Their analysis is based on a broad Aspect Stock Market Database, which is the best source at the moment. Nevertheless, we would like to point out several problems that arise when working with the data from the Czech Republic, problems we encountered as well.

Accounting data are in most cases produced according to the Czech Accounting Standards (CAS) which creates a serious problem with correct quantification of investments. Investments thus do not comply with the International Accounting Standards (IAS) definition, and as accounting items, they can be placed into inventories, or can be kept as material or immaterial, or can show up somewhere in assets in general. Therefore, the calculated Tobin's Q indicator of a firm's performance might be somewhat misleading.¹⁰

Another problem lies in the database itself. It contains a relatively small amount of data and thus functions as an incomplete panel. However, the database itself has an additional shortcoming because when the data is not available, the system indicates this as N/A (not available) or a numerical zero. Such an arrangement is likely to create quite a discrepancy in any analysis. Yet another flaw is an identification error that is due to incorrect firm identifiers at various places throughout the database.

Infrequent data on ownership structure naturally bias all the results where such a structure plays an important role. Therefore, one should hesitate before drawing firm conclusions based on the Herfindahl index. The index is defined as a sum of squared ownership shares and is thus by definition dependent on the quality of ownership structure data.

We have taken all the preceding problems into consideration when working with the Aspect database and aimed to correct them in a way that would eliminate the shortcomings as well as result in a reasonable analysis. However, as we noted earlier, the Aspect database is constructed on the basis of Czech Accounting Standards which preclude a precise identification of investments. High variability in different groups within the database affects the statistical value as well. The regressions which we ran had almost no information value since their R^2 s were close to zero. Such a failure is comprehensively illustrated by the following two box-plot diagrams in Chart 1 and 2.

Chart 1 offers a composite view of the change in Returns on Assets (ROA) of various firms distinguished by the majority owner. No significant pattern emerges here except the fact that foreign and broker owned firms have their changes in ROA's slightly skewed in positive and negative directions respectively.

Chart 1

Change in ROA Between 1993 and 1995 by Majority Owner

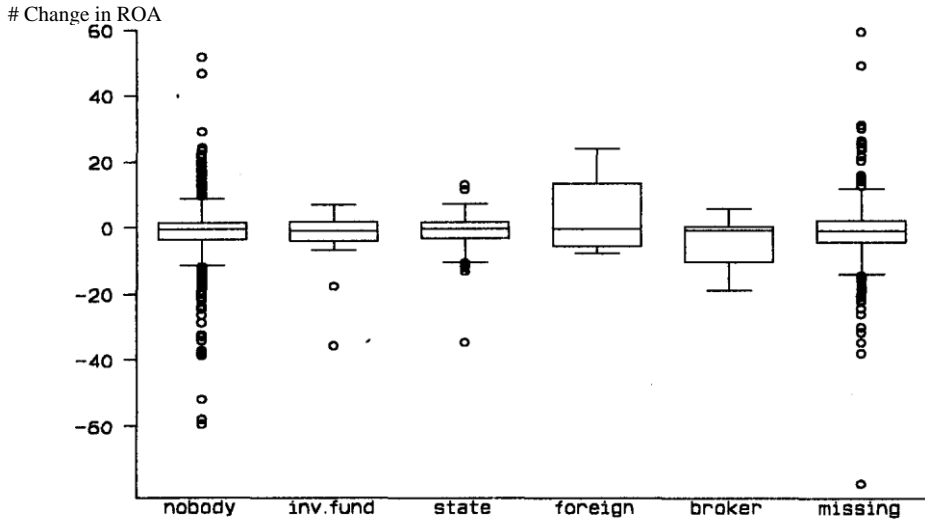


Chart 2

Change of ROA 1993-1995 by Percentage Share Held by Funds

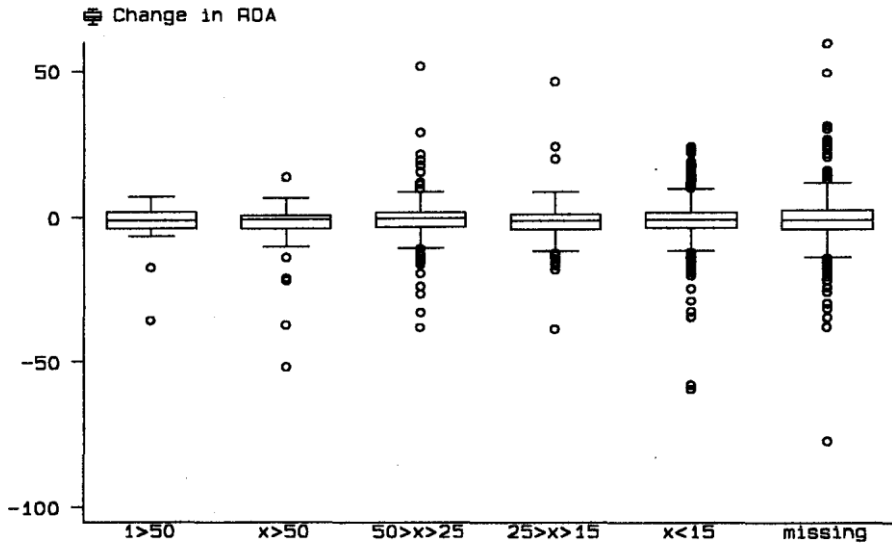


Chart 2 provides a view of the firms held by privatization investment funds only. The firms are distinguished according to the percentage share of the stake the funds own in them. Again, we cannot trace any pattern here that would enable us to translate the available statistical evidence into a sensible story involving corporate governance. We have formed another box-plot diagram that would distinguish the firms by the type of owner having control over the firm. Similar results revealing no substantial pattern of governance influence justify not including another figure on the subject.

It can be concluded that the presence of privatization funds in an ownership structure of a company is desirable from the point of allocation and use of financial resources up to a certain behavior is indicative of weak corporate governance.

Though a considerable amount of data is still lacking, it seems that the improvement in the profitability of mass-privatized enterprises was due to improvements in corporate governance. The final assessment, however, still lies ahead.

Notes

¹ We will discuss only the Czech Republic wherever possible. Prior to the January 1, 1993 split of the former Czechoslovakia, privatization was carried out jointly in the Czech and Slovak Republics. Generally, however, data is available for each republic independently. For other references see Frydman, Rapaczynski, and Earle (1994) and Kotrba (1995).

² The second largest share (23.3%) was retained by the Fund for National Property. Much of this share either has already been or will eventually be sold in the equity market.

³ We adopt standard Czech monetary notation. Prior to the split of the country the Czechoslovak koruna (crown) was abbreviated Kcs and placed before the numeric figure. After January 1993, the Czech koruna was abbreviated Kč and placed after the numerals.

⁴ A second, somewhat smaller, wave was completed by the end of 1994.

⁵ Czech corporate governance is a melding of American and German models. Each firm has two governing boards, a Board of Directors and a Supervisory Board. The Board of Directors is elected by the general shareholders to actively manage the company. 30% of the Supervisory Board is elected by employees and 70% by shareholders. It tends to have limited powers, best characterized as the ability to harass the Board of Directors.

⁶ Initially related funds from a single founder could own no more than 40% of a firm. This was later reduced to 20%. Funds could, in fact, acquire more than this limit if they agreed to sell the excess within six months of the firm beginning trading on the Prague Stock Exchange. In addition, mergers among funds may mean that this limit is violated and firms will have to sell shares to come into compliance.

⁷ The potential for financial concentration is evident from the fact that the six large financial institutions included in the first wave of voucher privatization controlled 5 out of the 6 largest groups of IPFs. Together these six financial institutions obtained the right to bid over 36% of all the points in the first wave of voucher privatization.

⁸ Although these guarantees sound extravagant, they were in fact rather conservative. They were based on the artificial Kcs 1,000 registration cost for a voucher book. Since the book value of assets being sold averaged about Kcs 35,000 per coupon book, there was little risk in promising to redeem shares in IPFs for Kcs 10,000.

⁹ See Singer and Svejnar (1994), Hanousek and Lastovicka (1993), and Hanousek and Kroch (1997).

¹⁰ Tobin's Q is defined as the ratio of the market value of a firm (value of equity plus the market value of its debt) to the replacement value of the net fixed assets of a firm. The higher the Tobin's Q is, the more valuable a firm is considered to be because it is likely to generate more profits from its assets.

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Polish Mass Privatisation Scheme: The Legal Framework

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Introduction

State run economy, the system which was in force in the post-war Poland for over 40 years, was not conducive to releasing efficiency in the sphere of economic activity. On the contrary, based on peculiar philosophy of “recognition” and subjectivism in shaping economic relations, it led to obliteration of the objective criteria of the evaluation of economic activity, its monopolisation, and what follows its stagnation. All this resulted in social and economic crisis in the seventies and eighties. The emancipation of social activity, especially thrift and initiative had to become the crucial task of the economic reform and system transformations, undertaken in the second half of 1989 and 1990. In order to break the current barriers and create the conditions necessary for the realisation of system transformations, it was necessary to follow the rule of “economic freedom” instead of administrative command and suppression, and instead of preference of the state-run economy - the principle of equality of all the enterprises, notwithstanding the fact whether they led their economic activity on the basis of state-owned or private property.

The principle of economic freedom and the principle of equality of all the sectors of the national economy in the field of economic activity should naturally result in competition in the economic turnover, which should release market forces. It could be assumed that the final goal of the under-taken reforms of the Polish economy is the transformation of the state-controlled economy into a free market one. The realisation of this transformation is done in different areas, especially the legal one.

From the legal viewpoint, the changes in the civil code, changes in the acts regulating the system and functioning of the economic enterprises, above all the privatisation act have a significant importance to the transformations taking place.

Privatisation acts create prerequisites to depart from the so far dominant state-controlled property to private property broadly interpreted. Privatisation of state enterprises is to create the balance in the market resulting from the participation in it on equal rights structurally different enterprises: state-controlled, co-operative, private and foreign. The expected result of the privatisation would be the increase in competitiveness in the market, increase in the worker’s initiative, and successively the increase in efficiency and more modern management.

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The General Characteristics of the Privatisation Process in Poland

Both the Act on Privatisation of state Enterprises and the Act on Establishment of the Office of Minister for Ownership Transformations (of State Treasury) are the effect of the legislative compromise between the draft presented to the Sejm (Parliament) by the government¹ and the one drawn up and presented by a group of Members of Parliament.² It was agreed that the performing tasks specified in the Act On Privatisation of state Enterprises is the government's duty obligation, first and foremost of the Minister's of State Treasury, while the Sejm (upon the motion of the Council of Ministers) outlines crucial annual directions of the privatisation and determines the use of the resources gained in the process. The regulations of the Act on The Privatisation of state Enterprises have also application to the privatisation of municipal enterprises, but the powers of the Minister of Treasury and of the founding organ with a respect to a privatised municipal enterprise shall be performed by the board of the commune or of a union of communes.

A commune or a union of communes may, on the grounds of an agreement with the Minister of the State Treasury, transfer to him the operations connected with privatisation of a municipal enterprise. Apart from a capital way of privatisation creating prerequisites for the foundation and functioning of the capital market, especially the market of securities, the act provided for and regulated the possibility of privatisation through liquidation of the state (municipal) enterprise in order to sell it, to contribute it to a company, or to give it to the Employees' Council for the non-gratuitous use.

Realising that the average Polish citizen's lack of the capital and habit of saving up by way of investing those savings in securities could be a tremendous obstacle in privatisation of the state-run (municipal) enterprises, the possibility of the issue of privatisation bonds of specific value was designed in the Act on Privatisation. The privatisation bonds shall be allotted gratuitously in equal quantity to all the citizens of the Republic of Poland domiciled therein. The Sejm, shall upon a motion of the Council of Ministers, adopt resolutions on the issue of this kind of privatisation bonds. The Council of Ministers shall regulate the form, set forth the time limits of validity of the bonds of particular issues, the principles of distribution and realisation thereof as well as the principles of limiting or possibly prohibiting the transfer thereof. The bonds could be used to pay or for the acquisition of rights on the shares issued as a result of transformation of state enterprises, or acquisition of titles to participate in financial institutions (societies of joint investments) having at their disposal shares issued as a result of transformation of state enterprises, or finally for the acquisition of liquidated enterprises or organised parts of state enterprises. The statutory announcement on the issue of privatisation bonds has not been realised so far. The Law dated April 30, 1993 set forth the principles for the establishment, operation and privatisation of national investment funds the purpose of which is to increase the value of their assets, in particular by enhancing the value of shares of companies of which the funds are shareholders (Art.4). All citizens of the Republic of Poland who are registered as

permanent residents in Poland and who by December 31 of the year preceding the year of issuance of share certificates shall be at least 18 years old, shall be entitled to receive an equal number of share certificates (Art.21 of the Law). The Law provides for the issue of "compensation share certificates" as well (Art.8).

In accordance with Art.37 all share certificates will be exchangeable at the National Depository of Securities, through an entity conducting brokerage business, for an equal number of shares in every fund existing at the time of issuance and designated by the appropriate minister for the realisation of such exchange.

The Act on Privatisation of state Enterprises also provides for a transfer of shares on preferential terms, i.e. at the price reduced by half in relation to the price offered on the first day of sale, to employees of the state-owned (municipal) enterprise and farmers who have remained bound by contract or co-operation with such an enterprise.

Both making the shares available on preferential terms and the issue of privatisation bonds should be regarded as an exception from the general rule. The general rule of the privatisation is non-gratuitous acquisition of shares and stocks or the purchase of the enterprise. In particular shares in enterprises transformed from the state-run enterprises owned by the State Treasury should be acquired by way of tender, by an offer announced publicly, or as a result of negotiations undertaken on the basis of public offer. Transfer of rights on shares owned by the State Treasury in a way other than the one mentioned above shall be null and void. However, the Council of Ministers under specific conditions, upon the motion of the Minister for Ownership Transformations (Minister of Treasury) allow for a way of transfer of shares different than the one provided by the above regulations. From one side, public transfer of shares and the assets of the enterprise, liquidated in the process of privatisation, ensures social control of the process, but from the other side the real, dictated by their demand and supply, price of purchase.

Capital Way of Privatisation

The capital way of privatisation, broadly regulated by the Act on Privatisation of state Enterprises, consists in transformation of state-owned enterprises into a sole-shareholder company of the State Treasury, next making the shares of the company available to the third parties (Art, items 2,7-8,10-30 of the Law).

As it would follow from the above, the capital mode of privatisation is two way, the result of the transformation of the state enterprise into a sole-shareholder company of the State Treasury are the organisational and legal changes of the state-owned enterprise. Upon the registration of the sole-shareholder company of the State Treasury in the commercial register and removal of the transformed state enterprise from it, the newly founded company operates either as a joint-stock company or as a limited-liability company; the pertinent provisions of the commercial code shall apply to a company formed as a result of transformation of a state enterprise, unless the Act on Privatisation of the state Enterprises stipulates otherwise (Art.3 & 7 of the state Enterprises' Privatisation Act). This sort of company shall succeed to all the rights and

duties of the transformed state enterprise (Art.8 Sec.2 of the Act). The rights and duties of the transformed enterprise, resulting from administrative decisions (i.e. licence), shall be transferred, by virtue of the law of entitlement, to the company. The employees of a transformed enterprise (with the exclusion of employees employed by appointment) shall become by virtue of the law, employees of the company, and the company shall be liable for the obligations resulting from employment relations which have resulted prior to transformations of the enterprise (Art.9 of the Act). The final balance of a state enterprise shall become the opening balance of a company, while the sum of the foundation fund and enterprise's fund become the company's own capital. The statute (the founding articles of the limited-liability company) shall determine the part of own capital constituting the share capital and the part of own capital creating the reserve capital (Art. 11 of the Act).

From the above regulations it follows clearly that a sole-shareholder company of the State Treasury formed by the transformation of a state-owned enterprise is a legal successor of the latter. The succession has a universal character, of one legal event, i.e. registration of the company in the commercial register with the forthwith removal of the company from the commercial register (Art. 12), leads to acquisition of all the assets (the whole of rights and obligations) by a company. This company is a capital enterprise with a legal personality, acting on basis of the regulations of the commercial code. The regulations on the state enterprise and its Employees' Council do not apply to the company. Until shares are made available to third parties, the provisions on general principles of accountancy in state enterprises shall respectively apply to companies, with the provisions of the Commercial Code taken into account. The Minister of Finance may, by a regulation, set forth special principles of companies' accountancy, with the provisions of the Commercial Code taken into account (Art. 14 Sec.2). However, the regulation of Art. 14 of the Act on Privatisation lost force as a result of Art.85 Sec.6 of the Act on Accountancy Dated September 29, 1994. It should be assumed that in relation to sole-shareholder companies of the State Treasury, formed as a result of the state-enterprise transformation, the regulations of this Act apply to as well as the acts on trade unions and the executive acts.

From the legal viewpoint the sole-shareholder company of the State Treasury formed as a result of the state-enterprise transformation is a different type of the legal entity, namely: it is a corporate entity, while the state enterprise is a foundation entity. In case of transformation of the state enterprise into sole-shareholder company of the State Treasury we not only deal with the transformation of one legal entity into another one, as it is in case of the transformation of a joint-stock company into a limited liability company, the transformation in the strict sense of the word. On the contrary, a new legal entity is founded, and as it has been mentioned above the legal event creating this foundation is the administrative decision on the transformation of the state enterprise made by the Minister of the Treasury (the Prime Minister) by registration in the commercial code. In that case all the provisions of the commercial code apply to the company formed as a result of the state-enterprise transformation, which makes Art.7 of

the Law, unless the Act stipulates otherwise. Thus, the registration in the commercial code has a constitutive character, and not declarative, whereas the administrative decision on the transformation is one of the necessary material and legal prerequisites of such a registration.

The transformation of the state enterprise into a sole-shareholder company also leads to property transformations. The subject of possession at the moment of transformation is no longer a state enterprise but a sole-shareholder company of the State Treasury. Though the operation does not lead to the privatisation of the state enterprise in the strict sense of the word, in the technical and legal sense it is of crucial meaning, because it makes the shares available to the third parties: the real privatisation. The assets of the state enterprise are not rendered in the shares, so the direct privatisation would be impossible.

A company formed as a result of transformation of a state enterprise shall remain a sole-shareholder company of the State Treasury until its shares are made available to third parties (Art.8 of the Law). This joint-stock company operates on the basis of the commercial code and the provisions of the Act on Privatisation (Art.13-16). Its organs are the supervisory board, the management board and the one-man meeting of shareholders. The Minister of State Treasury acts on behalf of the State Treasury. He shall set forth the content of the statute or the promoter's articles, resulting in the formation of the sole-shareholder company of the State Treasury (Art. 10 of the Act). The Act on privatisation contains a special provision consisting in obligation of the supervisory board notwithstanding the fact which type of company is taken into consideration (a joint-stock or a limited-liability company). Furthermore, employees of the company shall elect one third of the supervisory board from among themselves (Art. 17 Sec. 1). Provisions governing protection of employment relationships of members of Employees' Councils in state enterprises shall apply to protection of company's employees elected to the supervisory board. It should be emphasised that the provisions of company's articles governing the election of members of the supervisory board by the employees cannot be abrogated or amended also after the shares have been made available to the third parties, when over half of shares remain in the hands of the State Treasury. The consent for the separate regulations could be given by the majority of the supervisory board members elected by the employees (Art. 17 Sec.2). The sole- shareholder company of the State Treasury has the capacity to be a one-man founding organ of a joint-stock company or limited liability company, which constitutes, with reference to the joint-stock company, a solution different from the one stipulated in the amended Art. 158 of the commercial code. Thus, at this stage of privatisation of the state enterprise there is a possibility of formation of a group of sole shareholder companies of the State Treasury, i.e. a holding.

A sole shareholder company of the State Treasury formed as a result of the state enterprise transformation is an independent, autonomous and self-financing in the interpretation of the provisions of the commercial code. It should be assumed that the sole shareholder company of the State Treasury, as the subject structurally and

financially fully independent, is not responsible for the obligations of other entities, also the obligations of the sole-shareholder company.

The state enterprise is transformed into sole-shareholder company of the State Treasury upon the motion. The motion could be submitted alternatively by the director of the enterprise and the Employees' Council, after having sought the opinion of the general assembly of the employees (delegates) and the founding organ, or by the founding organ having sought the consent of the director and the Employees' Council and the opinion of the general assembly of the employees (delegates). The above motion should comprise in economic and financial evaluation of the transformed enterprise, the draft of the company's founding act (statute or unilateral founding act in case of a limited liability company), as well as the planned scope of the enterprise employees' preferences at purchasing shares in the company from the State Treasury and other details, which the promoter and the state organ making the decision shall regard necessary (Art.5 Sec.1 & 2), and furthermore the opinion of the Anti-Monopoly Office which ensues from the Law on Counteracting Monopolistic Practises in the state economy. If the Chairman of the Council of Ministers (Art.6) orders the transformation of a state enterprise into a joint-stock company, the motion is lodged by the Minister For Ownership Transformations (the Minister of State Treasury) after having sought the opinion of the director and the Employees' Council of the state enterprise as well as that of the founding body. Absence of an opinion within one month shall be considered that no objections have been raised.

It should also be raised that sometimes the consent of the Minister for Ownership Transformations is obligatory for the transformation of the state enterprise into a sole-shareholder company of the State Treasury. It particularly refers to enterprises being of particular importance to the economy of the state, the register of which is stipulated by the regulation of the Council of Ministers.³

The approval to transform a state enterprise into a sole-shareholder company, and the refusal to transform it is a domineering intervention into matters of the state enterprise by the Minister for the Ownership Transformations, so the possibility of appeal against such a decision by way of objection based on the stipulation of the Law on state Enterprises has been rightfully implemented (Art.5 Sec.4).

The right to appeal does not apply when the Chairman of the Council of Ministers lodged a motion to transform the state enterprise (Art. 6 Sec. 1).

The transformation of the state enterprise into a sole-shareholder company of the State Treasury in accordance with the stipulations of Art.5 and the Act on Privatisation of the state Enterprises is sometimes defined as 'commercialisation'. In relation to this it should be mentioned that in the commercial code this term is understood as J. Namitkiewicz claims-subjection of the state enterprise to regulations of the commercial code and forming a separate type of merchant - merchant being the state. Upon the registration the state commercialised enterprise obtains legal personality and acts as a merchant, in accordance with the rules of market economy. The legal form of the

commercialised state enterprise finds its expression in ordinance of the President of the Republic of Poland dated March 17, 1927, separating industrial trade, mining state enterprises from the state administration and their commercialisation.

Making Shares Available to Third Parties

The Minister for Ownership Transformations (of State Treasury) decides on making shares in companies with exclusive State Treasury's holding, formed as a result of transformations of a state enterprise, available to third parties (Art. 19 Sec. 1 of the Law). The Minister shall make this decision immediately after the transformation, however, the shares should be made available within two years following the company's registration in the commercial register, unless the Council of Ministers sets a longer time limit.

Prior to making shares available to third parties the Minister for Ownership Transformations (of State Treasury) shall order the economic and financial analysis of the company's enterprise to be carried out with a view to determine its value and the need of introducing the organisational, economic and technical changes. The Minister shall also order an analysis to be carried out with a view to determine the legal condition of the company's assets, especially taking into account third parties' claims towards the assets (Art. 20 Sec. 1 & 3 of the Law).

Prior to making shares available to third parties the Minister for Ownership Transformations may, having obtained the consent of the Minister of Finance, take over a part or the whole of the company's debts on behalf of the State Treasury. The Minister should announce his intention of taking over the company's debts to the creditors, calling the creditors to submit their possible objections within the time limit not shorter than two months from the day of the announcement. The creditors who, within the time limit set forth, have not consented to having their debts taken over should be granted satisfaction or security. The Minister for Ownership Transformations (of State Treasury) shall announce the take-over of company's debts in the manner provided for by the company's announcements (Art. 22 of the Law).

As follows from the above the decision of making shares of a sole-shareholder company of the State Treasury available to third parties is solely in hands of the Minister for Ownership Transformations (of State Treasury) who acts as a central organ of state administration, he also acts for the State Treasury as the owner. The minister's decision cannot be appealed against in any procedure as he combines commanding and ownership entitlements.

Making shares available to third parties is based on their sale, transfer, encumbrance and lease including new issuance of shares or increased shares in case of raising the share (initial) capital etc. In compliance with the regulation of Art. 18 Sec. 1 of the Law, transfer and encumbrance of the shares, as well as allotment of such shares in companies where the State Treasury is the sole-shareholder shall take place in compliance with provisions of the commercial code, unless the provisions of the law provide otherwise. Transfer of shares is non-gratuitous, gratuitous transfer of shares shall require the

consent of the Council of Ministers. The Minister for Ownership Transformations (of State Treasury) in agreement with the Minister of Finance sets forth by a regulation the principles to finance the availability of the shares of the companies formed as a result of the state enterprises' transformation to third parties (Art. 23 Sec. 4 of the Law).

The Act on Privatisation of state enterprises stipulates, as a rule, a public transfer of shares. Transfer of shares in a way other than the one provided for above shall be null and void. As mentioned above, these rules depart from the provisions of the Commercial Code, nevertheless they are applicable as provisions. It can only be added here that with reference to a tender, an offer, or negotiations or any other way of transfer of shares, if such was regulated by the Council of Ministers on the basis of Art.23 Sec.2 of the Law, the equivalent provisions of the civil code or other legal acts regulating the conclusion of a contract in this procedure should be applied. The purchase on preferential terms, regulated in Art. 24 of the Law, also departs from the provisions of Commercial Code on transfer of shares. The employees of a state enterprise are vested with the right to purchase up to 20 per cent of the total number of the company's shares in which they are employed. It does not exclude the right to acquire and take hold of further shares on general principles. Acquiring shares on preferential terms is based on the selling shares at the price reduced by half in relation to the price fixed for natural persons, Polish citizens offered on the first day of sale. Shares should be made available to the employees on preferential terms not later than within two months from the day the first shares were made available on general principles. Whereas the employees' right to purchase shares on preferential terms shall expire after a year from the day the shares were made available to them.

In compliance with the ordinance of the Council of Ministers dated December 1, 1990,⁴ the shares purchased from the State Treasury in companies formed as a result of a state enterprise transformation may be paid in cash, by an open cheque, settlement cheque or remittance order and also in bonds of the State Treasury issued after November 1, 1989; privatisation bonds and other state securities if such possibility ensues from provisions of the law. The Minister for Ownership Transformations (of State Treasury) may upon consent of the Minister of Finance allow to pay for the shares in instalments. The possibility for paying in instalments concerns only purchasers being Polish citizens (Art. 27 Sec. 3). state subjects, i.e. natural and legal persons, are authorised to purchase shares which have been referred to (Art. 1 of the Civil Code), but also organisational entities which are granted legal capacity and legal transaction capacity by provisions, for instance unlimited partnership. Only state legal persons, in order to avoid denationalisation, shall not without prior consent of the Minister of Finance purchase rights on shares owned by the State Treasury (Art. 29).

Purchasers of shares of privatised state enterprises shall also be foreign subjects, i.e. natural persons living abroad, legal persons having their seats abroad and joint-stock companies which do not have status of a legal body of these persons. The subject is considered "foreign" on the grounds of domicile: place of living or a seat abroad, not on the grounds of foreign citizenship (Art. 4 item 1).

The Act on Privatisation of state Enterprises included a separate legal restrictions from the Act dated December 23, 1988 on business activity in participation of foreign subjects, determining the participation of the above mentioned subjects in privatisation. The prevailing act, however, on companies with the foreign capital has amended this regulation subordinating the purchase of shares of privatised state enterprise to this law.

Purchasing shares by foreign subjects should be carried out on general terms, i.e. by tender, by an offer for sale advertised in public, or as a result of negotiations entered into through public invitation. Any other procedure of purchasing could only be set forth by the Council of Ministers. Foreign subjects are not vested right to purchase shares on preferential terms, designed for employees of a privatised state enterprise, or on privatisation bonds. Foreign subjects are not allowed to pay for the shares in instalments since in compliance with Art. 27 Sec.3 of the Law such purchase is solely designed for Polish citizens.

Where rights on all available shares have not been taken over within the time limit stipulated under the law, the Minister for Ownership Transformations shall transfer the possession of shares to a bank or another financial institution under conditions determined by contract. A bank or another institution shall in compliance with the contract exercise the rights resulting from ownership of the transformed shares. The obtain revenues shall be transferred to State Treasury (Art. 28 of the Law).

As it has been mentioned in governmental bill on privatisation of state enterprises the above provision is a realisation of the opinion of Employees' Council who fear the privatisation process shall be limited to transformation of an enterprise into a company wholly owned by the State Treasury.

Privatisation Through Liquidation

Privatisation of the state enterprise through liquidation is set forth in provisions of Art. 37-43 of the Law. The above provisions provide that liquidation of the state enterprise may ensue either under the provisions of the state Enterprises Act (Art. 40 of the Law in connection with Art. 25-27 of the state Enterprises Act), or under the Art. 37 Sec. 2 of the Law on Privatisation of state Enterprises. The decision on liquidation in second procedure shall be made by the founding organ, with the consent of the Minister for Ownership Transformation (of Treasury) on its own initiative or upon request of the Employees' Council of the enterprise. The Employees' Council and the director of the enterprise shall have the right to object against the decision specified under the Act on state Enterprises.

In the Act on Privatisation of state Enterprises there was no clear instruction as to the procedure of liquidation of the state enterprise, if the decision was reached under Art. 37 Sec. 2 of the Law.

With reference to liquidation carried out under the act on state enterprises, not only the relevant provisions of the law but also executive acts issued under the above mentioned

law particularly the ordinance of the Council of Ministers dated November 30, 1981 on execution of the law on state enterprises,⁵ are respectively applied.

In case of the liquidation of the state enterprise under Art. 37 Sec. 1 of the Law on Privatisation of the state Enterprises the same procedure of liquidation is applied as in case of a liquidation of a state enterprise under the law on the state enterprises and the ordinance of the Council of Ministers on execution of the law on state enterprises. In case of the sale of the entire enterprise executing liquidation may be abandoned.

The value of the liquidated state enterprise or organised parts of such enterprise is undoubtedly the value of the estate remaining after the liquidation, in particular gratifying all liabilities. By virtue of the law after a state enterprise is removed from the register of state owned enterprises it shall become the property of the State Treasury (Art. 49 of the Law on state Owned Enterprises). Therefore, the State Treasury is a vendor, founder of a joint-stock company or a party of the contract on granting non-gratuitous use of the estate or organised parts of the state enterprise.

Sale of Whole Enterprise or its Organised Parts

The purpose of a liquidation of a state enterprise, as it ensues from the provisions of the Law on state enterprises and the ordinance of, the Council of Ministers concerning execution of the Act on state enterprises, is liquidation of active and capital assets and gratifying a creditor under the bankruptcy law.⁶ Since, according to the above provisions the founding organ decides on disposing of its tangible and intangible assets; therefore, it may, under the provisions of the law on privatisation of state enterprises, sell the enterprise or organised parts of the state enterprise's estate. The provisions of the Civil Code shall thus be applied.

In compliance with the article 41 of the law, the founding organ shall sell the estate of a liquidated state enterprise or organised parts of such estates, or shall grant the use of thereof for consideration applying respectively the provisions under the law on privatisation of state enterprises. It means that the sale of the enterprise or organised parts of the enterprise after liquidation should be carried out in the following way: by tender, by offer for sale advertised in public, or as a result of negotiations entered into through public invitation, or way other than the above defined by the Council of Ministers. The purchase may be for privatisation bonds, or if other provisions shall stipulate it through other securities.

Contribution of the Post-Liquidation Estate to the Company

The founding organ deciding upon allocating the estate remaining after liquidation of the state enterprise may contribute the whole enterprise or its part to the company (Art. 37 Sec. 1 item 2 and Art. 40 item 2 of the Law). Thus it shall constitute "a contribution" in the form of a contribution in kind, of which valuation in case of lack of particular provisions, shall be carried out on the grounds of relevant provisions of the Commercial Code. The founding organ shall not be tied up by any restrictions

contributing the enterprise or organised parts of such estate to the company. Thus it may be “a contribution” to a joint-stock company or limited liability single- or multiperson one, already existing for example through taking over an increased initial and share capital, or to a company which is established as single or with other subjects by a founding organ acting in the name of the State Treasury.

Granting of the Liquidated Enterprise for Consideration

Granting the use of the liquidated enterprise or any organised parts of its estate for consideration within a specified time has been determined under Art. 37 Sec. 1 item 3 and Art. 38-41 of the Law and by an ordinance of the Minister of Finance dated November 10, 1990 in the matter of fixing the prices of payments due to the State Treasury for the use of its estates.⁸ From the provisions mentioned above follows that granting the use of the enterprise ensues under the contract concluded by the founding organ on behalf of the State Treasury with a company which the majority of employees of the enterprises being liquidated have joined. The last condition shall not be required when a company fulfilling such terms has not been formed within two months after the Employees’ Council had decided on liquidation or if General Assembly of employees has not given its consent to it. Thus, it is possible to conclude a contract by the State Treasury, represented by the founding organ of the enterprise being liquidated, with a company of a minority contribution of employees or even without such contribution. Only natural persons are shareholders unless the Minister for Ownership Transformations (of Treasury) decides otherwise and allows legal persons to be shareholders (Art. 38 Sec. 1 item 4 of the Law). The amount of the share capital or initial capital shall not be lower than 20% of aggregate value of the promoter’s fund and the fund of the enterprise being liquidated.

The company which is granted the use of enterprise or any organised parts of its estate for consideration within a specified time is either a joint-stock company or a limited liability company. Taking into consideration the strict requirements as to the amount of initial (share) capital which aims at guaranteeing the restitution of the estate in case of its damage or decrease in value, therefore, in practice this form of privatisation shall probably be used by medium and small enterprises, which should be considered as not so apt legislative solution. It can also be assumed that this provision may give rise to circumvention of the law, particularly in scope of taking over the initial and share capital by employees of an enterprise being liquidated. Provision of the Art. 311 Sec. 3 of the Commercial Code making it possible to take over the share capital before registering the company in the amount of 1/4 of the nominal value of a share, thus not solve the above problem.

Non-gratuitous use of the estate of the enterprise being liquidated by a company may follow on the grounds of tenancy contract, lease contract and innominate contract. The act does not limit the freedom of the parties in this scope. From the expression of Art. 3 9 Sec. 2 of the Law follows that it could be the contract of lease which is commonly used in many developed countries with market economies and in international trade. This

type of contract has not been regulated by Polish law, nevertheless, it could be concluded following the principle of freedom of parties, which was expressed by an amended civil code in article 353. In case of non-gratuitous use of the estate of the enterprise being liquidated by a company article 23 of the law shall be respectively applied, i.e. it can be sold in the following way:

- by tender;
- by an offer for sale advertised in public;
- as a result of negotiations entered into through public invitation.

Privatisation bonds may constitute a form of payment.

As it has been determined by the above ordinance of the Minister of Finance dated November 10, 1990, the basis for fixing the payment due to the State Treasury for the use of its estate by joint-stock companies constitutes the value of the enterprise, organised parts of this enterprise fixed while taking into account the prevailing market prices. The valuation shall be carried out by a founding organ through the mediation of other subject, which professionally deal with such activities. The founding organ may also accept the valuation made by the enterprise itself.⁷

National Investment Funds

National Investment Funds were regulated by the Law dated April 30, 1993 on National Investment Funds and their Privatisation (Dz. U. RP No 44, item 202; with later amendments). National Investment Funds are constructed as a new type of industrialised participants on Polish securities' market, which performs as an active investor to many enterprises. National Investment Funds were based on a design of closed type investment funds of a constant number of participants who own the shares of these funds as participation titles.

Establishing National Investment Funds was composed of several stages. The preliminary stage was based on selecting state enterprises, which were to enter the Programme of National Investment Funds and their commercialisation "transformation" into companies wholly owned by the State Treasury. A change of their organisational and legal form ensued; thus, the basis of their functioning underwent change since they were submitted to a regime of Commercial Code. As it has been mentioned above, transformation of state enterprises into companies wholly owned by the State Treasury followed their prior designation to this procedure by ordinance of Council of Ministers. However, the participation in the programme of National Investment Funds was voluntary, in consequence designated enterprises were vested a right to lodge an objection against including them in the above programme. According to the Art. 7 Sec.2 of the Law on National Investment Funds, the director (or its Employees' Council) of the enterprise included in the list could forward a reasoned objection within 45 days after the notification. An objection meant withdrawal of this enterprise from general privatisation programme. The absence of an objection was regarded as an expression of consent.

Next stage in programme of National Investment Funds proceeded in two areas. The first area encompassed establishing National Investment Funds. On December 15, 1994, the Minister for Ownership Transformation (of State Treasury) signed deeds of foundation for 15 National Investment Funds. Thus, *the only founder and initially the sole-shareholder of the Fund is the State Treasury represented by the appropriate minister (Minister of State Treasury)*. The State Treasury shall stay the sole-shareholder of National Investment Funds until privatisation of National Investment Funds, i.e. an exchange of share certificates into shares of National Investment Funds, which should take place at the beginning of 1997. National Investment Funds have been established in a *form of a joint-stock company*.

The share capital of each National Investment Fund amounted to 100 000 PLN, it is a minimum amount required for a share capital by Commercial Code. It is divided into a million of shares in the nominal value of a share - 0.1 PLN. It is one-tenth value of the minimum nominal value - 1 PLN - referred to for joint stock companies in Polish law. All shares are *bearer shares*. The State Treasury, in order to cover the shares, contributed money an intentional allocation, however, it was a minimum contribution required to establish National Investment Fund as a joint stock company. Registration of the funds as well as their establishing as legal entities took place on March 31, 1995.

Being the sole-shareholder of the funds, the State Treasury made non-monetary deposit in the form of shares of companies wholly owned by the State Treasury, which were established as a result of commercialisation of state enterprises, to raise the share capital. In compliance with the law on National Investment Funds (Art. 9), these contributions shall be used to cover the share capital and the reserve capital of particular funds. At the same time, calculation of the value of non-monetary contributions with the exception of verification procedure of the value of assets by expert controllers (Art. 13 Sec.2 of the law on NIF) is a departure from the general principles of commercial code. The value of shares shall be calculated:

- by dividing the total capital of the company as of the date of the last balance sheet by the number of shares of such a company at the time of contribution of its shares to the fund, if after its transformation the company has prepared an annual balance sheet for the previous financial year;
- by dividing the total capital of such a company at the time of either the transformation of a state - owned enterprise into such a company or the establishment of such a company, by the number of shares provided in the statutes of such a company at the time of the contribution of such shares to the fund, in the remaining cases (Art. 9). In this way the shares of companies established from transformation of state-owned enterprises were taken over by other companies with the State Treasury as a sole- shareholder. As long as the State Treasury remains the sole-shareholder, it shall contribute shares of other joint-stock companies to the funds. The Table 1 presents some data on the assets and financial results of the 15 NI funds.

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Table I

Financial results of the Funds in the first quarter of 1997

Balancesheet (in thousand PLN)	IN1F	It NIF	III NIF	NIF Progress	VMF Victoria	NIF Magna Polonia	NIF im. K. Wielkiego	NIF Helma
	363.gr	31.0197	31.03.97	31.03.97	31.03.97	31.03.97	31.03.97	31.03.97
Investment portfolio	416970	460996,1	368864	406047	329734	332229,6	384450,3	426976,9
Dues	2441	3053,3	6055,7	3486,3	123,7	15713,2	1480,5	5379,0
Financial resources	11294,7	12145,4	9609,4	16845,5	7858,7	319,9	8143,e	145,?
Other assets	3,3	1242	90	26,9	110,6	121,7	153,6	106,1
Assets together	430706	477437,£	381528,1	425405,7	337627	348384,4	304228	441883
Obligations	15777	13200,fi	34329,6	20782,8	22465,7	15013,4	15553,9	37655,2
Periodical settlements	2900,7	2357, £	1739,7	147	1730,2	5566,6	0	363,5
Reserves	0	2639,1	0	0	14182	0	0	C
Obligation and reserves	18757,7	18206,4	36069,3	20929,5	38407,£	20595,7	15814,1	40631,4
Assets netto	411952	459231,4	345458,8	404475,9	295219,1	327788,7	378413,9	401251,6
Assets netto per one share	13,2i	14,S		13,04	9,64	10,56	No	
Calculation of profits and losses	1 kw.97	1kw97	1Kw.97	1kw97	1Kw97	1kw97	1Kw97	1kw97
Incomes of investment	2622,2	3175,5	2147,5	5660,1	2780,2	3617	2359,7	774,fi
Other operational incomes	1,4	C	0	0	C	37,9	0	199,2
Operational costs	3723,9	1547,8	5721,7	2664,2	4835,3	4327,8	3428, £	5284,S
Other operational costs	3,6	C	3,5	10,2	71,2	2,7	3,5	134,2
Reserves	-19,6	1469,4	12,9	0	C	8032, S	0	3158,6
Results of netto investments	-1064,3	156,2	-3564,8	2985,7	-2126,2	-8708,5	-1072,2	-7802,8
Realised or not profits or losses	6616	5945,2	8273,2	52357,4	8447	9781,4	8391	8455,8
Profits (losses) of operational activity	5533,7	6103,£	4708,4	55043,1	6320,7	1072,5	7318,7	653
Results of extraordinary operations	C	C	0	0	C	0	0	C
Profits(losses) brutto	5533,7	6103,5	4708,4	55043,1	6320,7	1072,£	7318,7	653
Obligatory charges of financial result	0	1142,5	706,3	855C	881	0	603,1	C
Profits(losses) netto	5533,7	4961	4002,1	47378,1	5439,7	1072,5	6715,6	653
Profits(losses) per one share	0,18	0,16	0,13	1,53	0,18	0,03	0,22	0,02

Balancesheet (in thousand PLN)	NIF Odcwa	NIF im.E Kwiatkow2	NIF Foksal	XI MF	NIF Piast	NIF Fortun	Western NIF
	31.03.97	31.03.97	31.03.S7	31.03.97	31.03.97	31.03.97	31.03.97
INRestmer' portfolio	376790	356800,3	468313,6	379616,8	402195,3	401348	304337,7
Dues	4211	6861,4	3031,7	31575,7	5754	1766,2	1828,4
Financial resources	2539	7622,9	2134,4	5683,4	194,9	104007,3	90660,6
Other assets	1213,8	1317,4	65,8	3078	127,8	64,5	156,2
Assets together	384749	372602,4	474445,5	419953,9	408272	507206	396982,9
Assets netto per one share	11,19	11,92	14,94	12,91	12,32	15,39	12,06
Obligations	24823,1	1846,4	9313,7	14637,5	21933,2	22528,4	22896,5
Periodical settlements	681,7	1008,9	312,2	360,5	31202,1	138,5	47,1
Reserves	0	C	0	426C	C	17,6	0
Obligation and reserves	37901,2	2855,3	10786,8	19256	26008,8	29588,5	22943,6
Assets netto	346848	369747,1	463658,7	400695,9	382268,2	477617,5	374009,3
Calculation of profits and losses	1 Kw.97	1KW97	1kw97	1kw97	1Kw97	1KW97	1kw97
Incomes of investment	4092,9	-1013,4	4917	1606,3	2976,3	8493,2	-902,9
Other operational incomes	1,7	118	84,5	359, £	7,6	1412	2068,7
Operational costs	3657,7	1400,6	2015,3	2767,2	4258,5	3952,7	4016
Other operational costs	16,5	5	0	1,1	3,6	0	3390,7
Reserves	258,1	1248,41	-68,3	0	-7199,1	0	8018
Results of netto investments	678,5	-1052,8	3054,5	-808,1	-8477,1	5052,5	-14278,9
Realised or not profits or losses	8318,3	3645	8808,5	30236,4	9053,6	57825,5	66354,2
Profits (losses) of operational activity	8968,8	2592,2	11863	29428,3	576,5	1173d	52075,3
Results of extraordinary operations	C	d	C	0	d	0	0
Profits(losses) brutto	8906,8	2592,2	11863	0	576,5	11735	52075,3
Obligatory charges of financial result	1183,4	665,4	1907,8	2575,6	233,6	2707,6	87703,1
Profits(losses) netto	7813,4	1926,8	9855,2	26852,7	352,9	9027,1	43372,2
Profits (losses) per one share	0,25	0,06	0,32	87	0,01	0,29	1,4

Source: Rz Data 14.05.1997

The law on National Investment Funds specifies in which proportions shall contribution of shares of companies created after the transformation of state-owned enterprises to National Investment Funds. Thus, there is 60% of shares of each company of which the State Treasury is the sole-shareholder contributed to the established funds. Out of the 60% of the shares of each company, 27% of the shares of each company are held by all designated funds, except for one such fund which received as a whole a package of 33% of the shares of a given company, which gives him a substantial shareholding. There is only one such package of 33% of the shares that shall contribute as a whole to one fund. These principles apply only to the distribution of shares of companies among funds wholly owned by the State Treasury. The State Treasury may also contribute to the funds wholly owned by the State Treasury all or a portion of the shares it owns in a company not wholly owned by the State Treasury. Such shares should be divided among designated funds, provided that one fund may receive no more than 33% of the total number of shares of a given company (Art. 10).

The purpose of the funds is to increase the value of their assets, in particular by enhancing the value of shares of companies of which the funds are shareholders. The funds endeavour to achieve the purpose in particular through conducting economic activity through purchase and sale of shares of company's exercise of acquired rights. It applies not only to the shares of companies included into the Programme of National Investment Funds. The funds may also purchase shares, bonds of other companies and securities issued by the State Treasury for instance bonds and exchequer bills. National Investment Funds have also right to grant loans for the accomplishment of the above tasks as well as for the purpose of improving the management of the companies in which the funds have a substantial shareholding. The purposes may include strengthening of company's position in the market and obtaining new technologies and loans for the companies (Art. 4).

This activity, on behalf of the funds, is exercised in most cases by management firms, which shall be discussed thereafter. National Investment Funds, in their activity, are subject to different limitations, which result from the law or from statutes of particular funds. These limitations apply particularly to possibility of selling shares of companies, in which a given fund has a substantial shareholding.

Each fund at the time of beginning its activity has the following restrictions:

- it is prohibited to acquire securities issued by entities not having their seats in Poland or by entities not primarily engaged in business in Poland;
- it is prohibited to acquire shares in general partnerships or other entities, investment in which would create unlimited liability for the fund;
- it is prohibited to acquire shares of any company if as a result of such acquisition the fund would have over 33% of the votes in such a company, however, there are exceptions to the rule. The fund may acquire more shares if there is a new issuance, making use of the right to collect shares of new issuance. These shares may be obtained by way of pre-emption right;

- it is also prohibited to sell shares of a company, in which the fund owns more than 20% of the share capital and is at the same time its largest shareholder, if as a result of such sale the fund's holding in the share capital of such company would fall below 20%. The prohibition does not apply to situations where such sale is a result from a public offer made by the fund, an offer for sale to one or more investors, provided the buyer shall acquire all the shares of the company offered for sale in this way. It means that the fund may sell shares of a company, for which it is the fund with substantial shareholding, on condition that the fund shall either introduce the company to the market or shall find a strategic investor for the company;
- it is prohibited to sell securities that the fund at the time of making of the sale agreement does not own; unless at the time of making of such agreement the fund is entitled to acquire an appropriate number of securities of the same kind;
- it is prohibited to invest more than 5% of its net asset value in securities issued by another fund;
- it is prohibited to acquire precious metals and enter into commodities contracts, options of future contracts, except for transactions having the aim of reducing the exchange rate risk within limits permitted by Polish law;
- it is prohibited to acquire real estate (except for use as office space for the fund or its management firm) or invest in companies engaged primarily in real estate investment, if it exceeds 5% of the net asset value of the fund estimated on the basis of the last balance sheet;
- it is prohibited to borrow money or issued debt securities, if as a result the total value of the Fund's debt obligations would exceed 50% of the net asset value of the fund;
- it is prohibited to acquire securities, if as a result of such acquisition more than 25% of the net asset value of the fund would then be invested in securities of one issuer (Art. 44 of the law).

Elimination of any of the restrictions referred to the above needs amendment of the fund statutes, however, to amend statutes within three years of the date of the registration of the fund shall require an unanimous vote of the General Assembly of the fund. Altering this state of affairs, i.e. passing resolutions with a majority of votes, when the votes of important private investors shall decide shall be possible in 1997 at the earliest.

Governing bodies of a National Investment Fund organised in the form of a joint-stock company shall be: *the General Assembly, the supervisory board and the management board.*

As it has already been mentioned above, within three years of the day of the registration of the fund the sole shareholder of National Investment Fund until the distribution of share certificates is completed and then their exchange into shares of National Investment Fund, is the State Treasury. As a consequence, a group of shareholders of NIF shall alter, as a place of the State Treasury shall be taken by these entities who possessing share certificates shall exchange them into shares of the funds.

Those powers of the General Assembly which are not exclusively assigned to it by this law or the fund's statutes, shall be exercised by supervisory board with the exception of Commercial Code in this scope until the *first General Assembly meeting attended by* shareholders other than the State Treasury. The General Assembly shall have exclusive competence to make decisions in the following matters:

- change of statutes;
- issuance of new shares;
- merger of the fund with another company;
- dissolution of the fund.

Confirming a contract on management of the assets of National Investment Funds but belongs to exclusive competence of the General Assembly, which is concluded by the supervisory board. The remaining competencies of the General Assembly reserved by the statutes are:

- granting a vote of acceptance to the authorities of the fund;
- consideration and acceptance of the board's management report, a balance sheet and an account of profits and losses for the previous account year;
- passing a resolution concerning division of the profits and covering losses.

It has been reserved in global contracts that until the State Treasury is the owner of at least 75% of shares of National Investment Funds, the appropriate minister exercising the rights of the State Treasury shall comply with the following rules:

- until the first General Assembly of NIF is convened, in which shareholders other than the State Treasury may participate, all statutory amendments shall apply respectively to all NIF and no amendments, which could have an unfavourable influence on business activities of the management firms or National Investment Funds, shall be introduced;
- during voting at general meetings of "dependent" companies, the Minister shall abstain from voting.

These provisions shall secure a *passive role* of the State Treasury.

The voting at a General Assembly is open. Secret ballot during elections while putting a motion for recalling members of the authorities or liquidators of the fund to vote, or bringing them to justice as well as in personal matters is ordained.

The supervisory organ in NIF is *the supervisory board*. Unlike it is regulated by the Commercial Code, which stipulates for appointing a supervisory board or an audit board as a supervisory organ in joint-stock companies; or if the statutes stipulate both of these authorities. The supervisory board is an obligatory organ if the share capital exceeds the amount of 500 000 PLN.

The members of supervisory boards were appointed by way of course of competition conducted by a Selection Commission which also conducted a tender with the purpose

of selecting management firms as shall be discussed thereafter. The Selection Commission was composed of 12 people, appointed by the Prime Minister, including the chairman of the Commission, 4 persons selected by the Sejm, one selected by the Senate and 2 persons selected by trade unions, including one selected by "Solidarnost". The activity of Selection Commission shall be concluded on the day, which the State Treasury shall no longer be the sole-shareholder in NIF.

Candidates for members of Supervisory Boards, in accordance with the regulations of the Commission,⁸ had to be at least 30 years old, possess documentary evidence for graduating from national or foreign universities at the department of law, economics, engineering or management; or studies in other fields and additional postgraduate studies in law, economics, engineering or management. Furthermore, candidates were obliged to supply documentary evidence of professional seniority in Poland or abroad for at least 4 years (Domanski, G., J. Fiszer (1993), Kostrz-Kostecka, A. (1995).

First supervisory boards were called from candidates selected by the Selection Commission. The members of the supervisory board were appointed and recalled, and their remuneration determined, by the Minister for Ownership Transformations (of the Treasury) as a representative of the founder of NIF, which is the State Treasury. The term of the supervisory board shall expire on the day of the first General Assembly which may be attended by shareholders other than the State Treasury may (Art. 18). In the following terms, the General Assembly shall appoint supervisory board (from its team/circle). At least two thirds of the members of a supervisory board of a fund should be Polish citizens. 6860 candidates entered the competition. The first selection was carried out by Technical Secretariat of the Commission. They made an introductory assessment taking into consideration except for the above mentioned conditions also the knowledge of at least one foreign language by a candidate, the experience in holding a position in supervisory boards of a joint stock company or other similar function in Polish or foreign institution. Finally, in June 1994 the Commission approved a list of 257 candidates for chairmen of supervisory boards of NIF.

In accordance with the assumption that the State Treasury as the sole shareholder shall be the passive owner, on NIF, the supervisory board takes over a substantial part of entitlements of the General Assembly.

As it has been mentioned above, the supervisory board exercises the competence of General Assembly not reserved by the law or the statutes of the latter. Concluding a contract on management of the assets of NIF belongs to exclusive competence of supervisory board. However, in compliance with Art. 21 of the Law, the supervisory board may select and conclude a contract exclusively with management firm selected by way of (competitive) tender by the Selection Commission. It means that until the State Treasury is the sole shareholder of NIF, the assets of the fund shall be managed by management firms selected by an organ composed of the representatives of the highest state authorities.

In the remaining scope to the competence of the first and the following supervisory boards the provisions of Commercial Code are applicable (382-383 Commercial Code).

The supervisory board exercises a constant supervision of the activity of the fund. The supervisory board in particular examines a balance sheet and an account of profits and losses, both to the consistency with the books, documents and the facts. The supervisory board examines management board's reports and also motions of the management board concerning partition of profit and coverage of losses; it also presents to the General Assembly an annual written report on results of the above examination.

From the Law on National Investment Funds (Art. 18 Sec.3) arises that the supervisory board has an *exclusive* power to appoint members of the management board. The supervisory board may recall members of the management board before the end of the term of office as well as delegate its members to execute the activities of the management board if the board cannot perform its activities properly. There are also provisions in the statutes of the National Investment Funds, requiring the consent of the supervisory board for performing of some activities. They concern acquisition or transfer of shares or other assets, or contracting and granting loans, if the value of the above transactions exceeds 15% of the net asset value of the fund, indicated in the last balance sheet.

The supervisory board passes a resolution with the majority of votes. It acts on the grounds of regulations passed by the supervisory board and approved by the General Assembly. The supervisory board convenes ordinary and extraordinary General Assembly, if the management board has not done it in due time.

The management board is the executive organ of National Investment Fund. The management board may be one-man or it may be composed of greater number of members: the statutes limit the number to seven members. The exact number of members is defined by the supervisory board.

The management board is appointed for a period of two years, in compliance with Art. 19 of the Law on NIF. This solution departs from the appropriate regulation in Commercial Code (Art. 367 § 1), which provides that members of the first management board may be appointed for a period of no longer than two years, the members of the following for three years.

The management board administers the fund and represents it outside. Formally it acts irrespective of the management firm, though in practice, the principle of personal union has often been applied, i.e. members of the board of the management firm became members of the management board of the fund. Generally, in a contract for management of the assets of NIF there are provisions stipulating that management firm has an influence on the composition of the management board, i.e. persons appointed in its composition shall be recommended by the management board.

Up to eight months after the end of the fiscal year, the management board must present to the supervisory board a balance sheet, an account of profits and losses for the previous year and a written report on the activities of the fund in a given year. (The first fiscal year of the funds begins on the day of their registration, that is on March 31, 1995). The management board is also obliged to convene an ordinary General Assembly

within ten months after the end of fiscal year. An extraordinary General Assembly is convened by management board of its own initiative, on a written motion of the supervisory board or a motion of shareholders representing at least 10 per cent of the share capital within a period of two weeks from the date of lodging motion.

The Law on National Investment Funds stipulates some *restrictions* concerning persons who may act as members of the management board or supervisory board (Art. 28). Namely - within three years from the date of registration of a fund, parliamentary deputies and senators shall not be members of the supervisory board or the management board of the fund or of a company in which the fund holds at least 20% of the shares. By virtue of the law the appointment of such persons shall be null and void. Another restriction specifies that no member of the supervisory board or management board of any fund shall simultaneously serve as a member of the supervisory board or management board of another fund (Art. 25 Sec. 4).

The National Investment Funds received a special income tax status, namely they are exempted from income tax from legal persons by way of dividends (Art.43 of the Law). National Investment Funds is liable to 40% income tax from legal persons arising from income other than dividends.

Owners of share certificates and shareholders of National Investment Funds obtained a special tax status. The principle was introduced, according to which:

- revenue obtained from the sale of share certificates is exempt from income tax from natural persons, the exemption does not apply to cases in which such sale is the subject of business activity of the vendor;
- revenue obtained from the sale of shares of National Investment Funds is exempt from income tax from natural persons to aggregate value not to exceed in one year half of one month's salary in the national economy.

An intention to exempt the so called "petty savers" from taxation of small revenue, for who the taxation would be burdensome especially for a revenue apparatus and marginal from the point of view of taxation receipts constitutes the substantiation of this provision.

The transfer of ownership of a share certificate shall be exempt from stamp duty (Art.36). The adoption of such record is justified by the fact that encumbering the above transactions with stamp duty would constitute a legal fiction when a share certificate is a bearer security (see Chapter 4) and one of the obvious elements of non-market transfer of these share certificates is the lack of record of the executed transactions (Domanski, G., J. Fiszer (1993).

"Dependant" joint stock companies

The basic part of the assets of the funds constitute a non-monetary contribution of the State Treasury, i.e. these are the shares of companies wholly owned by the State

Treasury. There were 512 companies altogether introduced into the programme. The following Table 2 shows their distribution among the industry branches and the list of the 15 NIFs.

Table 2

**Enterprises included in the NIF Program (Mass Privatisation Scheme)
(grouped by branches)**

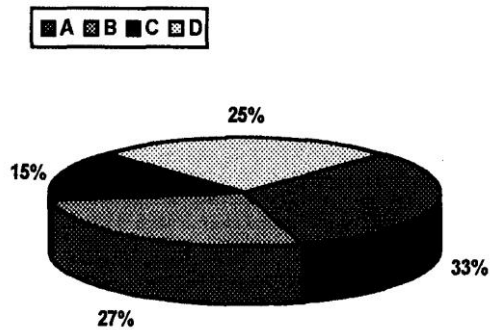
National Economy Branches	Privatised Enterprises in the NIF Programme				
		TRANCH			
dated on 31.03.1996	Sum	I	II	III	IV
National Economy	512	173	147	93	99
Industry	417	150	108	78	81
Bilding Industry	69	21	29	11	8
Agriculture	1	0	0	0	1
Forestry	0	0	0	0	0
Transport	9	2	2	1	4
Communication	0	0	0	0	0
Comme rce	15	0	8	3	4
Other Industries	1	0	0	0	1
Source:Ministry of Privatization					

The statutes of the funds determine the number of members of the supervisory boards. It must be odd and not to exceed 9 until the day of the first General Assembly is convened, in which shareholders other than the State Treasury may participate. The State Treasury may introduce to the funds shares, which it has at its disposal in the companies privatised by the capital way on the grounds of the law on privatisation of state-owned enterprises. The law does not exclude introducing non-monetary contributions to the funds by the State Treasury even later when the State Treasury is no longer the sole shareholder of NIF; however, the above principle of distribution shall not be binding.

It has not been defined in the Law on National Investment Funds, which enterprises may be included in the programme. It has been assumed that these should be large and prosperous enterprises, however, the gross profit which equals zero constituted the lower limit. In practice, however, there were enterprises in the programme which incurred losses. Thus, annual turnover of ten million dollars was adopted as a criterion of quantity.

Chart 1 shows the distribution of the stock in any company from the NIF program.

Distribution of the Shares in the “Dependent” Companies



- | | | | |
|---|---------------------|---|---------------------------------|
| A | Leading NI Fund | B | Other National Investment Funds |
| C | Company’s employees | D | State Treasury |

At the moment of contribution by the State Treasury to the funds of the shares of companies in which the State Treasury is the sole shareholder, the value of share capital of such companies shall be lowered to the level of 15% of the capital of the company (it is a share capital plus a reserve capital) on the day of its entry in the commercial register. This procedure does not mean decreasing the assets of the company since the amount of decrease of the share capital of a company shall be transferred to the reserve capital. The purpose of this procedure is to secure the “dependent” companies the so called issuing capacity and covering the possible losses of the company without the necessity to allocate the profits for this purpose in the following years at the cost of a dividend.

Management Firms

In compliance with Art. 21 of the Law dated April 30, 1993 on National Investment Funds and Their Privatisation (Journal of Law of the Republic of Poland No 44, item 202) the fund operating in accordance with the article of the law in the form of a joint stock company may conclude a contract for the management of its assets with a management firm (Art.21 of the Law). The above contract shall be executed by its supervisory board.

Making use of the concept of the contract for the management of the assets of the fund is under Polish conditions a unique experiment. The *management firm* appears beside the statutory power which is the management board and its obligations agree substantially with organisational task of the management board. Thus follows a

commission by way of to exercise specific tasks of the agreement of the management board to an outside subject in relation to joint-stock company. The aim of such a procedure is making use of specified professional skills of a “professional” manager, including his occupational prestige, influences and connections. The manager himself does not incur responsibilities towards a joint stock company such as a member of a statutory board. This form of transfer of executing tasks shall not mean transferring the tasks alone, i.e. organisational, statutory obligations of members of the management board.

In compliance with the above Law on National Investment Funds (Art. 21, Sec. 2 and 3) the contract for the management should be concluded with management firms, selected by way of competitive tender by the Selection Commission. The selection criteria should be made public. The detailed procedure for conducting the tender was determined by ordinance, by the Council of Ministers.⁹

The tender offers were submitted by 33 consortia, which included approximately 100 firms. The offers consisted of technical and financial proposals. The technical offer was first and foremost an information about a participant of the tender, and respectively the account of experiences in management, financial consulting, and restructuring of state- owned enterprises. And about the suggested method of managing of the assets of the fund, the exact information on financial means, the firm could allocate for realisation of its intentions concerning the management of the fund.

Evaluating the technical offer the Selection Commission paid attention particularly to the fact how the candidates see the possibility of providing help to dependent (“parterowe”) joint-stock companies by the ones holding at least 33% of the share capital and by the remaining funds. How the company intends to acquire financial means for a joint-stock company and the fund; and how the relationship between management firm and management and supervisory board should look like, and how the firm intends to increase the assets of the fund?

The financial offer, however, referred to the amount of the demanded fixed management fee for the management of the assets of National Investment Funds. Evaluating and calculating points for specific offers the greater emphasis was put on evaluation of the content related virtues of the candidates rather than on the proposed amount of remuneration, since it was more important from the viewpoint of the program. The greater importance was put on the best firms - not the cheapest. The aim of the tender was the selection of a specific number of firms, with which the contract for the management could be reached in future.

On this basis the Selection Commission designated 19 firms; the contract with the management firms was signed by 14 out of 15 registered National Investment Funds. The Supervisory Board of the given fund chose the management funds through negotiations. The first management firms were drawn for negotiations.

Three contracts were signed at a time. The contract of the management of the assets of National Investment Funds is a bilateral one, concluded between the fund and the

management firm (with the exception of few modifications negotiated separately between the given parties. They were made in equal form) and approved by the Minister acting as a General Assembly of a single joint-stock company of the State Treasury, which each of the funds constitutes. The two other contracts, the contract on remuneration for the financial results and a global contract concerning reciprocal relations among the State Treasury, the fund and the management firm, are tripartite contracts concluded by National Investment Funds, the management firm and the State Treasury.

The firm should be either a legal entity or a group of entities consisting of legal entities. In most cases management firms are consortia organised in the form of limited liability companies or joint-stock companies. Shareholders of the above consortia are in majority *foreign firms*: banks and other financial institutions experienced in managing investment funds or other consulting firms. Polish shareholders holding rather a minority block of shares or stocks in these consortia are *commercial banks*. Only in two cases: Ist and XIVth National Investment Fund the controlling shareholders are Polish banks. In majority, with the proportion of six to three these are private banks.

In accordance with the content of Art. 22, Sec. 1 of the law the contract for management between a fund and a management firm may provide that the fund will grant a *power of commercial representation* ('prokura') to the management firm. Commercial representation, in accordance with regulations of the commercial code authorises to all judicial acts and out of court ones, which are connected with running any enterprise. You need an authorisation to sell off or rent an enterprise or to establish on it the right of use and sell off and encumbrance of the property. In case of granting a power of commercial representation to the management firm, the name of the management firm and names of the individuals exercising the rights of commercial representation shall be disclosed in the commercial register. The management of the fund grants the power of commercial representation as the organ generally authorised to perform its tasks and represent it outside. Granting the power of commercial representation is to enable the management firm to function properly and wholly. There is also a possibility of convoking the personnel of the management firm to the board of the fund, in such a case they obtain the status of the board member.

In practice the power of commercial representation is rarely granted within the fund. In individual funds the principle of the *personal union* was taken into account, i.e. members of the management firm become also members of the management board. In such a case the management firm bears contractual responsibility as a legal entity. Individual parties who are members of the management board of the fund bear statutory responsibility as a natural person. In most cases in boards of fund there is one or two persons from the management firm, although there are cases in which the whole board of the fund consists of entitles who are members of the management board of the management firm. The management firm is also entitled to delegate its representatives but as observers without the right to vote, only to take part in the meetings of the management and supervisory board, which enables it to observe the current activities of these organs of the fund (Kostrz-Kostecka, A. (1995).

The management firm owning the commercial representation shall be enabled to *perform tasks on the basis of possessing shares in dependent joint-stock companies*. Thus management firms acting on behalf of the fund shall be able to execute the rights of the proprietor in relation to dependent firms. The fund owning the whole package of 33% of the shares of a dependent joint-stock company shall in fact own the *control interest*. The “dependent” firm would thus become a company controlled by the “dominant” one. The dominant investment fund and “dependent” joint-stock companies form a specific holding structure of (Kubot, Z. (1994), as the National Investment Fund which owns the control interest of shares in the “dependent” joint stock company can exert the dominant influence on its activities. Depending on the content of the specific contract on management for National Investment Funds those rights could be transferred to the management firm. The management would thus have direct *influence on appointing the members of the supervisory board, and indirectly members of the board of “dependent” companies*.

In accordance with the regulations of the Law on National Investment Funds and Their Privatisation (Art. 23) the duties and powers of the management firm shall be determined in *the statutes of a fund and in the contract* between the fund and the management firm.

The main duty of the management firm is *management of the assets of the fund*. The management firm was entrusted with executing basic activity of the fund irrespectively of the parallel board of the fund, a joint-stock company. The purpose of the management firm is to increase the value of its assets, in particular through enhancement of the value of shares of which the funds are shareholders. This activity consists of:

- exercising rights with respect to the shares of companies established as a result of transformation of state-owned enterprises into single-man companies wholly owned by the State Treasury, pursuant to the Law dated July 13, 1990 on Privatisation of State- Owned Enterprises,¹⁰ in particular for the purpose of improving the management of the companies in which the funds have a substantial shareholding including the strengthening of their position in the market and obtaining new technologies and loans for companies;
- conducting economic activity through purchase and sale of shares of companies and exercise of acquired rights;
- granting and obtaining loans for the accomplishment of the tasks set forth in items 1 and 2 above, as well as other tasks defined in the statutes.

Funds, as it was mentioned above, management firms which take over this activity, operate as *active investors*. The management firms as it results from their very nature use such implements of power as the following financial instruments:

- providing credits to finance the processes of restructuring and developmental projects;
- transactions in the international markets which as a result will allow access to other financial sources or co-operation with foreign partners. The separate form of activity of

management firms is financial, legal and marketing consulting, training of the executive staff also carrying out analyses of the current economic activity, financial condition or strategy of joint-stock companies, and any help needed when restructuring 'dependent' companies. The results of the above analysis constitute a basis for investment decisions of the whole fund. The management fund should present three- monthly account, containing among, others the analysis of economical and financial condition and the strategy of the management of the firm, to the management and supervisory boards within 90 days after the end of each quarter of the fiscal year.

Starting with the first quarter of the fiscal year of the fund, the account which the management firm is obliged to present to the management and the supervisory board shall also contain the *list of transactions* on the nature of capital investment, e.g. sale or purchase of block of shares, the account of capital loss and profits. The firm should also present *changes in the investment portfolio*. There shall also be a balance sheet for the last day of the reported period, calculation of the profits and loss of the fund for that particular period, information on the net assets of the fund for the last day of the reported period.

Within 120 days after the end of the fiscal year, the company also must present to the management and supervisory board a balance sheet for the last day of the fiscal year, the account of profits and loss for the above mentioned fiscal year approved by the expert auditors.

The management firm shall perform every possible matter/task which comes within the scope of administration and business activity of the fund, its accountancy; on behalf of the fund directly or through appointed proxies and subcontractors approved by the supervisory board of the National Investment Fund. The firm shall *supervise* the preparation of all legal documents connected with transactions of the fund, and preparation of issuing brochures in case of introducing the shares of the fund to public issue.

The *supervision of issuance* of shares and remuneration of dividends may also be transferred to the management firm.

In justified cases as it arises from the contract, the management firm shall be obliged to carry out consultations for a larger group of shareholders or for representatives of state authorities.

The basic right of the management firm is the right to remuneration for rendering services. This remuneration, in compliance with the regulations of the act (Art. 24 Sec.3), may comprise an annual fixed management fee, annual performance fee or the final performance fee, which are the subjects of a separate contract. The principles of remuneration of the management firm should be specified under the agreement between the management firm and the fund with regard to the following principles:

- the annual fixed management fee shall be established by way of tender which has been mentioned above ("Fixed management fees of the management firms controlling the funds vary within the range of 1.1 or 1.2 to 3.2 mln US dollars and are paid quarterly."¹¹);

- the annual performance fee, including any fee expressed in terms of percentage of fund shares, shall be determined in an amount not to exceed the value of 1% of the fund shares for each year of rendering services by the management firm, in an amount obtained from the sale of shares and the value of due dividend;

(On the day of entry into force of the contract for annual performance fee, 10% of share capital of the National Investment Fund shall be allocated to “the annual reserve packet of shares” and in addition 5% of share capital shall be allocated to the “final reserve packet of shares”. Beginning with the first fiscal year of National Investment Fund and ending at the tenth fiscal year, a part of the ‘annual reserve packet of shares’ in an amount of 1% of the share capital of the National Investment Fund shall constitute “a pool of shares allocated to finance the annual performance fee”. With reference to the tenth fiscal year of the National Investment Fund, i.e. the fiscal year ending on Dec 31, 2004, all shares of “the final reserve packet of shares” shall constitute a pool of “shares allocated to finance the final performance fee”. The contract for the annual performance fee determines/specifies that in case of its earlier termination the annual performance fee payment shall in proportion to the period/amount of time in which the management firm actually managed the assets of the National Investment Fund.);

- the final performance fee including any fee expressed in terms of a percentage of fund shares, shall be determined in both cases in an amount not to exceed the value of 0.5% of fund shares multiplied by the number of years of service of the management share in an amount obtained from the sale of share and the value of due dividends; such fee shall be payable only after the termination of the contract with the management firm. The fee referred to in Sec.3 above shall not exceed an amount determined in proportion to the period for which the management firm provided services to the fund. Once any shares of a fund were held by new shareholders, the principles of remuneration of a management firm which renders services to the fund must satisfy the condition that the portion of fees paid to the management firm which is dependent on the financial performance of the fund even when expressed in terms of a percentage of fund shares, in no event may exceed the value of 2% of the shares of the fund with respect to each year of service of the management firm.

The above regulations aim at excluding the possibility of owing shares by a management firm in a fund to which it is rendering services, unless the prior approval of the Anti-Monopoly Office is obtained.

In accordance with the content of the act (Art.38 Sec.6), the appropriate minister, Minister of the Treasury is obliged to pay the remuneration and dividends due to the shares of the management firm, that is why the settlement or right and duties in the scope of remuneration is drawn up in two separate though functionally interrelated contracts.

The contract for managing the assets of the national Investment Fund should establish *limitations for investment activity of the management firm* as well as limitations in other fields/spheres of activities (Art. 25 Sec. 3). Unless the prior approval of the Anti-

Monopoly Office is obtained, no management firm shall simultaneously provide management services to two or more funds, and no management firm shall own shares in any fund to which it is then providing management services. This limitation applies accordingly to entities, which occupy a dominant and dependent position with respect to the management firm. The limitations of the Commercial Code shall apply to the management firm namely no member of the board shall render/provide services to the competitive joint stock company or participate in it as a declared associate, or a member of the authorities, without the consent of a joint-stock company. The approval may be obtained by the organ appointed to establish the board, unless the statute of the joint- stock company states otherwise.

Another scope in which to consider the limitations for the management firm results from directing the firm to restructuring activity. The above limitations may arise from the fund statutes. The statutes include limitations to which the funds and indirectly management firms are subject to.

Additional limitations for the management firms may result from the contract, for instance through indicating the activities for which the consent of the fund organ shall be required. The restrictions stipulated in particular, that the purchases requiring engagement of more than 15% of the fund assets or the sell off of more than 15% of the fund assets the written approval of the supervisory board shall be required.

The management firm is supervised and controlled by the management board, the supervisory board and the General Assembly of shareholders of a fund. The control of the most important part of the management firm activity by the supervisory board that is its investment decisions shall be made in most cases *post factum*, on the basis/ground of its delivered reports. The management firm is obliged to inform in writing about its investment decisions the management board, which without delay shall take actions to execute these decisions.

As it has been mentioned above the execution of some of the activities by the management firm shall require the approval of a supervisory board. If the supervisory board does not give consent to an investment decision of the management board, it shall adopt a resolution explaining the reasons of its decisions - if the management firm applies for the adoption of such resolution.

In accordance with the statute of the fund, the supervisory board has the right to represent the fund to the management firm and to close and terminate the contract for management. Any modification of the material term of a contract between a fund and a management firm, in particular any modification of the terms and conditions of remuneration of the management firm, shall require a ratification by the General Assembly of the fund.

The basic sanction for not carrying out or inadequate completion of the contract for management of the assets of the National Investment Funds, is termination of the contract by the fund without giving reasons, with no longer than 180 days' notice. In

case of termination of the contract by the fund in circumstances for which the management firm is not responsible, the possible compensation for terminating the contract to which the management is entitled shall not exceed in a amount one half of the annual fixed management fee (Art. 24 Sec. 2).

There is however a substantiation of other reasons of an early termination of the contract. One of the reasons for this may be a departure of one person of the staff of the management firm employed in Poland referred to in an annex to the contract and not appointing a new person by the firm. Another reason may be a crucial change on the part of the shareholders or partners of the management firm or any other change.

The liability of the management firm is contractual and torturous for not performing or inadequate performing of an obligation on general terms of the Polish civil code. The regulations of the act on National Investment Fund however, strengthen the regime of this liability prohibiting stipulated exclusion of the liability for the damage or loss caused to the fund by intentional wrong or gross negligence of the management firm.

The contract for the management of the assets of the National Investment Funds expires on the day of conclusion of the tenth ordinary/common meeting of the National Investment Funds unless it is terminated earlier by one of the parties giving reasons or without giving them.

Share Certificates

The first plan of the organisational stage which consisted in the formation of National Investment Funds have been discussed in chapter III of the above study . The second plan of the organisational stage is the issuance and distribution of share certificates among all entitled Polish citizens. The distribution which commenced in November 1995 lasted one year and terminated on November 22, 1996.

It is estimated eventually 90% of the entitled persons shall receive share certificates after the next ten weeks with the termination of the distribution of share certificates for the persons who applied for but because of administrative reasons could not receive them. The turnout in the distribution places administered by PKO (state owned Bank) selected by way of tender by the minister for Ownership Transformations (of the State Treasury) surpassed all expectations since before the beginning of distribution experts estimated that maximum six million out of 27,8 million entitled would call for. The unexpected popularity of the National Investment Fund program did not result that it had a large number of supporters. The number of collected certificates was rather determined by the intention to obtain a profit, as the fee was three times lower than its price on the secondary market; there were such moments when the price of the share certificate was ten times higher than the fee. The turnout of the distribution rose respectively with the prices of the secondary market.

A share certificate is bearer security within the meaning of the Law dated March 22, 1991 - the Law on the public distribution of securities and trust funds (final text):

Journal of Law of 1994 No 58, item 239; with later amendments.) Whenever a security is mentioned it is understood as "a document which is to state or is stating the existence of a specified pecuniary right established in such terms and in such a way that it could constitute an independent object of public trading". However, this is not a statutory definition of a security. In Polish law there is lack of such a legal definition, and the concept of a security was first and foremost shaped by the jurisprudence. There is a consistence with respect to the fact that it is a document which incorporates specified by its content right, the most commonly - liabilities. This right is immanently connected with the possession of this document, in consequence it is a necessary prerequisite of attributing the rights to a person formally entitled on the basis of the document and the prerequisite enabling the person to claim this right (Kruczalak, K. (1996). As it is accurately expressed by A. Ohanowicz and J. Gorski (1970) "who owns the security he is considered entitled, so the right follows the document". In other words such a person has a formal authorisation in relation to the obliged on the basis of a security, moreover in favour of the formally authorised there is also the presumption that he is rightfully entitled to the right incorporated in the document, thus the presumption that he is also materially authorised (Domanski, G., J. Fiszler (1993). Sometimes the definition of a security is limited by the introduction of the additional requirement, namely that it should be designed, to trading. As S. Grzybowski (1995) comments on this, incorporation of the pecuniary right through a security becomes such a causative reason of these mutually connected legal relations that the transfer of documents and the right incorporated with are the same transfer. As far as the category of the security is concerned it does not really matter, as the author mentioned above says, whether the obligation corresponding with the incorporated in it liability is abstract or causative.

The above mentioned feature of the security was included in the statutory definition, included in Art. 2 item 2 of the Law dated march 22, 1991 - the Law on Public Transfer of Securities and Trust Funds.

There are several different types of securities distinguished, what is more as a rule the criterion of the division is either the object of entitlement incorporated in securities (the division on the grounds of legal functions), or the legal function of the trading (the division on the grounds of the trading). See Jurga, R., M. Michalski (1995).

Taking into account the first criterion we can, distinguish:

- securities which amount to financial encumbrance, for example bills of exchange, cheques, bonds, maritime insurance policy to the bearer and to order, monetary coupon etc.;
- securities containing entitlements to manage merchandise which is entrusted to the care of the drawer of the document (bills of lading, warrants for goods, warrants etc.);
- securities in which shareholding rights are incorporated (stock in a joint-stock company); in the interpretation of Polish law neither documents drawn up on the shares

nor claims to profits in the limited-liability company, nor savings-bank books are securities.

Taking into account the criterion of trading of securities we can distinguish:

- inscribed securities, which authorise the person indicated by name in the content of the document, and who can convey the vested rights to another person only by way of transfer (cession) and issuance of the document (Art. 509-516 of the Commercial Code);
- securities to order which authorise as the entitled person mentioned by name or indicated by it, or other purchasers, alienation of rights ensues on the grounds of endorsement and handing out the security;
- bearer securities which do not indicate the entitled person, since any person who owns the document can be entitled. The conveyance of rights is carried out by way of transfer of ownership of the document, which requires the issuance of the document (Art. 517 § 2 of the Commercial Code).

As it follows from the above, in the scope of trading of securities to the bearer and to order, the rights incorporated in them follow those securities, and in case of inscribed securities the situation is different: a security follows the right incorporated in it.

Each share certificate incorporates rights clearly stipulated in the Law on National Investment Funds (Art. 29 Sec. 1 and respectively Art. 17 and 38 Sec. 5). These are:

- the right to exchange for equal number of shares of each of the National Investment Funds which designated for the realisation of such exchange;
- the right to obtain due payment in the form of amounts relating to the shares of the funds connected with dividends, liquidation proceeds and interest earned on such amounts. The appropriate minister (the Minister of the State Treasury) orders the payment of the amounts. The above provisions fundamentally depart from the regulation of the Commercial Code of paying the dividend only to the shareholders, since in this case dividends and derivative amounts shall be paid not to the shareholders, which until the day of payment shall be the State Treasury, but to the third parties not owning at the time any corporation rights in relation to the funds, i.e. the holders of share certificates (Domanski, G., J. Fiszer (1993).

According to the criteria of division presented above, a share security is a bearer security amounting to pecuniary credibility and other securities, which are National Investment Funds, so indirectly they incorporate the right to participate. A share certificate does not possess nominal value, Art. 37 of the Law only says that for each share security an equal number of shares is due in each Fund.

A share certificate is a security of temporary character. It entails the necessity of realisation of rights incorporated in it in the specified time limit. The day of expiration of share certificates shall be determined by ordinance of the Council of Ministers.

The expiry date of share certificates cannot be announced later than a year before such date. In the content of the share certificate there is a marginal note on entitlements. The exchange of share certificates for shares is voluntary, depending only on the volition of the entitled person. Determining the expiry date of share certificates results in the fact that after such date the exchange of share certificates for shares of funds shall not be possible, in consequence the holder of a share certificate shall not be able to demand this and he shall have no right to payments connected with a share certificate.

A share certificate does not constitute a uniform category. The stipulations of the Law on National Investment Funds establish grounds for distinguishing two types of share certificates, i.e. *universal shares and compensation shares* (Art. 2 Sec. 2 of the Law). Compensation share certificates have a character similar to exchangeable bonds, since they are subject to exchange for special shares of the specially established for this purpose investment funds, creating a group selected in relation to other National Investment Funds, i.e. compensation share certificates (Art. 8).

In compliance with the above mentioned Art. 30 of the Law on National Investment Funds the following persons are entitled to *compensation share*:

- persons referred to in Art. 24 of the 1992 Budget Law dated June 5, 1992;
- persons employed by state budgetary entities from July 1, 1991 to December 31, 1991;
- soldiers and officers of the Police, Penitentiary Service, state Security Office and Board Guard, who performed their duties in the period from July 1, 1991 to December 31, 1991;
- persons who in the period from July 1, 1991 to December 31, 1991 held the positions of judges, public prosecutors or held state management positions, except for persons whose claims on the above basis have already been fully satisfied.

2. Retirement and disability pensioners entitled before November 15, 1991 to pension increase due to their having worked in special conditions or having performed work of special character, pursuant Art. 1 of the Law dated October 17, 1991 on the Revaluation of Pensions, Principles of Determining Pensions and the Change of Certain Laws. This provision has been introduced upon the motion of the Minister of Labour and Social Policy in order to compensate the employees of the state budgetary entities and several categories of retirement and disability pensioners the lack of indexation of pensions for employees, retirement and disability pensioners, which in compliance with the decision of the Constitutional Tribunal was discordant with the law (Domanski, G., J. Fiszer (1993).

The above regulations also specify:

- a) organs and institutions obliged to prepare lists of persons entitled to receive compensation shares and to exercise supervision and control over the preparation of the lists;
- b) the detailed principles and procedure of preparing such lists (Art. 30 Sec. 3);

- c) the general procedure of settling disputes;
- d) delegations for the Council of Ministers to introduce regulations with reference to the above matters.

Because the economic function of compensation shares differentiates them from universal share certificates mostly by the compensatory character of the former, distributed as substituting performance, in exchange for the lack of pecuniary performance by virtue of employment, service relationship, or pension performance of ZUS (Social Insurance Institution). So the disputes concerning rights to receive compensation are settled in accordance with the rules regulating the procedure of settling labour and security disputes (Art. 30 Sec. 4 of the Law on National Investment Funds).

The number of compensation share certificates allocate to individual groups of entitled persons may depend on several factors, and the detailed methods of calculating the number shall be determined by the ordinance of the Council on Ministers (it has not been established so far). The differentiation of the number of compensation share certificates allocated to individual groups of the entitled, justifies its issuance in multiple form (in compliance with Art. 29 Sec. 3 of the Law on National Investment Funds), which cannot apply in case of universal share certificates. Compensation share certificates shall be exchanged at the National Depository of Securities, through an entity conducting a brokerage firm, for an equal number of shares in every fund existing at the time of issuance of the share certificate.

All citizens of the Republic of Poland who are registered as permanent residents in Poland who by December 31 of the year preceding the year of issuance of share certificates shall be at least 18 years old shall be entitled to receive share certificates. Every entitled person could receive only one share certificate, which had to be collected by an authorised person in a procedure and on conditions specified in an ordinance of the Council of Ministers dated August 6, 1995. The delivery of a universal share certificate is subject to a fee, unlike compensation share certificates which by virtue of its specific compensational function are delivered gratuitously, in the amount of 20 PLN (7 USD approximately). In compliance with Art. 34 Sec. 1 of the Law on the National Investment Funds, the right to receive a share certificate shall not be transferable or inheritable. As it ensues, in the scope of primary trading, i.e. at the stage of their distribution the circle of their potential purchasers as well as the conditions of receiving the share certificate have been precisely defined by regulations of *iuris cogentis*. Thus the right to acquire a share certificate cannot be transferred to another person by way of dispositive legal transactions, neither it may be the subject of agreement in court in proceedings with complaints. However, the collected share certificate could be the subject of trading as well as of inheritance (Grabowski, J. (1996).

The circles of persons entitled to receive share certificate coincide in certain scope. Each person entitled to receive a compensation share certificate shall be entitled to receive universal share certificates, provided the person fulfils the following conditions: citizenship and permanent residence.

The economic significance of a share certificate amounts to enabling the entitled persons to participate in the Mass Privatisation Programme in the scope of the privatised state property. Taking into account the fact that few of the entitled persons have the qualifications, ability to manage efficiently the received share in the economic assets, the indirect construction in the form of National Investment Funds was provided. National Investment Funds were established to enhance the value of the shares of *dependent joint-stock companies*. As the entitled within the confines of the privatisation programme Polish citizens act as the shareholders of the funds, their interest is connected with the economic condition of the individual dependent companies, in which the major shareholder are National Investment Funds.

In each dependent joint-stock company the individual funds hold the so-called *controlling interest* of shares of the company, which amounts 33%. The controlling interests allow the funds which hold them, the so called dominant funds, to decisive influence on the activity of the company. It ensues by way of carrying out share rights, which the possessed shares entail. It refers to all the corporation rights, so such thanks to which the shareholder can influence the activity of the company.

However, the introduction of the commercialised enterprises into the Mass Privatisation Programme does not ensure, by itself, the improvement of their economic conditions. It requires carrying out restructuring activities, the change of the method of managing the enterprises, new investments. These tasks were entrusted to funds, which can delegate them to specialised management firms acting within the confines of a contract for the management of the assets of the fund. However, it requires time. Therefore, in order to stop the realisation of the programme, an indirect instrument (share certificate) was introduced. It provides the right to participate in national Investment Funds, but it also enables the entitled persons to wait until the necessary improvement of the economic condition of dependent joint-stock companies, without their direct involvement in the results of the restructuring processes.

Only at the moment when the economic condition of "dependent" joint-stock companies reaches the satisfactory level making shares of National Investment Funds available to entitled persons shall be possible. Within this meaning the construction of a share certificate allows to secure the interest of individual persons entitled to participate in the Mass Privatisation Programme.

The construction on which a share certificate is based secures *freedom of its trading*. Each holder of a share certificate who shall not be willing to wait till the moment of carrying out the exchange shall be able to sell the share certificate held by himself for the price which shall be settled on the market at which trading of share certificates shall be carried out. On one hand, it allows for accumulation of share certificates by entities interested in larger shares in National Investment Funds, the possibility of exchanging share certificates for a large number shares. On the other hand, the freedom of trading of share certificates allows for their earlier exchange for cash.

As it follows from the above we can distinguish between the *two main functions of a share certificate*. In accordance with its purpose it performs the following function:

- investment as quasi investment certificate, which first of all makes taking the possession, at later date, of deeds of participation in National Investment Funds possible, i.e. the shares of these funds; and second it makes operation in the open market possible, i.e. purchase or sale connected with different adjustment of prices of share certificates in trading;
- circulation as a bearer share certificate, which could be object of trading between persons interested, from one side in receiving as fast as possible, in exchange for the held share certificates; from the other side, persons who expect either the increase of the value of share certificates in circulation, or who shall acquire the certificates in order to gain greater package of shares of the National Investment Funds.
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Exchange of Share Certificates for Shares of National Investment Fund

Exchange of share certificates for shares of National Investment Funds constitutes one of the most important processes provided under the Mass Privatisation Programme. Taking into consideration the subjective scope of the Mass Privatisation Programme, exchange of share certificates for shares of the fund shall constitute an operation of a wide range, encompassing a great number of people, of which a substantial part has never had any direct contact a capital market. As a result of the exchange being carried out, the group of subject taking part in transactions on securities market shall undoubtedly extend. The beginning of this process is stipulated on the beginning of 1997.

The Minister of the State Treasury shall designate by ordinance the funds, if which shares shall be subject of exchange, the date from which the share certificates may be exchanged for shares of the funds and the procedures of such exchange. In connection with the above, there are several points to be considered.

First, appointing the National Investment Funds, which shall be designated to make their shares available to holders of share certificates, belongs to the competence of Minister of the State Treasury. The funds designated by the Minister to carry out the exchange shall fulfil two basic requirements:

- the funds shall already be operating on the day of issuance of the share certificate which is a subject to exchange;
- shares of these funds shall be admitted to public trading of share certificates.

In such a case it signifies the necessity to apply a procedure towards these funds specified in provisions of the law on public trading of securities. According to Art. 49 § 1 of the Law the introduction of securities to public trading shall require the consent of the Commission. It should be pointed out that shares of National Investment Funds are not securities issued by the State Treasury, since their issuers are National Investment Funds functioning in the form of joint-stock companies. Therefore, exemption from duty of acquiring consent of the Commission shall not apply to these shares. Admission of the shares of National Investment Funds to public trading has the effect that these shares shall be deposited in the National Depository of Securities.

Second, the Minister of the State Treasury shall fix the commencement of the exchange. Therefore, persons not interested in participation of share certificates trading shall be able to exchange their share certificates for shares of the funds, immediately after the commencement. However, the commencement date set by the Minister of the State Treasury is not the final date of carrying out the exchange. The date may ensue from the ordinance of the Council of Ministers, which has been authorised to set the expiration date of the share certificates. Many factors undoubtedly shall decide on the final date of the exchange, most significant of which shall be the capacity of the share certificates' market and the economic situation of particular funds. There is no doubt that a period of exchange shall be rather long therefore all interested persons shall have the possibility to carry it out, although it is a completely voluntary action. It cannot be forgotten, however, that negligence of carrying out the exchange, in situation where the Council of Ministers has set the date of expiration of the share certificates, shall cause after this date the loss of incorporated rights in the share certificate. While the persons who would not like to participate in National Investment Funds as shareholders are obliged to sell a share certificate they hold prior to termination of the above date.

Third, the Minister of the State Treasury has been entitled to define a procedure of carrying out the exchange of share certificates. Yet, the law on National Investment Funds introduces certain settlements in this scope, which may be formulated in several items:

- The entitlements to carry out the exchange of share certificates for shares of National Investment Funds come within the duties of the Minister of the State Treasury. The Minister is obliged to make all shares of a given fund available in order to carry out the exchange. Only the package of 15% of shares of each fund is excluded from the procedure of exchange, due to the necessity to reserve these shares for other purposes stipulated in the law. It regards allocation of these shares to a sale in order to obtain amounts of remuneration due to firms managing the assets of the funds. Thus, the law endeavours to combine the activity of management firms with the results of activities undertaken by them.
- In compliance with Art. 37 of the Law on National Investment Funds, a share certificate shall be exchangeable at the National Depository of Securities, through an entity conducting a brokerage business. If the trading of share certificates may assume different forms both materialised and dematerialized the exchange of share certificates signifies coming into possession of securities, the trading of which is of dematerialised nature. The shares of National Investment Funds may be exchanged after being admitted to public trading, that is after being deposited at the National Depository of Securities. Executing the exchange of share certificates hitherto existing holders of share certificates enter a market of dematerialised trading, thus the way to the market has to lead through one of its fundamental institutions. Consequently, the Law on National Investment Funds stipulates introduction of brokerage constraint as far as transactions of exchange of share certificates for shares of the fund are concerned. Each holder of a share certificate executing its exchange shall have to submit to the requirement prevailing on a controlled market. In relation to the above, it shall be indispensable to open

an investment account with a brokerage firm. In connection with this, brokerage houses shall have two groups of customers, the first group shall constitute those who have already been investing on a capital market and have investment accounts. The second group of customers of brokerage houses shall constitute persons who enter the secondary market of securities. Also in case of share certificates it should be distinguished between share certificates previously deposited at the National Depository of Securities, on account of their trading on the controlled market especially on the exchange market, and share certificates which have not been the subject of dematerialised trading. Share certificates which have been so far in an uncontrolled trading of share certificates as well as share certificates kept by their holders until the exchange, shall constitute the second category. Mediation of a subject conducting a brokerage business in the scope of exchange of share certificates for shares of National Investment Funds shall be undoubtedly connected with fees in form of commissions charged for this activity.

- Each share certificate is liable to exchange for an equal amount of shares in each of the funds designated to carry out this exchange. It means that the holder of such a share certificate shall become a shareholder of all National Investment Funds which have been designated for exchange. In this way distribution of economic risk connected with participation in one or in several funds shall ensue.

The persons entitled to realise the exchange of share certificates for shares of National Investment Funds are all holders of these share certificates. Thus, it is of no importance whether the person realising the exchange of a share certificate has been entitled to acquire it on the grounds of the provisions of the law on National Investment Funds. As a consequence also those who have not fulfilled the conditions to acquire share certificates, universal or compensation, may easily realise the exchange of share certificates held by them, which have been purchased or obtained in a different manner (Jurga, R., M. Michalski (1995).

The basic consequence of the exchange of a share certificate for shares of National Investment Fund is a fact that hitherto existing holder of the share certificate becomes a shareholder of each of the funds. Thus, he shall be vested all the share entitlements connected with holding these shares.

The rights vested to share holders of joint-stock companies are regulated by the commercial code. There may be several groups differentiated among these rights:

1. Corporation rights which consist of the following:
 - the right to participate in a General Assembly of a joint-stock company and the right to information;
 - the right to vote;
 - the right to appeal against resolutions of a General Assembly;
 - the right to institute an action to compensate the damage caused to a joint-stock company;
 - the eligibility right to organs of a joint-stock company.

2. Property rights:

- the right to dispose of a share;
- the right to participate in an annual profit of a joint-stock company and dividends;
- the right to acquire shares of a new issuance;
- the right to participate in a liquidation of assets of joint-stock companies;
- the right to demand nullification and termination of shares.

3. Minority rights:

- the right to demand an examination of a report of founders' of a joint-stock company;
 - the right to demand convocation of an extraordinary General Assembly and the right to put particular cases on the agenda of the next General Assembly;
 - the right to demand verification of the shareholders' list at a General Assembly;
 - the right to put forward a motion of completion of a composition of liquidators' of a joint-stock company;
 - the right to establish the second supervisory organ of a joint-stock company;
 - the right to demand election of members of the supervisory board by way of group voting;
 - the right to demand election of members of an audit board by way of group voting
- (Bandarzowski, K. (1996).

Minority rights are connected with representation of 1/10 of the capital, 1/5 of the capital or 1/5 of the votes and secure the interest of shareholders having at their command a specified fraction of a share capital in relation to shareholders representing the majority of the capital. Until the realisation of exchange of share certificates for shares which shall take place, as it has already been mentioned above, at the beginning of 1997 the earliest, the *sole-shareholder of National Investment Funds and at the same time the sole executor of share right is the State Treasury represented by the Minister of the State Treasury*. The way and scope of execution of these rights have been discussed in Chapter 2 whereas the scope of execution of the above rights after the exchange of share certificates for shares of National Investment Funds shall be subordinated, in my opinion, to distribution of ownership of these shares. At present it is difficult to evaluate how the ownership structure shall change. Since transactions in these securities on a material and dematerialised market thus it is here that the accumulation of ownership rights occurs. The authors of the program, however, have expected this accumulation. The extent of the accumulation is not known for the time being. Different west European investment funds and other institutionalised investors, including Polish - rather financial ones shall probably be the shareholders of the funds. As the party concerned claims, i.e. the representatives of the authorities of the funds and of the management firms. Yet, there shall also be a large number of small shareholders, that is persons who have purchased shares, for instance,

from a family. Thus, it may happen that a several percent of shares, held by institutionalised investors, shall cause that they shall play an important role being active investors and having the adequate knowledge and experience for this (Kostrz-Kostecka, A. (1996). The question, however, of legal protection of small shareholders investing on the stock exchange arises. The problems connected with this issue are generally regulated, thus only in relation to the holders of share certificates, (as dated March 22, 1991 - the Law on Public Trading in Securities and Trust Funds.¹² This law provides for investors special duties mainly of antimonopoly character but it also includes legal instruments aiming at minimising the investors' risk and providing the protection against results of dishonest means sometimes used by issuers of brokerages firms, or even stock-exchange employees. The above mentioned instruments have been regulated in detail in executing provisions and in statutes of the stock exchange.

From our point of view *antimonopoly provisions* need to be given special attention.

In compliance with Art. 72 § 1 of the Law, an investor who after a purchase of shares of a public joint-stock company exceeded 5% or 10% of votes at the General Assembly or held such a number of shares of the company before their transfer which secured him the number exceeding 5% or 10% of votes at the General Assembly and who after the transfer has become a holder of shares securing him respectively less votes than the above pointed percentage requirements shall be obliged to notify within 7 days the Securities Commission, the Antimonopoly Office and the company thereof about the number of votes from shares acquired as a result of transaction. Until the above information is passed on the investor is prohibited to acquire or sell other shares. The same duty is incumbent on the investor, who having acquired more than 10% of votes in a public company, purchases or sells shares in amount changing the number of votes by 2% or more. Whereas a public company itself is obliged to transfer information concerning the number of votes being exceeded at the General Assembly immediately to the agency. The above provision is pursuant to the norms which are in force in this scope in the European Community.

In case when an investor intends to acquire shares in a public company in the amount securing him respectively 25%, 33% and 50% of the general number of votes, he is obliged to notify the Commission. In such situation, having sought the opinion of Antimonopoly Office, the Commission may within 14 days from the notification forbid the acquisition of shares if an important interest of the state or the national economy would be threatened. If the Commission has no objections to the intended transaction then it shall convey information on the intended transaction directly to the information agency (Art. 73).

Yet another rigor, and at the same time a restriction, inflicted upon the investor while acquiring shares admitted to public trading is introduced by article 74 of the law which orders when intending to purchase in an amount that guarantees the investor reaching or surpassing 10% of votes, an application of a special procedure called "an invitation subscription for the sale or exchange of shares" approximated in substance to a typical tender procedure.

The third type of restriction inflicted upon investors purchasing considerable packages of shares according to which any person who has become a holder of shares in one company representing 33% of the votes at a General Assembly, shall be obliged, prior to exercising any powers resulting from the right to vote, to announce an invitation to subscribe for the sale or exchange of the remaining shares in that company. A certain peculiarity of this provision is undoubtedly the specification by legislator of the principles setting forth a price limit for shares proposed in the invitation. The price offered in the invitation mentioned above cannot be lower than the highest price paid thereby for the shares in the last 12 months, or where no such price has been paid - the average market price in the last 30 days before the announcement of the invitation.

On a clearly antimonopoly function of all the restrictions discussed above, which the law stipulates in connection with the acquisition of considerable packages of shares, shows first of all that the criterion deciding on the quantity of a package is not an absolute number of purchased shares in a given company, but a reference to the number of votes which the shares acquired by the investor secure him at the General Assembly.

Thus, if a certain amount of preferential shares is a part of a package held by the investor, securing him a greater number of votes at the General Assembly, then the acquisition or holding of a package of shares within the meaning of the law does not have to agree with proportional contribution of that shareholder in a share capital. It should also be pointed out that in compliance with the law, in all discussed cases, the intention to acquire as well as the acquisition or sale of shares by a dependent subject shall be regarded as accomplished by the dominant subject. The sanction of non-compliance to the above regulations is a lack of possibilities of exercising any voting rights in shares acquired incompatibly with the conditions stipulated by the law (Art. 86). The legal act itself therefore on the grounds of which the investor acquired a substantial package of shares disregarding the statutory requirements, is not avoid act but "only" legally ineffective in scope of impossibility of exercising the right to vote in these shares, which makes them "silent shares" in practice (Grabowski, J. (1996).

Governmental Influence on Mass Privatisation

Securities Depositor

In accordance with the practice followed in many countries, the law on public trading in securities provides that in such trading inscribed deposit securities are drawn up confirming depositing securities specified in a content of a certificate. The issuer of a certificate is a bank or other authorised institution. The person specified in a deposit certificate is entitled to execute any rights in securities specified in their content.

The provisions of the law on inscribed deposit securities in connection with the operation of National Deposit of Securities shall enable to create, such is the assumption, a system of trading in securities not requiring a physical transfer of documents incorporating specified rights but enabling a complete computerisation of such trading.

In compliance with the amended law on Public Trading in Securities And Trust Funds (Art.71a-71e of the law), the National Deposit of Securities is a **joint-stock company** of which shareholders may be exclusively stock exchanges, subjects running a brokerage enterprise, trust funds societies, the State Treasury, the National Bank of Poland and other banks. The shares of the National Deposit of Securities are solely inscribed shares whereas shareholders are not entitled to a dividend. The National Deposit of Securities may not aim at profit.

The subject of activity of the National Deposit of Securities is:

- 1) keeping and registering of securities admitted to public trading (secondary),
- 2) keeping the register of deposit accounts for subjects entitled to keep securities therein,
- 3) registration of transactions concluded among those entitled in deposit accounts,
- 4) controlling the proper ratio of the volume of securities issued to the number of securities in circulation,
- 5) servicing deposit accounts resulting from the fulfilment of the issuers' obligations towards owners of securities,
- 6) issuing deposit certificates,
- 7) organising and servicing the settlements of transactions.

A joint fund for insurance against civil liability arising out of transactions concluded should be established in the National Deposit of Securities.

In Mass Privatisation Programme the National Deposit of Securities shall act as a trustee of share certificates issuance. Since dematerialization of share certificates shall take place in the National Deposit of Securities. Dematerialization shall be followed by a destruction of a share certificate.

Furthermore, the National Deposit of Securities shall act as a subject managing dividends until the exchange of a share certificate for shares of National Investment Funds takes place.

Securities Commission.

The Securities Commission is a central **body of government administration** which is to be supervised by the Prime Minister (Art. 6 of the law). Its composition, organisation and tasks are stipulated in provisions of Art. 7-13 of the law. It follows from therein that it is an organ of **wide competence**, particularly of controlling and supervising as well as inspiring and co-ordinating the effective operation of the securities market and the protection of investors.

The Chairman of the Commission is vested entitlements in civil cases pertaining to the public trading in securities. Particularly significant are the Commission's entitlements

of administrative and legal nature by virtue of which the Commission influences practically all subjects of trading, i.e. issuers, the brokers, subjects intending to acquire considerable blocks of shares as well as the stock exchange itself. It ensues from the above that Polish law in ensuring the proper trading in securities is based, in a large extent, **on administrative instruments rather than that of market**. This solution ensures, however, in a large extent the proper course of public trading in securities and does not depart from parallel solutions in many well-developed countries.

Privatisation Fund.

Created on the grounds of Art. 39 of the law on National Investment Funds is a state fund unmarked for a specified purpose, i.e. unlike the budget, the remaining assets of a fund at the end of a fiscal year may be used in the following years. The purpose of establishing the Privatisation Fund is collection of assets to cover the costs of implementation of privatisation of National Investment Funds, whereas the source of receipts are fees for distribution of universal share certificates. The Minister of the State Treasury has disposition over the assets of the Privatisation Fund (Domanski, Fiszer, pp. 93-94).

The Privatisation Fund is established for a specific period only, namely it should be liquidated six months after the end of distribution of universal share certificates, whereas assets remaining in the account of the Fund on the date of its liquidation shall constitute revenue of the State Treasury.

Privatisation Agency

Appointment of Privatisation Agency is provided for in Art. 40 of the law on National Investment Funds. The Privatisation Agency was established by the Council of Ministers on October 5, 1993 (Journal of Laws No 97, item 442). The Privatisation Agency is a state legal person supervised by the appropriate minister (now Minister of the State Treasury).

The basic tasks of the Agency are the following:

- 1) co-operation in collecting amounts received in connection with ownership of fund shares by the State Treasury, including dividends and liquidation proceeds and interest earned on such amounts, as well as amounts obtained from the sale of fund shares which are being made available in order to exchange them for share certificates,
- 2) payment of the above mentioned amounts,
- 3) paying remuneration to the management firms and dividends relating to the shares which constitute their remuneration,
- 4) administering the assets of the Privatisation Fund having obtained the consent of the Minister of the State Treasury.

Moreover, the statutory tasks of the Privatisation Agency are:

- 1) undertaking activities for the benefit of development of capital markets in the scope of operation of the National Investment Funds and their privatisation
- 2) initiating the research and projects in the scope of operation and privatisation of the National Investment Funds and other informational and training activity.

The Privatisation Agency runs a financial activity in the form of a budgetary institution.

Notes

¹ Project dated March 15, 1990 - Druk Sejmu RP no 283-284.

² Project dated April 6, 1990 - Druk Sejmu Rp no 335.

³ Dz. U. No 25 item 195.

⁴ Dz. U. No 84 item 493.

⁵ Dz. U. No 31 item 170 with amendments.

⁶ Final version - Dz. U. No 118 item 512, 1991.

⁷ M. P. No 43 item 334 with later amendments.

⁸ Ordinance of the Council of Ministers dated September 1, 1993.

⁹ Journal of Law 1993, No 86, item 401

¹⁰ The Law dated July 13, 1990 on Privatisation of state Enterprises (Dz. U. No 51 item 298 with later amendments); the Law dated August 30, 1996 on Commercialisation and Privatisation of state Enterprises (Dz. U. No 118 item 561) which shall enter into force in January 7, 1997.

¹¹ Rzeczpospolita Nov. 28, 1995.

¹² Dz. U. 1994, No 50; item 239 with later amendments.

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Polish Mass Privatisation Scheme: The Program of National Investment Funds

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Introduction

The Polish Programme of National Investment Funds (NIF) is a particular form of mass privatisation. The mass privatisation is to mean the possibility of a mass participation of the population in distribution of the state property rather than to indicate the size of the state property to be covered by the Programme. For it ensures to all adult Polish citizens who are registered as permanent residents in Poland, the participation in distribution of a certain part of the state property. Indeed, the latter to be covered by the Programme amounts but to about 10 per cent of its total.

The purpose of the Programme of National Investment Funds is:

- to implement the privatisation of a definite part of the state property,
- to create conditions for all adult Polish citizens residing in Poland to participate in distribution of the value of that property,
- to provide more favourable conditions of development to the enterprises covered by the Programme and to improve effectiveness of their operation.

The above tasks are to be realised by the National Investment Funds. However, the extent to which the tasks 2) and 3) will be realised, depends not only upon activities of individual Funds and the co-operation of enterprises covered by the Programme but also upon proper working of the institutional arrangements related to the activity of the Funds.

According to the mass privatisation in that form, National Investment Funds are introduced as an intermediate link between the state-owned enterprises which are to be privatised, transformed into wholly-owned companies of the State Treasury, and the citizens who are to acquire ownership of those companies. Acting in benefit of the persons entitled, they are to increase the value of the managed part of state-owned property, in particular by enhancing the value of shares of companies of which they are shareholders. (Law..., 1993, art. 4).

Owing to such a solution the participants of the mass privatisation are not required to possess any knowledge of the capital market or the laws governing the latter, since their parts of the state-owned property are managed on behalf of them by specialised entities. The National Investment Funds shall also play an active role in benefit of the companies covered by the Programme, through lending them assistance in various

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forms depending on their needs, possibilities and effectiveness in the area of organisation, promotion, financial services, etc.

The solution of the mass privatisation in the adopted form of the NIFs that provides to all the participants the possibility of equal sharing in the part of the state property to be divided, does not require any earlier correct estimation of the value of individual enterprises covered by the Programme. Such an estimation would be very complex and costly and it would cause many controversies. However, avoiding the possible controversies relative to the valuation of the state property being divided, does not mean that the mass privatisation, like i.a. that through the NIFs, is free of any controversies.

The main objection raised against the mass privatisation is formulated in extreme terms as follows: under the guise of the mass vesting the public with property it leads to its mass expropriation; the mass supply of property certificates in the capital market causes their prices to maintain at a very low level compared with the real value they represent. This enables those having capital at their command to take over the parts of the state property at relatively low prices.

Mass privatisation leads to the great dispersion of shares of the state property so that tendencies to their concentration are inevitable. There are people who are not interested in holding those shares and may wish to sell them. And if they do it at prices approximate to the real value, this is not comparable with an expropriation. Certainly, mass privatisation might create favourable conditions to a cheap take over of shares of the state property, especially in a country, where broad social strata are poor. This, however, does not seem inevitable: even there it is possible, at least, to limit the scale of such an alienation of the state property. For this it is required i.a. that an extensive informative action be undertaken right in advance of the distribution of the title papers.

In Poland, information about distribution of Participation Certificates (PCs) can be considered to have been sufficient. The public promotion of their issuance was satisfactory. This, however, cannot be said on promotion of the rational behaviour of those entitled; this was not visible till the last phase of the issuance. Very low prices of the PCs on the secondary market in the early phase of their issuance bear evidence of the phenomenon of a cheap appropriation of a part of those shares.

Another objection was raised against the mass privatisation in Poland because of delayed beginning of its implementation, the more so as its idea emerged there earlier than it did in other countries that entered the way of transformation of their socioeconomic systems (Winięcki, 1995).

The objection might seem justified, if no account is taken of the particular socio-political conditions prevailing in Poland. Functioning of state-owned enterprises was based there on the principle of independence and self-government, with a dominant position of workers councils. Privatisation of an enterprise used to be undertaken on its own initiative (i.e. by its director and the workers council), which had to be confirmed by its crew.¹ It is therefore sometimes called "privatisation from below", as opposed to other countries in transition where it was proceeding "from above" (i.e. from entitled authorities). Given

the widespread aversion of the Polish workers to privatisation, which had been confirmed by a number of surveys (Gardawski, Gilejko and Zukowski), one can have serious doubts whether a mass privatisation would have been successful in Poland at an earlier date. For this it would have been necessary first to obtain agreement of the many pertinent enterprises during a short period, which seemed quite difficult though that aversion concerned foremost the capital privatisation, whereas the shareholding by workers and citizens at large had quite a lot of partisans. In such conditions, in order to obtain agreement of enterprises to a mass privatisation, various privileges to the workers, financial support from investment funds, etc. would have to be granted. "If not for those reasons - said the former Minister of Property Transformations, Janusz Lewandowski - a coupon privatisation was impossible at the beginning of the 'nineties" (Lewandowski, 1996).

Polish mass privatisation is also objected for its modest scope. Compared with about 28 million entitled participants, the National Investment Fund Programme may seem modest, indeed. However, taking into consideration that it has been based on a voluntary participation of enterprises, and that it is a unique programme lacking any experience at the world scale, it seems that it could, and it should, be only such one. Besides, the Programme itself was treated as an experiment that if successful could be applied at a larger scale.

Furthermore, a similar model of privatisation including restructuring of enterprises has been devised by the Law on National Investment Funds (Art. 8 and 30) to be applied for financing Compensation Share Certificates, that is outstanding government liabilities owed to employees of the budget sphere and the retirement and disability pensioners. Although those certificates are not of a mass character, they may relieve the state budget of a part of expenditures that are a burden to be born by all the taxpayers.

In connection with preparations to the reform of the Polish pension system it is also contemplated to designate a part of the state property as a financial support of that reform. Moreover, the issuance of reprivatization coupons has been postulated for a long time. Finally, in connection with the transfer of a group of state-owned enterprises under the authority of voivods, as decided by the Law on the reform of the centre of economic administration, a concept of regional funds, each covering a certain number of voivodships, is being elaborated in order to provide for restructuring and privatisation of those enterprises.

All those new proposals of using the state property put the said objection of the excessive limitation of the National Investment Fund Programme in a quite different perspective: had it to be significantly larger, the realisation of the above proposals would be impossible or, at least, considerably limited.

Objections are also being raised to the National Investment Fund Programme because of the risk associated with admission of foreign firms to the management of the NIFs. Most of those firms, is said, had never been dealing with problems of restructuring of enterprises and/or compensations they have been accorded, are too high. It is also pointed to the insufficient protection of interests of the State Treasury in the contracts concluded with the management firms.

However, beside foreign experts, many Polish specialists are appointed in the governing bodies of the National Investment Funds. The management firms themselves are consortia usually with participation of Polish members. The aim of the appointment of foreign firms and experts to the implementation of the NIF Programme has been to benefit not only of their know-how and experience but also their contacts, which may help promote Polish firms and products in international markets, gain foreign strategic investors or the access to foreign sources of credit, etc. To what degree these expectations will be fulfilled, is a question of the future. Actually, implementation of the NIF Programme is watched carefully by the Ministry of Property Transformations through its continuous monitoring, and by a Special Commission of the Sejm that has been appointed just for that purpose. One may thus hope that the Programme will not degenerate.²

Stages of implementation of the Programme of National Investment Funds

1991- Start of the detailed conceptual and design work on the mass privatisation and the National Investment Fund Programme.

April 30, 1993 - After a long discussion, the Law on National Investment Funds and their privatisation was passed by the Sejm.

1993 - Appointment of the Selection Commission to carry through a competition for membership of the Supervisory Boards and an open international tender to appoint the firms for management of the NIFs. The Selection Commission is composed of nineteen members (thereof twelve appointed by the President of the Council of Ministers, four elected by the Sejm and one by the Senate, and two representatives of trade unions). The Commission carries its work till the day on which the State Treasury will no more be the sole shareholder of a Fund. (Prognoza, 1995).

June 1994 - The Selection Commission has selected 257 candidates to the Supervisory Boards of the NIFs and 35 candidates for chairmen of those Boards from among whom the Minister of Property Transformations has appointed, with consent of the President of the Council of Ministers, the members and chairmen of Supervisory Boards of the 15 NIFs.

September 1994 - The Minister of Property Transformations opened the competitive tender for management firms, basing on which the Selection Commission prepared the ranking list of the nineteen firms meeting the established requirements.

December 15, 1994 - Fifteen National Investment Funds have been created, the registration of which as joint-stock companies has been then carried out on March 31, 1995.

December 16, 1994 - The Supervisory Boards of particular NIFs have drawn by lots the management firms, with which they had to negotiate contracts. In the event that no agreement is reached, further candidates to negotiations would be drawn by lots.

1995 - In the first half of July, three kinds of contracts were signed with fourteen of the fifteen NIFs: contracts concerning management, contracts determining relations between the State Treasury, individual Funds and management firms, and contracts on

compensation for financial results. The remaining (IX) Fund, after the breakdown of the firm with which it negotiated the contracts, elected its Management Board in a normal way according to the Commercial Code.

- In September 1995 the selection of enterprises to be covered by the NIF Programme was completed. Attempts were made to include large (with not less than 10 million USD annual turnover, and later on also the middle-size enterprises) showing healthy financial positions. Enterprises that were called in to join the Programme, could reject the proposal while notifying it with indication of their reasons within 45 days. Enterprises that declared a voluntary access, were also included, provided they met the established criteria. The selection proceeded gradually in four successive rounds.

- The first round took place in August, and the second in September 1993. The third was completed more than a year later - in October 1994. Thereafter the list of selected enterprises was slightly modified for various reasons; after the three rounds their number amounted to 413. In September 1995 the fourth round was completed. In this way the Program covered 512 enterprises, which then were gradually transformed into companies wholly-owned by the State Treasury.

July 17 and 18, 1995 - The companies included in the first three rounds were divided between the NIFs so that each of the latter was granted lead packages of their shares (33 %). The division was made by the management firms (or the Management Board for the IX NIF) by lots drawn in a changing order according to an algorithm that provided each of them with equality of chances. (Stankiewicz, 1997). Further 27% of each company's shares were divided uniformly between the 14 NIFs. After such an allocation of shares of all the 512 firms (including those of the fourth round whose allocation took place in December 1995), each NIF was in possession of leading packages of shares (33 %) in 32-34 companies of its own choice and minority packages (of about 1.93 %) in all the remaining companies. From the remaining 40 % of shares of the companies covered by the Programme 25 % constitute the reserve of the State Treasury and 15 % are designated for employees of the given companies.

September 2, 1995 - Leading (33 %) packages of the 321 companies of the first three rounds were handed over by the Minister of Property Transformations to the respective NIFs. (Those of the remaining companies were handed over later in 1996).

November 22, 1995 - Beginning of distribution of the Participation Certificates (PC) authorising the holders to participate in the NIF Programme, against the payment of a fee of 20 PLN (slightly above 7 USD). As a bearer security the PC may be dealt with in the market. After admission of shares of the NIFs to the stock-exchange, the PCs holders will be authorised to exchange their Certificates for shares of the NIFs in proportion of one share of each of the 15 NIFs for 1 PC. The exchange will be carried on in the National Depository of Securities by intermediary of the brokerage houses.

June 3, 1996 - Beginning of dematerialisation of the PCs in the National Depository of Securities, which consists in exchange of their physical forms for computer records as required for their admission to the stock-market.

July 15, 1996 - First notations of the National Investment Funds Participation Certificates on the Warsaw Stock-Market.

November 1996 - Submission of drafts of issuance prospectuses by National Investment Funds to the Ministry of the State Treasury (former Ministry of Property Transformations).

November 22, 1996 - Completion of distribution of the Participation Certificates.

According to the preliminary data, they have been distributed to 25 675 thousand persons. In proportion to the number of those entitled the highest rate (98.7 %) was recorded in the voivodship of Zamosc, and the lowest (88.4) in that of Warsaw. The final number may reach 26 million as the result of complaints of those who did not receive the PCs for various reasons and the statement by the Constitutional Tribunal (probably to be accepted by the Sejm), that qualified as illegal the exclusion from the distribution of those having no registered residence.

December 6, 1996 - First notations of PCs on the public regulated market outside the stock-exchange by the Central Table of Offers (CTO), a joint-stock company founded by 43 brokerage houses on January 29, 1996 to carry the public, regulated secondary turnover of securities outside the stock exchange, as allowed by the ordinance of the Council of Ministers of June 30, 1995.

December 15, 1996 - Deadline for submission by the NIFs of their prospectuses approved by the Ministry of the State Treasury to the Security Commission.

February and March 1997 - The expected admission of all the NIFs to the public turnover.

Second quarter, 1997 - The expected beginning of notation of shares of the National Investment Funds on the stock-market.

Structural Characteristics of the National Investment Fund Programme

The main characteristics of the National Investment Fund Programme are:

- privatisation of a part of the state property through making it available to the public;
- providing institutional conditions for increasing the value of that property through restructuring the enterprises covered by the Programme;
- elimination of the procedure of pricing the enterprises that was checking the processes of transformation, costly and leading to controversies.

"The purpose of the Funds is to increase the value of their assets, in particular by enhancing the value of shares of companies of which the Funds are shareholders," (see Art. 4 Sec. 1 of the Law of April 30, 1993).

The purpose as stated above, has to be achieved through:

- exercising rights with respect to the shares of companies established as a result of transformation of state-owned enterprises into companies wholly owned by the State Treasury in particular for the purpose of improving the management of the

companies in which the Funds have a substantial shareholding, including the strengthening of their position in the market and obtaining new technologies and loans for the companies;

- conducting economic activity through purchase and sale of shares of companies and exercise of acquired rights; and
- granting and obtaining loans for the accomplishment of the tasks set forth in items 1 and 2 above, as well as other tasks defined in the statutes." (Art. 4 Sec. 2 of the Law of April 30, 1993).

Directions of restructuring to be realised in order to increase the value of the Funds, are treated by the Law - in opinion of Tomasz Stankiewicz, former deputy minister in the Ministry of Property Transformations - in a quite declarative way, since ... "it doesn't decide either of the size or the time for those tasks to be realised, nor it provides any sanctions for the tasks having not been realised." (Thieme, 1995)

Intentions of the legislator have been clearly formulated in the Law. Lacking provisions of the size and time of restructuring do not mean that the legislator didn't attach due importance to restructuring. If there exist no measures of restructuring, its size cannot be determined in contracts, whereas precisising the time for restructuring would lead to a superfluous rigidity of the Programme. And as far as the sanctions are concerned, they are present in the Programme in general terms of compensation for its realisation, including cancellation of the contract.

The character of the National Investment Funds was subject of a sharp debate and is still debated, as may be seen from the current press. A sharp debate was taking place also in the Sejm until the Law has been passed. The importance that was attached to restructuring, may be seen from the criteria of selection of management firms, including i.a. appraisal of the declared forms of their assistance in that regard to companies of which they had to be leading shareholders. Also in the process of selection of enterprises to the Programme, the possibilities of various kinds of its assistance, particularly in the area of restructuring, were emphasised.

The National Investment Fund Programme provides for some kinds of limitation of activities of the Funds. Some are aimed at securing the interests of the Polish state and shareholders, the others at preventing any development of monopoly tendencies or breaking the rules of fair competition, and still others at preventing the excessive dispersion of shares which would affect dominant positions of leading shareholders within the individual Funds. This is i.a. why the Funds are not allowed to purchase the securities issued by the firms that have no seat or do not their main business in Poland; they cannot have any parts of economic entities which would involve an unlimited responsibility of the Fund; their contracts involving purchase of not less than 10 per cent of shares of any company are to be notified to the Anti-Monopoly Office (now called Office of Competition and Consumers Protection).

The Law on the National Investment Funds while allowing sales of minority packages, contains i.a. the following restriction: "within three years of the registration of the

Funds, a prohibition of the Fund to sell shares of a company in which the Fund owns more than 20 per cent of the share capital and is at the same time, with the exception of state legal persons, its largest shareholder, if as a result of such sale the Fund's holding in the share capital of such company should fall below 20 per cent.; this prohibition need not apply to situations where such sale takes place as a result of a public offer made by the Fund or an offer for sale to a single investor or a group of investors, provided however that the buyer shall acquire all the shares of such company offered for sale in this way." (Art. 44, Sec. 1 point 4.)

The fact that the Funds may sell minority packages of shares or, under certain conditions, even the lead ones, does not imply that they might limit their activity to trading the shares only. Any attempt to consider that way of transformations by the Funds as conforming to the Law, is with no doubt an over-interpretation. The Programme comprises two elements, that is restructuring and privatisation. This doesn't mean, however, that each case of privatisation should be associated with restructuring. On the other hand, while selling lead packages of shares, the Funds should not ignore, generally or to a large extent, the restructuring aspects. In this regard, the formulation of the Programme is quite flexible but unequivocal. "The National Investment Funds had been designed as 'instruments' of privatisation and restructuring of companies. They will play the roles of first private proprietor of companies, whose aim would be to increase the value of the administered portfolio of their shares which, depending on the existing market conditions and those of the companies involved, may be implemented through restructuring a certain part of the portfolio and selling the other part", said Jerzy Thieme, chief adviser of the Minister of Property Transformations in questions of the Programme of Mass Privatisation, at times of its elaboration and introduction. (Stankiewicz, 1996)

The purpose of the Funds is to increase the value of the administered portfolio of shares, while restructuring is the main instrument of realisation of that task. Any question of restructuring, its forms or appraisal of its effectiveness should be considered and decided of, for each individual case taking account of the existing conditions. While increasing the economic effectiveness of the companies involved, it will contribute to a rise in the value of their shares, thus raising also the value of shares of the Funds to which they belong.

The NIF Programme does not allow any alternative treatment of privatisation and restructuring. The question whether the Funds should assist in restructuring or in privatisation is therefore misleading. They are bound to participate in both processes. The concept of NIFs is an attempt to integrate assistance in restructuring with the processes of privatisation. This is what decides on its uniqueness, and it is owing to this uniqueness that it has been positively appraised by foreign experts, i.a. those of the OECD. The National Investment Fund Programme is an experiment at the world scale. In view of the lacking experience of such a venture, the complexity of problems of jointly treating the processes of restructuring and privatisation, as well as the great scale of those processes, a careful and continuous watching of its course is required.

Organisation of the National Investment Funds

Within the National Investment Fund Programme fifteen Funds were created, which are acting as joint stock companies. In conformity with the provisions of the Commercial Code, their governing bodies are: General Meeting, Supervisory Board and Management Board. The membership, the way of appointment and the powers of the company's governing bodies are defined by the Commercial Code, the Law on National Investment Funds and statutes of the Funds.

So long as the State Treasury is the sole proprietor of the company, the powers of the General Meeting are limited in favour of the Supervisory Board. The Law on the NIFs and their statutes define the powers which are reserved to the exclusive competence of the General Meeting for that time. They embrace i.a. passing directives relative to conditions of contracts negotiated by Supervisory Boards with management firms and approving the concluded contracts, approving the prospectuses of issuing shares of individual Funds and issuance of new shares, change of statutes, dissolution of the Fund, merger of the Fund with another company, acquitting activities of members of Supervisory and Management Boards etc.

Until the first General Meeting is convened in which shareholders other than the State Treasury may participate, the members of the Supervisory Board of a Fund are appointed and recalled by the Minister representing the State Treasury, with consent of the President of the Council of Ministers, from among persons selected through a competition conducted by the Selection Commission.

Duties and powers of the Supervisory Board are defined by the Commercial Code and the statute of the Fund. Its duties consist in surveying activities of the Fund. In particular, the Board examines the Fund's balance sheet and its account of profits and losses, it provides for their verification by expert auditors, it examines and appraises the written report of the Management Board on activities of the Fund, and presents to the General Meeting for approval the yearly report of its own, based on the mentioned documents, with suggestions relative to principles of division of profits or covering the losses. In addition to its powers arising under the Commercial Code, the Supervisory Board has, according to the Law on the NIFs, the exclusive power to appoint the members of the Management Board (which in its statute is defined as power to appoint the chairman of the Management Board and, on his motion, the other members of the Board), as well as to select the Fund's management firm. To the exclusive competence of the Supervisory Board it belongs also, according to the Statute, to approve the transactions (purchases and sales, loans contracted and granted) the value of which is higher than 15 per cent of the value of net assets of the Fund from its last balance sheet. The members of the Supervisory Board are appointed for a period of no longer than three years, and at least two thirds of them, including its chairman, should be Polish citizens.

The Management Board is appointed for a period of no longer than two years. So long as the State Treasury remains the sole shareholder of a Fund, only a Polish citizen may be its member. The Management Board is charged with all the duties related to

management which are not reserved, by legal provisions or decisions of the statute, to other governing bodies of the Fund. In particular, within eight months after the end of each fiscal year of a Fund, the Management Board is obliged to prepare and present to the Supervisory Board a balance sheet as at the last day of the fiscal year, an account of profits and losses for the previous year and a written report on the activities of the Fund in the given year.

In fourteen from among fifteen National Investment Funds that have been established, there exist, beside the statutory bodies, management firms selected by way of competitive tender by the Selection Commission. These are consortia the members of which are various entities, like Polish commercial banks, foreign investment banks, consulting firms and lawyers' offices, that in many cases have not previously worked together. In view of that limited experience on both sides, entering the mutual co-operation within an original programme of little, if at all, relevant precedent in other countries, is thus for them, like for the governing bodies of the Funds, a demanding challenge.

Appointing a management firm, that embraces experts of various areas of management, creates additional opportunities for modernisation of functioning of Polish firms, and improvement of professional skills of their employees, in particular, of their managerial groups. While the management firms do not have their own capital for the possible investments, they may facilitate access of the Fund to financial markets, both domestic and foreign. International position of the firms members of the management consortia should markedly strengthen the promotion of Polish firms in the international market. This should help not only to expand their outlets but also to gain strategic investors. For a skilled assistance in restructuring the enterprises and management of packages of shares, economic analyses at various levels are required, concerning primarily the position of companies with lead packages of shares. It may be supposed that the kinds of activity of the management firms, as exemplified below, will promote the effectiveness of operation of the enterprises included in the Programme.³

The activity of the management firm is based on the power of commercial representation ("prokura") delegated by the Management Board of the Fund in the contract concluded with the management firm. Beside the detailed operating procedures which are separately negotiated by the parties, under a standard form agreement, the management firm has in particular the rights and obligations to:

- manage the assets of the National Investment Fund;
- assist the Supervisory Board of the National Investment Fund to establish and periodically review goals and policy relating to investment, capital structure, borrowing, guarantees, security and division of profits; exercise all shareholder's rights on behalf of the National Investment Fund, including the right to appoint Supervisory Board members of companies where the National Investment Fund has such rights;
- present the Management Board and Supervisory Board of the National Investment Fund with certain quarterly reports and an audited annual balance sheet and profit and loss account of the National Investment Fund. (Informacje, 1995)

The management firm should lend any necessary assistance in the field of both short- and medium-term management to the companies of which the given Fund is shareholder of a lead package. However, assistance does not mean to supersede the governing bodies of those companies in the current management.

Any limitations of activity of the Funds previously discussed apply also to the management firms.

The management firms are subject to the control of the governing bodies of the National Investment Fund, in particular of its Supervisory Board, as agreed in the contract concluded between the latter and the management firm. In the event, when the management firm is responsible for the delay in their fulfilment, damage or loss caused to the Fund by intentional wrong or gross negligence or delay in their fulfilment, the Supervisory Board may exact elimination of delay within 60 days, and otherwise the restitution of damage or loss caused by the delay. Non compliance to the above time limit, as well as an intentional wrong or gross negligence of the management firm may entitle the Fund to terminate the contract without notice.

The system of remuneration of management firms is composed of three parts. First, there is a fixed annual management fee (with allowance for inflation) payable quarterly in arrears in cash, which was agreed separately for each management firm, with significant variation between them, reflecting in some cases changes in the number of the NIF's lead shareholding, and in part their different staffing and cost structures. The fee is fixed in USD terms for the 10-year life of the Fund Management Agreement. The two other parts of remuneration are performance related ones: a cash payment representing the proceeds of an annual allocation of one per cent of the share capital of the Fund, and a final cash payment representing the proceeds of sale of five per cent of the share capital of the Fund, including in both cases payment of dividends due for the respective periods.

The main component part of the NIF Programme are the relevant companies. Sole transformation of the state-owned enterprises into wholly owned companies of the State Treasury was followed by establishment of new management structures. Contribution to the Funds of 60 per cent of shares of the portfolio companies divided between the lead packages of 33 per cent of shares in the selected companies, and the minority packages each 1.93 per cent of shares of all remaining companies (27 per cent in total for the fourteen Funds), have caused further changes.

Although the portfolio companies remain formally independent, in practice they cannot feel like this because of the dominant influence granted to the Supervisory Board of the Fund (that i.a. appoints and recalls their management boards) through contribution of lead packages of their shares to the Fund. So long as there is no conflict between activities of the companies and the essential interests of the Fund or the management firm, they may expect that their independence will be respected. However, in case of a conflict, their independence will be challenged. Such situations may take place, for instance, in case of selection of a strategic investor or determination of conditions of its entry in the company.

What is expected by the portfolio companies from their lead shareholding Funds or management firms, is generally consistent with what the latter had declared while competing for their selection. However, those declarations were rather general and must not apply to each company, and this may cause disappointment. The companies may fear, at the same time, an excessive interference on the part of management firms.

According to the Law on the National Investment Funds, employees of the state-owned enterprises transformed into wholly-owned companies of the State Treasury are to be granted, without payment, 15 per cent of shares of their companies. The total nominal value of those shares shall not exceed 24 average monthly wages multiplied by the number of entitled employees. The rules of distribution of those shares to the employees could have been determined within the company before the contribution of its shares to the Fund, otherwise they shall be made available to the employees in equal numbers. Generally, the companies adopted a differentiated distribution to their employees depending, at least in part, on the length of their employment, position or remuneration.

Similar rights have also been granted to individual farmers and fishermen providing raw materials on a contractual basis to the state-owned enterprise which has been transformed into a company, under condition that they remained bound by contract for a continuous period not shorter than two years immediately preceding the transformation. The shares are to be made available from the 25 per cent of their total reserved for the State Treasury.

Strategies of the National Investment Funds

The National Investment Fund Programme has embraced 512 companies. Shares of each of them have been divided as follows:

33 per cent - lead shareholding of the Fund which selected the relevant company;

27 per cent - minority shareholdings (each of 1.93 per cent) allocated in equal proportions to all the Funds, other than the Fund having a lead shareholding in the relevant company,

15 per cent - distributed, free of charge, to employees of the given company;

25 per cent - reserved to the State Treasury, including further 15 per cent of shares to be distributed to other entitled persons (farmers and fishermen). The remaining part shall be used to replenish the future system of social security and, if necessary, the compensation of employees of the budget sphere as well as retirement and disability pensioners.

The shares of companies contributed to the Funds will be exchanged in 85 per cent for Participation Certificates, and 15 per cent will be reserved for remuneration of the management firms. As a result, only 51 per cent rather than 60 per cent of the total value of companies' shares contributed to the Funds, will fall to the total number of Participation Certificates.

The assets of each of the Funds, after the selection of companies, consisted of 33 to 35 lead packages and 477 to 479 minority packages. (Not equal numbers of the lead and

minority packages falling to the individual Funds was a result of indivisibility by 15 of the two groups from which the companies were selected.)

According to the information of the Ministry of Property Transformations, based on a simple aggregation of balance sheets as per December 31, 1994, (i.e. just before the transfer of shares to the Funds) in most cases non-audited (and therefore taking no account of any adjustments which might have been found necessary in the course of an audit), 51 per cent of the value of the share capital of the companies, that is the part of the latter to be exchanged for the Participation Certificates, amounted to 7.2 billion PLN (according to the then exchange rate equal almost to 3 billion USD). Assuming that 27 million Participation Certificates will have been distributed, the share capital (net assets) per one Certificate amounted to 136.5 PLN (equal to 56.1 USD). (Informacje, 1995)

The financial reports of the companies for 1995, which have been prepared according to the new Law on Accounting (dated September 29, 1994, in force since the January 1, 1995), have shown mostly a tendency to set apart reserves for uncertain owing items. However, it can be hardly assumed that the accounts of financial results and net assets have been adjusted to an equal degree, since the adjusted figures for 1995 have shown losses almost for all the Funds. It may be rather assumed that in the process of those adjustments there has been a tendency to lower the relevant figures in order to have a more favourable point of departure.

In absence of the final figures concerning the distributed Participation Certificates, it has been assumed that each Fund was contributed 33 million shares (including a 5 million reserve for remuneration of employees of management firms). The resulting average value of assets per one share as on December 31, 1995 amounted to 9.76 PLN. (Kostrz-Kostecka, 1996). Given 15 shares (one of each Fund) to be exchanged for one Participation Certificate, the balance sheet value of the latter amounted to 141.45 PLN. In view of the tendencies shown in financial reports of companies, the above figures should also be treated with caution. It seems that it is only on the stock exchange, and not without a certain delay, that a better information on the real value of shares of the Funds will be available.

The selection of the lead packages of shares of the companies was carried out through drawing lots for individual Funds in the first round and the algorithm which determined the sequence of selection in further rounds so as to equalise, so far as possible, chances of choice for each Fund. The system of selection of lead packages of companies required previous acquaintance with the latter. For a more detailed analysis of five hundred companies or more neither the Funds nor the management firms had enough time, so that they had to concentrate attention on the most important features of companies, and primarily of those selected in the earliest rounds. The following ones the importance of which for the individual Funds was less, were simply determined by initial choices.

It is interesting that, in spite of the limited knowledge of companies before their selection, the Funds generally have been satisfied with the choices they had made. This might be due to their fears of facing objections of wrong choices, but on the other hand,

any complaints on the wrong choices which could not be changed, would have no sense and might only spoil the existing willingness of co-operation.

Governing bodies of the Funds and the management firms did not disclose much of the strategies underlying their preferences in selection of companies with lead packages of shares. Nonetheless some inference on this subject can be drawn from certain tendencies in their behaviour. So it can be supposed that, generally, use was made of sets of economic-financial indices which, however, were not identical and differed in the relative weights given to various indices. Among the typical economic-financial indices were: value of sales, gross and net profit, profitability of sales and profitability of assets. They were supplemented, as a rule, by estimates of development perspectives of relevant industrial branches or particular companies. A number of Funds gave a high rank to the index of sales, assuming that it will be possible through restructuring to obtain considerable increments of profits and assets.

Beside the quantitative economic-financial indices the qualitative criteria were also used. Among them, a high rank was given foremost to the technical condition of the productive equipment, the level of the technology in use, attractiveness of products, quality of managerial cadres and possibility of appointing a strategic investor. Considerably less weight was attached to the value of assets and location of plants. The criterion of industrial branch seems to have been used in connection with economic-financial indices and estimates of development perspectives rather than to have played an autonomous role. It was given more importance in further rounds of selection, when the choice was made of enterprises to co-operate with the earlier selected ones. For some Funds, however, a considerable differentiation of the selected companies by branches can be observed.

About the degree to which preferences of industrial branches were used, one can infer from the size of relative shares of the portfolio of individual Funds going to the most numerous enterprises of particular branches. Such an analysis was made by the firm Nicom. It disclosed that the highest branch preferences have taken place in the Fund XI, where the companies of two top industrial branches amounted to 57 per cent of the portfolio of lead packages. A little lower degree of branch preferences could be observed in the Funds XII and XV where the companies of the two top branches accounted for 48 per cent of the total number of companies of that group. The successive lower degree of branch preferences was recorded in four Funds, where the companies of the three top branches, quite different indeed, accounted for 50 per cent or more. The remaining Funds showed a much more differentiated branch composition of their lead packages of shares. One can thus assume that the industrial branch criterion did not play any major role for those Funds. However, the case of more Funds preferring the same branches may also point to the domination of another criterion of choice, such as that of the expected profit related to the developmental character of the given branches of industry.

A quite high degree of differentiation of value of net assets as between individual Funds may point to the assets criterion having been taken in account by some of them.

However, that criterion could be convergent with another one, e.g. the branch criterion. Some representatives of governing bodies of the Funds have stressed that one should not attach weight to the value of the companies' assets, their high value being accompanied by their generally low effectiveness.

Minority packages (1.93 per cent each) of companies (in number of 477 to 479) accounted for a considerable part of assets of each Fund. An active management of such a portfolio is not only impossible but also unprofitable. What remains in such a case is the strategy of a passive investor, who relies on a sufficient carefulness of the Funds which are lead shareholders of relevant companies, for the rise of their profits and the value of assets. The advantage of that strategy is its safeness. It is furthermore supplemented by getting rid of some minority packages of the companies, not necessarily the least profitable or having no developmental perspectives, but even those promising a quite attractive price. The weakness of such a strategy consists in a low interest of potential strategic investors in companies that show such a dispersion of property, because of the possibly adverse effects that dispersion might have on notations of such companies on the stock exchange.

Most Funds share the belief that negative effects of the dispersion of minority packages prevail on the positive ones, and this is why they are inclined to be in favour of a strategy of consolidation of those holdings, i.a. through increasing their packages of shares of the companies of kindred branches of which they are holders of lead packages. In spite of a major interest in the consolidation of minority packages, there were only six Funds as in October 1996, which were carrying into effect that strategy, covering 162 companies. As a result, the structure of property of those companies has changed. Beside the package of the lead shareholding Fund which owns 33 per cent of their shares, and minority packages (each of 1.93 per cent) of the Funds that did not follow that strategy, a minority package of the Funds that did participate, came into being. In exchange for 162 packages (of 1.93 per cent, each) the latter six Funds obtained 27 packages of 9.64 per cent each. The consolidation has been treated by the relevant Funds as the first stage of their strategy, and they plan further moves in the future to increase their smallest packages through exchange with other Funds or purchase of shares from the latter or from employees.

Some Funds interested in the idea of consolidation of minority packages, did not follow that strategy because they did not agree with the accepted lots and algorithm method of its implementation. They plan to effect such consolidation on commercial principles.

The outline of the medium-term strategies of individual Funds, as presented by Ada Kostrz-Kostecka in Rzeczpospolita in the second half of 1996, points to a number of similarities as well as substantial differences between them. Underlying these differences is a different attitude to restructuring.

In one of the models of strategy, restructuring is treated as the central means of increasing the profits and the value of net assets of the company, while the involvement of the Fund itself in that process is seen as necessary in a variety of forms, from

consulting, training, promotion and financial assistance , through participation in preparation of its programme, up to the implementation of the latter. In that model sale of shares is applied, first of all, to minority packages (but not only those of the weak companies), and the means obtained in that way are planned to be designated for the needs of the Fund's "own" companies, i.e. of which the Fund is the lead shareholder. However, loans can be granted to those companies only of which the products enjoy high demand and which have established outlets for them and the efficient management. If the companies need new technology, launching new products or extending their markets, the Fund tends to look for a strategic investor for them. Conditions of entry of the strategic investor may vary, including take-over of an additional issue of shares, purchase of a part of the lead package or of its total. Within the strategy of restructuring, consolidation of minority packages is contemplated through shares purchases from, and sales to other Funds, as well as purchases from employees. Sales of lead packages will be limited for some years to come. Predominance of the restructuring strategy is being designed for about five years, and it is only thereafter that the Fund will become a "pure" financial investor. The above strategy has been chosen primarily by the Funds, whose lead packages comprise shares of many companies in need of restructuring.

An extremely opposed type of the model is presented by predominance of the financial investor strategy since the beginning. The Funds that choose this type of strategy, put stress on their quality of financial investors. A direct involvement in restructuring the relevant companies is to be limited to a minimum, and for the necessary restructuring of the Fund's "own" companies strategic investors are to be sought. Contemplated are at a large scale sales of shares, not only of minority holdings but also of the lead packages, and investing the proceeds of these sales foremost outside the NIF Programme, including i.a. instruments at constant interest rates. It is thus possible that a complete change in the portfolio of the Funds involved in that strategy might take place within some years to come. In the strategy discussed, ensuring a high degree of liquidity of the portfolio is pursued, and not only a consolidation of minority packages but also the reduction of the number of the lead packages are contemplated. Such a model of strategy is plead for by the Funds whose structure of the lead packages portfolio is highly differentiated.

Between the two opposite models there exist mixed ones with varying combinations of restructuring and financial elements of those extremes, some showing a predominance of the former and others that of the latter ones, and still others rather balanced proportions between them. Most Funds seem to have adopted mixed strategies.

For the choice of strategy it is the Supervisory Board of the Fund who is first of all responsible. The management firm is held to assist the Board in preparing the strategy and its pursuance. However differences of views may arise between the Supervisory Board and the management firm as far as the "right" strategy is concerned and the possible conflict lead to delays in the realisation of the Programme.

Both the management firms and the Funds' governing bodies are aware that, after the Funds will have been listed on the Warsaw Stock Exchange, the structure of their assets

will change. At present it is hardly possible to foresee how fast that process will proceed, and when a structure will be attained that will make it possible for the new owners to decide of the future strategy and composition of governing bodies of the Funds.

The influence of the National Investment Fund Programme on the capital market

The Programme of the National Investment Funds has a manifold influence on the capital market. Following directions of its impact may be distinguished:

- a significant increase in capitalisation,
- rising turnover,
- a considerable rise in the number of participants,
- introduction of new types of securities (Participation Certificates),
- launching of the regulated public trade of securities outside the stock exchange (CTO),
- starting the trading of shares of the companies covered by the Programme.

When the implementation of the Programme was considered, some fears were expressed whether the capital market was prepared, from both the legal and institutional point of view to its absorption, as well as whether its scale would not cause important disturbances. However, in view of the delays that took place in its implementation,.. "the capital market in Poland had time enough to establish adequate principles of operation functioning and standards" (Socha, 1995). To a lesser degree it was managed to increase the number of companies listed on the stock exchange.

The Programme of National Investment Funds presents large potential opportunities for development of the capital market, its higher capitalisation and diversification as well as a rise in the number of its participants. Realisation of these possibilities proceeds gradually. In particular, preparation of the companies to listing on the stock exchange is a slow process: from the six companies covered by the Programme which presented their prospectuses of issuance to the Securities Commission, only three have been listed as on December 6, 1996. More accessible for the relevant companies, because of lower requirements and costs, is the regulated public market outside the stock exchange. A huge rise in the number of the companies listed on the stock exchange might be expected in connection with introduction of shares of the fifteen National Investment Funds, especially if this were to take place at one date (as announced, in the 2nd quarter 1997). This would mean a considerable inflow of companies, in addition to the regular one from outside of the Programme. It may thus come to an over-supply of securities by the mid-year 1997.

Jacek Socha, chairman of the Securities Commission, and Wieslaw Rozlucki, president of the Management Board of the Warsaw Stock Exchange, both point to the danger of

the National Investment Fund Programme missing its aim. "If the Programme of NIFs raises radically the supply, it will be necessary to have investment funds, insurance companies, pension funds, which might create long-term demand in order to stabilise the market and open chances of profit to the companies of the NIF." (Rozłucki, 1995) Unfortunately, investment funds are small and, for the time being, there are neither Polish insurance funds nor pension funds. In spite of announcements of their creation, this will not happen soon.

Participation Certificates are bearer securities issued by the State Treasury within the NIF Programme. As soon as the Funds will have been listed on the Stock Exchange, they will be exchanged for their shares. For one Participation Certificate the bearer will receive fifteen shares, one of each Fund. Nearly 26 million Certificates were issued and distributed to adult Polish citizens for payment of a fee of 20 PLN. Of their issuance 520 million PLN were received. After having covered the related cost, the surplus of about 300 million PLN will supplement the state budget.

Soon after their issuance, the Participation Certificates found the way to the market. Banks, brokerage houses as well as foreign exchange offices were allowed to buy them up. Initially, their price in the secondary turnover (25 to 35 PLN) didn't depart much from their nominal value. The characteristics of the market for Participation Certificates has been a great differentiation of purchase prices: the lowest prices were offered by the PKO BP, which issued the Certificates, while selling them at prices similar to those paid by other purchasers, thus earning high margins. The highest purchase prices were paid by foreign exchange offices, which contented themselves with low margins.

Sales of Participation Certificates on the stock exchange were launched only eight months after beginning of their issuance. This has significantly narrowed the differences between their purchase and selling prices with all the intermediaries. Since the stock exchange prices tend to maintain at a higher level compared with the purchase prices outside the stock exchange, this still enables the middlemen to benefit of their price differences.

The highest notations of Participation Certificates on the stock exchange were recorded in October 1996, exceeding 160 PLN. This was eight times the price in the primary market and five times the price in the secondary market during the first period of their trading. The size of their trading in the stock market shows wide oscillations - from some thousand to some ten thousands pieces. From the 26 million Certificates issued till the beginning of November, six million were traded in the stock market.

Now a process of concentration of Participation Certificates has been taking place, on the part of both the Polish banks and foreign investors. According to the BOSS agency, the share of the latter in the stock change trading has amounted to 11 per cent (Jedlak, 1996).

By the end of January 1996 the joint stock company Centralna Tabela Ofert S.A. (CTO) was founded by 43 brokerage houses, in order to carry out the public regulated trading of shares outside the stock exchange. This is considered to be the adequate market for most companies covered by the NIF Programme. The conditions of participation there

are less rigorous and the cost lower than in stock exchange trading. The participation in that market would ensure to the companies the possibility of pricing their shares and implementing the intended changes of their portfolio structures. The said market has been opened only at the beginning of December 1996.

A specific type of the market is that of non public trading of shares of the companies members of the National Investment Funds, the participants of which are their employees and the entitled contracting partners of those companies (farmers and fishermen) as well as the Funds themselves, or the time being, the market is not large, foremost because of the limited demand.

Summing up, the influence of the Programme of the National Investment Funds on the capital market has been marked, in the first place, by the emergence of Participation Certificates in the market trading. The amounts that have been traded in the secondary market

are not known, since initially their trading was taking place in the private market, and it is only since mid-July 1996 that it has been taking place also on the stock exchange. The turnover on the latter has been not large yet, but basing on the numbers of the Certificates dematerialised hitherto (about one third of all the certificates distributed), it can be expected to develop at a fast rate. The rate of profitability of investments in Participation Certificates has been positively higher than that of any other investments, the effect of which was a certain shift of capital from the shares market toward the market for Participation Certificates. Nonetheless, the inflow of new capital, including the foreign one, seems rather to prevail. In the years to come, the influence of the National Investment Fund Programme on the capital market will be increasing as the shares of the Funds will appear, the number of the companies members of the Programme listed on the stock exchange will increase, and the others will gradually enter the regulated public market outside the stock exchange.

Functioning of the Funds hitherto

Although the basic tasks related to the implementation of the National Investment Fund Programme have been realised by the end of 1996, there still remain two important stages till its final termination: introduction of shares of the Funds on the stock exchange (designed for the 2nd quarter 1997), and exchange of Participation Certificates for shares. These two stages, being a continuation of the Programme, will bring about, at the same time, a substantial change in its character. Owners of Participation Certificates will become owners of shares of the fifteen Funds, and as owners of the lead shares packages will gain influence on composition of governing bodies of the Funds and their strategies. The single price of Participation Certificates on the stock exchange will be replaced by different prices of shares of each Fund. Notations of the share prices of individual Funds on the stock exchange will reflect the effects of their activity.

Along with the organisational arrangements the implementation of the Programme itself has been proceeding. Governing bodies of the Funds and their management firms

were getting a preliminary knowledge of the companies participating in the Programme, then they studied them more thoroughly, in particular the selected companies of which they held lead packages of shares. After having acquired a sufficient knowledge of those companies, their environment and conditions of functioning, they proceeded together to elaboration of diagnoses which had to serve a basis for drafting the concepts of programmes of individual Funds, including their restructuring programmes. The advancement of that work, however, varies considerably.

Gradually but not evenly the Funds engage in the restructuring processes, those smaller directly, while the bigger ones through strategic investors. One of the forms of assistance has been granting or helping to obtain loans. Modernisation and extension of some plants have been i.a. undertaken for acceptance by strategic investors of additionally issued shares or, in some cases, also for acceptance of parts of those issued previously. Contracting of a number of joint-ventures has contributed to launching production of some new products or extending the existing production.

The Funds take also part in preparing repair programmes for the companies subject to conciliatory bank procedures, and afterward in conversion of their debts into shares. They conduct negotiations with the creditors of the companies on clearing of their debts in cases when the conciliatory bank proceedings cannot apply. Conversion of a company's debts into its shares permits to avoid its collapse. And in case of declared bankruptcies, they apply for conducting controlled bankruptcy procedures which, provided an adequate accommodation of claims of the creditors, enables the company to continue its production for established outlets.

The National Investment Fund Programme creates favourable conditions for cooperation between companies, especially within the Funds that adhered to the branch criterion during selection of their companies, Co-operation in production, trade or marketing helps the companies to reduce their costs and to raise the effectiveness of their activity.

In spite of the many positive effects of the operation hitherto of the Funds, they are frequently blamed for their "commercial mentality" and taking not enough care of restructuring their companies and assisting in their "curing".

During the implementation of the Programme characteristic of such a complex legal and organisational structure and lacking any experience, it was coming sometimes to sharp conflicts. In one of the Funds this led to cancellation of the contract with the management firm, in another one to recalling the Supervisory Board and appointing a new one. It came also to changes of members of management firms and their Management Boards, as well as of members of Management Boards of the Funds, not always caused by internal conflicts. Quite important personal changes took place in Management Boards of portfolio companies, yet rather rarely for reasons of arising conflicts.

Implementation of the Programme has been carefully watched. It is actually under control of the Minister of the State Treasury who, by virtue of his office, is steadily monitoring the functioning of the Funds. Within the Commission of Property

Transformations of the Sejm there exists a special subcommittee for the National Investment Funds related problems. Their operation is also watched by owners of the Participation Certificates, politicians and journalists. Whereas the politisation of the Programme has been causing more damage than benefit, so its publication may safeguard it against degeneration, even when it is not adequately protected by legal and institutional provisions.

In spite of the various reservations which one may have so far the realisation of the National Investment Fund Programme is concerned, it has brought about quite a lot of positive effects. One can also hope that those effects will be augmented, that they contribute to an improved management and a more effective allocation of resources. (Soltysinski, 1996) One should also not leave out of account the valuable experience acquired through realisation of that experiment, which may be used for similar kinds of programmes in the future.

Notes

¹ The Law dated August 30, 1996 on the commercialisation and privatisation of state-owned enterprises (J.of L. dated October 7, 1996, No. 1 18) changes principally the situation in that area. In virtue of its provisions, commercialisation is carried out by the Minister of Property Transformations (now Minister of the State Treasury) not only on motion of the director of the state-owned enterprise and its workers council, but also on motion of the founder authority and the Minister himself. (Art. 4).

² A more extensive presentation of proposals submitted by management firms to the Selection Commission during the competition, see "Pakiet informacyjny" No. 7, Ministry of Property Transformations, Warsaw, March 27, 1995.

³ For presentation of governing bodies of individual Funds, management firms and their members as well as criteria adopted by them in the selection of lead share packages, see i.a.: A.Kostrz-Kostecka, Program Narodowych Funduszy Inwestycyjnych. Vademecum. (The Programme of National Investment Funds, A guide), Twigger, Presspublica, Warsaw, 1995.

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Romanian Mass Privatisation Scheme. Implications on Corporate Governance

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The General Context of the Mass Privatisation

Economic and Socio-political Framework of Privatisation

Romanian economy by 1989, could be characterised like overcentralised and submitted to some of the most rigid planning and central control mechanisms from all the East and Central Europe countries. Lacking a pre-reform period Romania, unlike the other countries from the area, was not in the favourite position for the transition to a market economy.

During the 80's, the economic growth slowed down and the GNP (gross national product) collapsed after 1987. The efforts to repay the external debts affected not only the living standard, but also the economic potential through the decrease of the investments and suspending the imports.

Marking an instant breakage with the former system, the December 1989 Revolution had actually meant the pass to a new economical design and to concentrated efforts for a new legal and institutional framework, as well as for mechanisms allowing Romanian economy to function on the principles of market economy. These were substantial changes of management mechanisms at different economy levels, including the role of the government as a mediator between the ministries and the non-governmental, the give up from centralised planning system and the decisional discretion of the economic agents.

The reorganisation of economic units as “regies autonomus” (RA) and commercial companies (CC) by the Law 15/1990 and Law 30/1990, with their autonomy growing up, had actually constituted the first step toward the demonopolisation of the national economy and to the pass from the order economy to the market one. Thus, a number of 800 regies autonomus was set up, owning 45 percent of the national economy patrimony and covering strategic areas as energy, mining, transports, defence and others. Over 6,300 commercial companies were also registered, most of them joint stock companies with 100% state-owned capital. All these were owning almost 55 percent of the national economy patrimony.

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Constitution of the majority of state-owned agents as joint stock companies released a large process of corporatisation of the Romanian economy. This process, laid the basis of private initiative and private area development. Enterprises functioning on the principles of the corporation presume, apart of the decisional autonomy, more other conditions: market mechanisms ensuring efficient resource allocation, adequate legal framework; local currency convertibility and exchange rate established on a real base; economy stabilisation by mastering inflation. At the beginning of the process, these premises were not ensured.

The organisational restructuring started with the breakage of the former structures. Consequently, a number of institutions and organisations ensuring strategic management on macro and mezzo-economic levels (ministries, agencies) had lost importance. They had been reorganised or abolished. Although, some of their attributions and competencies had not been transferred, taken over or exercised by the new economic levels or by other organisations able to act as an organisational and functional framework of the national economy. As one can expect, this instant transfer from centralism to autonomy, based on a real mismatch between the substitution of the old structures and mechanisms with the new ones had experienced not only positive, but also negative effects, like break of horizontal and vertical connections, commercial and co-operation connections between economic units; breakage of the informational and administrative systems; lack of prospects for the economic and environmental demands; restrictions of general and especially of market character. See Nanes (1994).

Simultaneously with the decentralisation of Romanian economy an ensemble of measures was adopted, aimed at price and foreign trade liberalisation, banking system reform and revision of fiscal, credit, monetary, wage and employment policy.

Unfortunately, the incoherent strategy of the transition dropped in Romanian economy reality with its inconsistency, and delay of the reform programs, led to a crisis characterised by disbalances and dysfunction (some of them inherited) at the macro level - drastic decrease of the industrial and agrarian production, prolonged financial blockages and undercapitalisation of many enterprises; inflation, unbalanced aggregate demand and supply; increase of the unemployment and decrease of purchasing power of population etc. A slight improvement of the situation was recorded after 1993, and especially in 1994, but by now the growth rates can be considered, only as a retrieving ones, taking into account the registered level of 1989 and the involution and strong collapse of the economy in the first transition years.

It can be said, that the decentralisation of the decision process and the economic policy measures concerning the change of the economic environment were not sufficient to create a competitive framework and specific behaviour necessary for a modern market economy. Thus, one of the major and urgent task for competition of the reform process became privatisation.

The Content and Targets of Privatisation

Representing the main way for restructuring of the property system, privatisation was one of the most important and controversial problems of the Romanian economic reform. Thought as a way for achievement of transition to a competitive market economy, from one hand, and as a “goal” itself, from the other hand, the privatisation was often approached in an improper manner. The debates referred especially to the privatisation rhythm and size, and to the conflicts between government and privatisation organisations or among the latter (Zaman (1993)). Those problems seemed to be abstractly taken out of the context, of the large impact of the privatisation over the transition as a process, and over the population as a support of change. That impression was confirmed by the countless proofs, that privatisation can not be conceived like old communist “programs”, and that it does not represent a political-administrative action, but an essential institutional change in the base of the old economic system, a “way” destined to orient and contribute to the targets of economic efficiency, democracy and social justice, and to the creation of a new economic environment.

In this way Romanian experience points out that the privatisation was projected not as a reverse of nationalisation, that constituted the base of previous system, but as a complex process based on legislative, institutional and administrative measures, in order to create a new economic foundation - the privatisation institution.

Privatisation was conceived to change the system, through creation of new constitutive, functional and operational structures, through strengthening of the potential and autonomy of the new economic agents, through development of new markets and institutions, through restructuring of the old enterprises and economic activity, through reconsideration and delimitation of the economic functions of the state and, of course, through sketching of a new economic policy (Sava, Zaman and Pert (1994)). The new structures created by privatisation must answer to the logic of market economy functioning and to contribute to the efficient resources allocation. Consequently, being a priority of changing economy process, of moving it in a modern efficient market economy, the ownership reform means (in Romanian conditions) an extension of the private ownership in all the economy, by moving some part of state’s assets in private ownership (great privatisation), and by encouragement of the free enterprise and stimulation of the new private enterprises, mostly small and mid-size ones (small privatisation).

In addition, taking the form of denationalisation, privatisation brings in the first place of attention the topics of future status of public enterprises and, of course, of the state role and functions. The tendency outlined, is not of state ownership exclusion, but rather of state participation limited to economy management and creation of more large assertion room for the market economy specific factors. By privatisation taken in a broad sense, a consolidation of social system is desired, which changes the transition from a centralised administrated economy to an economy exposed to the market rules and laws.

Privatisation is a support of the reform, of the market economy transition, by which is intended a creation of a new economic environment and a new economic mentality

(especially for economic agents as well as for all types of employees, shareholders, employees-shareholders and others population categories). It contributes to the new criteria and value system required, that which defines every economic agent activity, in other words, a communication code different from one designed by the socialist economy, with more disciplinary and punishment value and with a unitary language capable to assure economic coherence and cohesion of the economic environment. More than that, privatisation does not touch exclusively economic management area, but lowers deep in all society stratum, at least from an educational point of view.

The movement of the accent from the enterprise privatisation to the privatisation economy by specifying the rights and responsibilities of economic agents could contribute in this way to the shaping and spreading of the new economic behaviour, characterised by regaining the desire for risk and initiative, competitive spirit, propensity for savings and investments. It could contribute to draft a new macroeconomics policy and, finally, to constitution of new corporate governance structures. Privatisation goals give the best definition of these trends and they can be found by a correct analysis of the new transitional, institutional and legislative framework. Shortly, it can be said, that mass privatisation and provides not only private an open economy advantages, but also a necessary push because of the Romanian economy from stagnation by modernisation and efficiency. Consequently, privatisation refers to economy revivification and its liberation from state control by decreasing administrative decisional interference in the enterprises management, to efficiency improvement, such as of economic environment that guarantee in fact political freedom and democracy.

At the same time, as well as in other Central and East European countries, political motivation had an important role in privatisation process (Backhaus (1997)) because the political improvement needed some economic measures for granting new winning freedom by ownership rights - like an important step which may contribute to reduce the gap between political equality and social inequality, and to one between formal and material rights.

From the other hand, the democratic institutions have some influence upon formulation and choosing the options that encourage the change.

At present, privatisation process acceleration is considered a priority problem. This approach comes from the "need" of rapid elucidation of rights and duties regarding enterprises management. The solution finally consists of property rights analysis. Next to that, it is considered, that in present Romanian economy, privatisation constitutes an accelerated way of creativity resources and entrepreneurship, of application of a performing management and of realising of a more severe agreement discipline. It may drive to more organised dynamic and flexible founded enterprises, capable to cope with internal and international markets competition.

These goals, which seem to exist outside governmental or non-governmental programs, do not regard privatisation as an "ideal" of economy changing and does not exaggerate its role in solving present or future problems. On the contrary, the economic area - recently dominated by decline, unbalances and distortions - proves that privatisation

was a necessary, but not enough condition for changing economy. Romanian economy example proves that privatisation, in any of its forms, is one of more complex aspects of transition. It last long and it is expensive. This notice drives us to conclusion that privatisation could not be possible like a spontaneous, self-correcting process.

The change in the laws and institutions generate not at once but after a while, new structures. Obviously, if privatisation is too slow, it may lose credibility and may affect economic policies causing permanent damages. Because of that, privatisation is one of the most difficult problem in the transitory post-communist economies. A clear evidence for that is the economic history study showing that “creation of the market” is not only a designed, deliberate process, but a spontaneous action caused by society requirements and needs.

Economic analysis of the establishment and functioning of the property rights is very important. The crucial importance of legislation and institutional infrastructure results from the fact that “ownership privatisation” means first, clear property rights, and second, conditions assurance for protection and practising all attributes of property rights, namely: possession, use, order and usufruct. This is due to the fact that the property rights represent, practically, the building frame of the incentive system of a market economy and a wide repartition of it can hamper the political power concentration in the hands of political class and is a factor of social stability.

Therefore, transformation of state property into private property is, or should be, accompanied by a clear definition of property rights and the creation of a new institutions which follow to generate new incentives in the economy. Consequently, the object of privatisation is not only the juridical transfer of property of enterprises assets but is also a decision power transfer and a sanction in the favour of new owners. This transfer determine a new governance of enterprises, that is to say, a new incentive and control structure of managers by the owners, and, of course, new managerial and organisational structures at the firms' level (Phelps, Frydman, Rapaczinsky and Shleifer (1993), Labaronne (1995)).

Legal Framework of Mass Privatisation

In order to privatise a number of important laws had been elaborated and adopted, namely:

Land Fund Law no. 18/1991 that regulates mainly, the individual ownership rights establishment and reestablishment over the agricultural lands, as well as some aspects regarding state ownership lands;

Lease Law no. 16/1994 that regulates the relations between owner and the tenant;

Law no. 35/1991 regarding foreign investment regime' specifying the rights and obligations of the foreign investors, as well as pledges and facilities that they benefit from between we can count: custom duties exemptions on the destined for production imports, for a seven years period, from the company registration, profit tax payment

exoneration for a five years period from the date of its obtaining (in the case of foreign commercial companies with a minimum capital of 50 millions dollars); the possibility to repatriate annual profit, participation to increase nominal capital and, obtaining shares to the commercial companies with majority state capital, obtaining industrial and intellectual rights etc;

Law no. 58/1991 regarding commercial companies establishing the legal and institutional framework needed for the transfer of state ownership in private property by Romanian or foreign natural or legal persons. It sets up the organisation and functions of the National Agency for Privatisation (NAP) as well as that of the independent privatisation funds. These are the State Ownership Fund (SOF) receiving 70% from the nominal capital of the commercial companies (organised according the chapter III from the Law no. 15/1990) and the five Private Ownership Funds (POF) entrusted with 30% of the commercial companies' nominal capital. According to the provisions of this Law the enterprises whose activity belongs to sane strategically fields (arms industry, energy, mines, natural gas, post-office and railway) are excluded from privatisation. According the law, the 30% quota from the nominal capital attributed to POF was provided for free of charge distribution ownership certificates (OC) to the authorised Romanian citizens (ageing 18 years at 31st of December 1991 and being stable residents of Romania). The law settled the procedure the free distribution of OC to the Romanian citizen (book- notes of five OC for each person); the OC regime, privatisation methods, and the selling of shares or assets to Romanian or foreign natural or legal persons by SOF.

According to the law ownership certificate (OC) holders could choose for:

- selling ownership certificates to natural or legal persons excepting foreign ones;
- exchanging OC for shares on market conditions, at any commercial company which followed whenever, to become private in a period of most 5 years since law function;
- transforming OC (remained at the end of the period of 5 years) in shares at POF.

On the basis of the same legal provisions the OC owners have the following rights:

- to receive dividends which are paid by POF settled conditions;
- to propose improvement actions of every fund specific activity and to require, motivated, the replacement of Board of directors members under condition that proposals must be assimilated by the owners of at least 10,000 OC;
- to buy commercial companies shares which are going to be sold by SOF in limited time, previous to whatever public selling, with a reduction of 10% as compared with the public offer, in a period of five years from entrance in the force of the law, in the limit of market value of detained OC;
- to obtain brokerage services from POF, for exchanging OC in shares, by market conditions at any commercial company offered for selling.

In what concern the quota of 70 percent from commercial companies nominal capital detained by SOF the low provide that it may be transferred by selling shares or assets to natural or legal persons domestic or foreign, through the following methods: offer for

selling shares to the public; selling shares by open auctions with pre-selected participants; selling shares by open negotiation; any combination of previous proceedings.

For the employees and management staff of commercial companies of which shares were sold by SOF, the law foresight same facilities and namely:

- in case of one share selling by public offer, they have the right to buy most of 10 percent from selling shares, with a 10 percent discount of public offer price, in limited time;
- in case of one share selling by auction, they have the right of preferential selling shares, only when they offer a price with the most 10 percent smaller then biggest price offered on auction and respect the other condition;
- on equal conditions with another potential buyers, commercial companies shares going to be sold by open negotiation by SOF, will be given to employees and management staff of commercial companies.

Law no 77/1994, regarding employees associations and the members of the managing commercial companies that privatise. The law objectives are facilitating the managers and employees access to the sales establishing The Shareholders Employees Association (SEA) as a potential buyer of all parcel of shares detained by SOF and POF.

Representing an important impulse for the state enterprises privatisation from Romania, which establishes the constitution and organisational conditions of SEA, its management bodies, as well the way of obtaining delivering and transmitting shares.

According the law, SEA is an association with legal person regime which contains employees and management staff of commercial companies, former employees and retires with the last job at those commercial companies, in order to obtain and to use commercial state-owned companies shares submitted to privatisation.

SEA has its own statute and its management organs are General Meeting and Board of Directors. SEA negotiate with SOF and POF selling-buying contract, advance rate, rates and the interest for the received credit.

The obtaining of company shares could make in the name of their members who subscribed shares and who individually pay for them, by one of the following ways: cash payment; OC exchange; payment by instalments facilities with SOF agreement; credits contracted by association. The shares obtained by association are taking in its account and the dividends delivered by commercial companies for the shares obtained and saddled with credits or unpaid instalments, will compulsory serve for covering them.

Commercial companies that became private by association shares conveyance, will benefit by a number of important fiscal facilities, applied to a single share purchase and namely: decreasing with 50% of income tax afferent to shares obtained, for all the period of paying instalments or credit retirement under condition of the contract; without taxation dividends of obtained shares for all the period previous mentioned. Another facility given to SEA concerns at following:

- SOF agreement with payment by instalments, in next conditions: first minimum advance of 20 percent of settled price; payment by instalment on minimum 5 years negotiable annual interest no more than 10 percent;
- The obligation of POF at which the respective company is allotted, to receive OC from association members, in the limit of at least 2/3 from its 30% quota, from the total of commercial company shares, at the value negotiated with it.

Law no 55/1995, regarding accelerating privatisation process which complete legislative framework previous mentioned by reconsidering of some economic political and social elements in the benefit of citizens, as well as in the benefit of the economic agents interests. These elements refer mainly to:

a) restoring equal participation chance to the free of charge privatisation process of all Romanian citizens, who match the age requirements (18 years till 31 December 1995 and stable residence in Romania) by:

- bestowing of compensations of economic and social nature, to which Romanian citizens were authorised, as a consequence of the efforts made under communist regime;
- elimination of inequalities committed with the occasion of the emission, distribution and alienation of a big number of certificates by their owners, caused by the lack of information, capital, or underdevelopment of the organised change market and the manner somehow restrictive in the deployment of privatisation. Till the appearance of this law in Romania the priority emphasis was put on the techniques of Management and Employees Buy Out type (MEBO) and the population distrusted the reliance in the OC utility, because within three years they could not be changed in shares and did not receive any dividend;

b) preventing the opportunity of the natural and/or legal persons who amassed in their hands a big number of OC to use them strategically, by transferring to a single enterprise and obtaining, by this way the controlling stake, and, therefore, the decision power. Those persons took advantage from the ignorance, distrust, the money lack of population and the non-existence of securities market.

While designed as the amendment law of the fundamental privatisation law (no. 58/1991), the new one, known as *mass-privatisation law*, raises two big objectives:

- to give the privatisation a decisive impetus by creating a critical mass of private companies needed to change the ownership structure of economy and Romanian economic environment. In this sense, government Decision no. 732/1995 approved the list of about 4,000 commercial companies submitted to accelerate the privatisation;
- to create a mass shareholding by attracting in the effective privatisation process of the big number of OC (million orders) being owned by citizens.

In essence, the new law means, a modification of the initial scheme of the privatisation by:

- issuing nominative coupons of privatisation (NC) with an unique value of change (975,000 lei) and the limitation of their distribution only to those citizens that did not

use all the book-notes of ownership certificates in the privatisation process or which from ignorance, or lack of money, alienated the OC;

- establishment (by government, SOF, POF) of an unique value of 25,000 lei for a book- notes of five ownership certificates;
- free transfer to Romanian authorised citizens of the shares afferent to the 30% quota of nominal capital of commercial companies with majority state capital, based on OC and NC;
- providing the possibility for subscription of privatisation titles (OC and NC), with a view to obtain shares directly from the commercial companies, included in the accelerating privatisation list, or from one of the five POFs, which in this way shall accomplish financial intermediaries role;
- allowing the exchange of OC and NC for shares from any single company, included in the list, can be carried out up to 49% - 60% of its nominal capital, subject on demand (following that late, after the subscription to make régularisation taking into account that, the free of charge transfer to citizens represent only 30% quota from the nominal capital of all 6300 commercial companies with state capital, quota administrated by POFs);
- leaving at company's disposal the shares from the SOF's quota remaining after the exchange for privatisation titles (51-40%), including the sell of the stake for sinking the registered debts or investment activities;
- interdiction of NC alienation (they could be obtained by legal succession);
- possibility to warrant between them of natural persons in view to subscribe OC and NC.

Normative documents and special methodological norms, that detail, explain and support the provisions stipulated by the Law no. 55/1995. Such through Government Order no. 39/1995, it is establish that selling shares and assets of state-owned companies can be made also by instalments to natural or legal persons, on following conditions; minimal advance of 20 percent of assets or share selling price; instalments payment on a period of no more 10 years; annual interest of no more than 10 percent. For instalment sale of shares and assets, constitute mortgage and pledge and till total payments shares, respective dividends flow into due instalment account.

Mass Privatisation Institutional Infrastructure

The transition from order economy to market one supposed like a “sine qua non” condition the creation and development of an institutional infrastructure, adequate to the Romanian economy specifics and to the incumbent demands of the new type of economy. The new institutional infrastructure must contribute to the creation of the framework and necessary conditions to accomplish the economic reform process, to avoid and surpass some negative phenomena appeared on the route, by the specific means of direction, support and control of economic agents. Besides the institutions of general influence upon economic reform like: Parliament, Government, Co-ordination Strategy and Economic Reform Council (CSERC), economic ministers, National Bank,

commercial banks etc., a number of institutions with specific attributions in the field of privatisation have been founded in this period.

National Agency for Privatisation (NAP) is a special institution of central public administration subordinated to the government, having the role of interface between the two non-governmental institutions (SOF and POF) and the Government. It co-ordinates, guides and controls the whole privatisation process.

Its main attributions are:

- to watch the state capital commercial companies program implementation and tightly co-operate in this aim with SOF and POF;
- to present to Government proposals regarding strategy and mechanisms of private sector development;
- to settle the lists with commercial companies that follow to be submitted to the privatisation process;
- to solve diverging problems between SOF and POF regarding commercial companies privatisation;
- to assure a legal and institutional framework for creating mutual funds;
- to elaborate the evaluation and selling methodology of commercial companies assets and of their shares and ensure staff training in the field of evaluation of commercial companies, auction organisation, selling shares and others privatisation activities;
- to watch the implementation of technical assistance and ensure a dissemination of information at home and abroad, with a view to promote the process of privatisation etc.

State Ownership Fund (SOF) is a public institution with commercial and financial character, which initially owned 70% of the nominal capital of all commercial companies. Having the biggest capital and economic power from Romania, SOF constituted like a mandatory of state with privatisation commercial companies task. SOF is the major shareholder at this companies by yearly selling (during a period of 7 years) of a package shares, corresponding of a percentage of 10% from the nominal capita. SOF will end the activity when all commercial companies, where is principal shareholder, will be privatised. To exercise a full autonomy, SOF is directly subordinate to Parliament and it has his own budget.

According the legal regulation (Law no 58/1991), SOF has the next principal attributions:

- to carry out together with POF GMS functions relying on law;
- to take measures for decreasing state participation to nominal capital of commercial enterprises, till their complete privatisation;
- to elaborate and to submit to Government and Parliament, annual privatisation programs;
- to define minimal performance criteria for commercial companies, such as policy regarding justified dividends utilisation;

- to take measures for restructuring commercial companies for their rehabilitation or for liquidation of unprofitable companies;
- to co-operate with POF for accelerating privatisation process;
- to give facilities provided by regulations in force at the selling commercial companies shares, that enter in its portfolio and others;

The supreme organism that manages this fund is Board of Directors, constituted from 17 members, of which: 5 appointed by the President of Romania, 3 by the Senate, 3 by the Deputy Chamber, 5 by the Government and a State Secretary who is the president of NAP. The Board of Directors mandate is for 5 years and can be renew only once. The members of Board of Directors can be revoke by the authorities that appointed them.

Executive management of SOF is assured by its general manager, appointed and revoked by the President of Board of Directors.

The main functions of Board of Directors are following:

- to approve SOF strategy, such as annual privatisation program proposed by Board of Directors President, program that will be approved by Parliament and it will be send to Government information;
- to establish selling methods of commercial companies shares;
- to approve resources distribution for some SOF activities;
- to settle up incentive or stimulation systems of Board of Directors members and submit them to Government approval;
- to name and revoke SOF representatives at general meetings shareholders of commercial companies;
- to approve criteria of minimum performance for the commercial companies proposed by the President of Board of Directors.

The five **Private Ownership Funds (POFs)** are organised as joint stock companies, that initially owned 30% of the nominal capital of about 6300 state-owned commercial companies allocated, having in this way all the shareholder rights and obligations stipulated by the law regarding commercial companies.

Till the adoption of the Law no. 55/1995 about 15.54 millions authorised Romanian citizens were represented as their shareholders. They received OC, issued by POFs, according the provisions of the Privatisation Law no. 58/1991. At the present moment, their shareholders are the citizens who subscribed to these funds with privatisation titles (OC and NC) in the framework of mass- privatisation process, released with the Law no. 55/1995. According the provisions of Law no. 58/1991, POFs were endowed to function during a five years period after the law promulgation. In November 1996 they were reorganised (without losing the legal person statute) in Financial Investment Societies (FIS).

Commercial companies allocation between the POFs was made on territorial or activity object criteria, accepting CC from “critical”² industries that were divided among funds

with the tasks of: risk distributions, avoiding one POF domination on such an industry, restructuring possibilities improvement. By this followed as well as to realise a more well-balanced institution regarding the size and performance potential, such as for their sectoral individualising in order to promote mass-privatisation strategy. It resulted, thus, following sectoral profiles:

- POF I (Banat-Crisana): wood industry, non-ferrous metallurgy;
- POF II (Moldova): textile and ready-made clothes;
- POF III (Transilvania): naval transport, fishing, tourism and entertainment;
- POF IV (Muntenia): glass and ceramics, building materials, pharmaceuticals;
- POF V (Oltenia): electronics and electro-techniques, leather goods and footwear.

POFs' main functions:

- to issue OC relying on law;
- to follow obtaining the highest profits which goes to OC owners;
- to ensure services for exchanging OC that issued, in shares, based on market condition;
- to restructure the shares portfolio and to make investments for maximising OC market value;
- to initiate acceleration measures for companies.

According to their statute, POFs are managed by a Board of Directors constituted from 7 members, of which are chosen a president and a vice-president. Board of Directors members were proposed by Government and approved by Parliament. They can be revoke by the same authorities. Board of Directors president, which is also general manager, organise and manages decisions implementation of the Board of Directors and of the Investment Committee - organ that function also inside every fund.

Besides, administrative organ regular tasks, organ that represents General Meetings of Shareholders, Board of Directors of POF, has specific tasks, like as:

- to approve and to announce public and regular market value of OC and of accounting unit;
- to propose to SOF measures for accelerating privatisation process and to co-operate at annual privatisation program elaboration;
- to approve selling condition of whole package of shares of commercial companies according with mandate that SOF gives to them.

Romanian Agency for Development (RAD): is a central and special organ of the government, which applies the development strategy and the economic policy for attracting foreign investments and for small and middle sized enterprises development, having the main functions:

- to elaborate and to present for Government approval the annual; general and sectoral programs of attracting foreign investments;

- to elaborate and to submit for approval to CSERC methodological norms, relying on present legislation, norms regarding foreign investments in Romania;
- to make investments offers, working together with invested institutions, commercial companies and regies autonomus;
- to examine foreign partners proposals for investments in Romania and to establish the actions to their turning to account and pick up foreign investments proposals, consulting involved institutions;
- to organise in a unitary way, promotion activity of foreign investments opportunities in Romania in relation to extern partners;
- to give specially assistance required by foreign or domestic partners for realising investments objectives with foreign capital participation; also the procedure of finalising formalities for confirmed foreign investments;
- to collaborate with SOF for setting up joint ventures companies with foreign contribution at capital, where Romanian partner is a state-owned company.

At the same time with adopting of the law regarding privatisation acceleration, the role and functions of privatisation funds increased. Considerably increased also the CSERC (Reform Ministry, as of December 1996) role with the elaboration of the project “Mass privatisation program” and the restructuring project as well as with finding the needed resources to finance “regies autonomus” and commercial companies with the majority of state capital.

Although created to shape the Romanian society evolution, the transition institutions are, in our opinion, still fragile and their role, responsibilities and competencies are not yet fully clear. Thus, for example, the statute the competencies and responsibilities which come back to POFs are not only complicated, but to some extent even contradictory. While their final object is to privatise i.e. divestment of the shares, they also have to act as a temporary administrator of a patrimony, which supposes investing in order to maximise the profits for their shareholders.

Also, often, in practice it can ascertain multiple parallelisms and superposition between different organisms and even a slip to administrative roles and functions, to a bureaucracy. The fact, that many institutions are fighting for the decision power and that all of these have their own conception regarding privatisation, leads to new non-correlation and distortions in their liaisons and in conceiving and progress of privatisation. All these problems constitute some of the main causes of a slow start of privatisation.

At last, it must not forget that these institutions were created to solve the specific for the transition period problems and that later, simultaneously with the advancement to the market economy they will “metamorphose” or simply will “disappear”. So, for example SOF, it is obvious that in time its activity will reduce up to the point of loosing its object, which theoretically means its disappearance. At their turn, the POFs, changed in FISs will obtain a new function and namely of administration of collective shares portfolios which they can register to the stock exchange.

The Privatisation Strategy of Romanian Enterprises

The basis of this strategy is a combination of privatising methods:

- free of charge privatisation through distribution of privatisation titles (book-notes of OC and NC) to the authorised Romanian citizens, encompassing the 30% quota from the companies capital administrated by POFs;
- privatisation by selling in cash the packages of shares detained by SOF (70% quota) to Romanian or foreign natural or legal persons. In order to fulfil this task, SOF is authorised to use whichever from the techniques for shares commercialisation, recognised in the international practice.

The Main Strategic Orientations

The strategic orientations regarding the state enterprises privatisation resulted from the Social-economic reform strategy of the Governmental Program and they took into account branch and sub-branch forecast, the foreign capital attract policy through direct investments or establishment of joint-ventures companies such as the whole law regulations. The legal designation of SOF and POF as shareholders for over 6300 commercial companies has needed the identification of the main privatisation coordinates. One of the main instruments for the implementations of the privatisation strategy constituted “The shareholders agreement” (as part of the POF frame statute). This agreement has been concluded between SOF and POF to guarantee the coordination of the SOF and POF activity and to strengthen the rights of POF, to give them the opportunity of initiative in the leading and privatisation of commercial companies, though they were minority shareholders. Essentially, the main strategic orientation aimed at:

- applying various privatisation approaches depending on the size of commercial companies (in terms of capital, number of employees, activity);
- giving priority for the small enterprises privatisation, through simple and fast methods;
- privatising the mid-size enterprises through various methods and combination of methods;
- restructuring of commercial companies regarding their preparation for privatisation;
- decentralisation of privatisation through authorisation of strategy companies, POF and SOF territorial directories for launching and completing privatisation and restructuring projects. Depending on the number of commercial companies and the rhythm of privatisation asked by the legal regulation, these strategic orientations involved the next distribution of competencies between the Funds:
- as a majority shareholder, SOF is responsible for the big commercial companies privatisation, where, generally speaking, a “case by case” strategic sector studies and restructuring and privatisation plans are necessary;

- POFs are responsible, having the mandate given by the SOF, of the mid-size commercial companies privatisation (excepting those who are economically linked with the big companies and/or who need a strategic sectoral approaches).

The Stages of the Mass Privatisation

Developed in a legal framework (the Law no. 58/1991, 77/1994, 55/1995), the privatisation process of state owned enterprises had covered several stages. Practically, the privatisation of state-owned company started in 1992 by initiating “The Pilot privatisation Program” lead by NAP that included 30 commercial companies (almost 0.5 percent from the total number). The NAP selection was made after analysis of the proposals received from the commercial companies and the recommendations sent by ministries involved in. The privatisation programs had been achieved with foreign consulting.

Defining the strategy privatisation, the NAP has take into consideration the possibility to attract a foreign strategic investor for some of the middle sized enterprises, while for the small enterprises MEBO privatisation has been adopted. In all the cases, the main criterion for adopting a privatisation strategy was the company viability; they were taken, also, into consideration, both the present job places protection and the possibility of developing a capital market in Romania. The pilot privatisation program has been finished in 1993, having as result the privatisation of 22 commercial companies. It achieved: testing the Law no. 58/1991 foresight on a small number of companies; making familiar typical privatisation problems to the specialists, decision factors and population; creating a perception of the necessary elements for the privatisation legal and institutional framework improvement; selecting of same privatisation methods, able to be adopted on specific types and size enterprises; increasing the privatisation credibility and obtaining the financial resources, necessary to finance the SOF and the POFs.

Beginning with 1993, the privatisation process has been developed extending over a larger number of commercial companies, usually the small ones. The majority of commercial companies has been privatised by the SOF through direct negotiation with the employees associations and the managers of these companies (MEBO). There was also other privatisation methods (offering shares to the public, selling shares by auction or with pre-selected participants, direct negotiation, selling assets), but all these had a reduced weight.

The predominance of “case by case” privatisation and also the low interest of POFs to transfer the owners certificates into shares has gone to a slow rhythm of privatisation process. Practically, until the 31st of October 1995 only 1463 companies, representing 21 percent from the total number of state-owned companies in the SOF’s portfolio have been privatised.

Wishing to eliminate this situation and the preferential character of utilised privatisation methods favouring a certain collectivism and restricting the freedom of participation for other employees categories, for other companies and for the population a law project had been drawn, which become effective on 19th of June 1995 (Law no.

55/1995). It initiated the mass privatisation of a number of 3944 commercial companies (Table 1) selected by profitability and attractiveness criteria of the activity field (the big majority registered rates of profitability more than 8%) and relatively uniform distributed on all the country territory.

Table 1

**The number of commercial companies included in mass-privatisation process
(The Law no. 55/1995)**

NUMBER OF UNITS	
TOTAL	3944
of which:	
- Industry	1226
- Agriculture, sylviculture, pisciculture	915
- Building	336
- Transport, post, telecommunications	420
- Trade	499
- Other branches	548

Source: Four years of government, Bucharest, 1996, p.85.

As it was elaborated earlier, the mass-privatisation program encloses the following stages:

- the nominative coupons distribution stage that ended by distributing 16.560 million coupons, representing 95.5 percent from the authorised citizens;
- the working out of the list of the enterprises submitted to mass privatisation by OC and NC subscription. This list included besides the quota of capital offered to the population (up to the limit of 49%-60%) a number of data regarding the activity profile, the nominal capital, the profits and losses etc;
- the privatisation titles subscription (OC and NC) to the commercial companies included on the mass privatisation or directly to the POF regarding obtaining shares;
- the delivery of property titles (OC and NC) to the commercial companies included on the list of mass privatisation or directly to POFs with the view to obtain shares;
- the delivery after the subscription of shareholder certificates as non-material form of shares;

The shareholder certificates are not transferable and negotiable. They do not constitute value titles or transferable securities, being only an inscribed paper, which attest the quality of shareholders and the proof of detaining a certain number of shares to the preferred commercial society or POF. These shares has an equal value and confer to the owner equal rights.

It choose the shareholders certificates from more considerations: the very high cost of issue of an immense number of nominative shares: the extremely short term in which the law established the shares to the authorised persons; the avoidance of some possible risks of forgeries, destruction, robberies etc.

The shares inscribed in the shareholder certificate constitute property of his titular and he can be dispose of them according their own interest: to keep, to sell, to give them to other persons. The share selling can legally realised only by intermediary societies authorised by the National Committee of Transferable Securities (NCTS), the seller having the simple obligation to inform the commercial company and the POF (FIS at present) were detained shares on alienation.

Regularisation of quotes of the capital detained between POFs (FISs) and SOF, knowing the fact that the share up to 49%-60% of nominal capital of commercial companies included on the accelerating privatisation list, destined to the free of charge transfer in exchange of privatisation titles had two components, respectively one component POF (30%) and another SOF going from 19% to 30% and secondly that a part of citizens subscribed to POFs. This is a difficult and complicated process taking into account different situations that appeared in the mass privatisation process (over- or undersubscription) as well as the necessity to harmonise the POFs options for different commercial companies with the SOF. The mediation of the negotiation between SOF and FISs is assured by the NAP. The present regularisation situation is an following: FIS I - from 1,648 companies from its portfolio made regularisation 42.7%; FIS II the corresponding figures are 1,276 and 55,02%; FIS III 1,086 and 98,07%; FIS IV 800 and 73,75%; FIS V 942 and 78,2%. Without finalising this compensation we can't have a clear situation about shareholding structure, and of companies included in the privatisation program;

The sale of the surplus package of shares upon the nominal capital quantum destined for changing for OC and NC to Romanian or foreign natural or legal persons (stage simultaneous with the development of the subscription.) This package of shares that represents 51% in the case of major economic important commercial companies included on the list and respectively 40% in the case of others companies on the list is administrated and negotiated by the SOF as a seller.

The peculiarities of this accelerating Privatisation process consisted of:

- the inclusions of commercial companies in 3 groups: big commercial companies (with over 18 billions lei nominal capital), middle -sized (with a nominal capital between 2- 18 billions lei), and small -sized (with a nominal capital up to 2 billion lei);

- the foresight, through regulations in operation, of more selling methods: public offer, auction or auction with pre-selected participants, direct negotiation with strategic or potential investors, such as combinations of previous variants;
- determination of selling value by simplified estimation methods or by expertise of specialists;
- the finding of strategic investor with suitable economic - financial capability in order to recover and/or continue development of privatised company in case in which the complementary parcel of shares submitted for selling is of 51% of the nominal capital of enterprise (this is the case of 806 commercial companies, of which 253 are of strategic importance);
- bestowing of some facilities in the case of open auction including a decrease of the offered price up to 10% per share in the case of underwriting in the first round of auction; instalments sale, advance of 25%-30%, the reimbursement period of 6-9 years, annual interest between 5%-10%.

Simultaneously, measures have been taken, so poorly performing companies or for the time being without attractiveness to be restructured or, according the case, liquidated in an immediate next stage.

Forms and Methods of Privatisation³ the State-Owned Enterprises

With a view to implement the property transfer from the state sector in the private one several privatisation forms were used:

Privatisation by total or partial liquidation of unprofitable commercial companies and selling of resulted assets to domestic or foreign investors or to commercial companies with foreign capital participation. Practically in Romania the privatisation under the form of assets selling begun in January 1992. In the programme initially included a number of 7,061 assets. The biggest part came from trade (28,3%) and industry (8,5%). The proceeding of selling of assets were settled by a special methodology approved by the government decision that beyond of other provisions included a series of measures in order to protect the Rumanian capital such as:

- the organisation of auction in two stages: on first could participate only natural or legal Romanian persons, and when the assets were not sale, it organise the second stage - where could participate foreign natural or legal persons;
- when the assets were not sale, it was organise the second stage - where could participate foreign natural or legal persons;
- when employees, retired persons or persons who had concession or management contract with company that sell, equal buying conditions with ones of the potential buyers, it exists a preference for them.

Given the legislative problems and the deficiencies in the assets appraisal, this privatisation method had been often degenerating in a spontaneous privatisation, consisting in buying assets by managers at reduced prices and sometimes in pure and simple unjustified appropriation.

For creating a perception about privatisation through selling assets, we show that from all selling assets by 10th October 1993, the biggest share (68.3%) were assets under 10 millions lei, 29.9% between 10 and 100 millions lei and only 1.8% with over 100 millions lei (Constantin and Dimitriu (1994)).

Privatisation by selling implemented by several variants: selling shares through direct negotiation; selling shares through public offering; selling shares through open auction or with pre-selected participants; combinations of the above proceedings.

Privatisation by MEBO, a variant of direct negotiation, (used more frequently till the appearance of the Law no 55/1995), which combine the free of charge transfer of shares from the POF in exchange of property certificates with the selling of SOF shares by direct negotiation with the Shareholder Employee Association. Practically from the total of about 1500 privatised till the beginning of the 1996 enterprises, this method was applied in 1400, that represents approximately 90%. Beyond the other reasons, the appeal to this method of Privatisation is due also to the fact that the demand of the privatised capital in Romania - due to the lack of domestic and foreign capital - was continue to be less than the supply.

Indirect privatisation that included: increasing nominal capital of enterprises by Romanian or foreign capital contribution for financing investments or development plans; restructuring activity through contribution to enterprises with mixed capital (state and private); gradual privatisation through management relying on Law no. 66/1993 of management contract, according to that managers must make investments of 50% to 100%) of participation share to enterprise profit, in enterprise shares by SOF.

Mass privatisation implemented by the Law no. 55/1995 is based on the simultaneous privatisation strategy by free of charge transfer of a value equivalent representing between 49%-60% from the nominal capital of about 4000 commercial companies included on the privatisation list and exchange it in shares for OC and coupons. All these are made in the same time with selling by SOF of 40-51 percent of shares from not "privatising lot" to Romanian or foreign strategic investors.

The mass privatisation is the largest method, almost 62 percent of 6,500⁴ state enterprises had been privatised by this method. It has deep implication on economic reform deployment, as well as on creating a new economic environment and a new ownership structure in Romanian economy. Moreover, it opens new opportunities for foreign investors providing possibilities to participate like strategic investors. The achievement of mass-privatisation goals will have as a result, an important share of private sector in the whole economy releasing at the same time the state from the charge

to re-capitalise 4000 enterprises stipulating that, at least 60 percent of amounts received by SOF from selling of the complementary share stock, should be left at the enterprise disposal in order to utilise them for technological restructuring, re-capitalisation and financial recover. The latter makes the real gratuitousness⁵ (Table 2) of privatisation in Romania very high (Zaman (1996a)).

Table 2

Real gratuitousness of mass-privatisation in Romania relying on Law § 5/1995 of accelerating privatisation

Company type	Companies' capital for free transfer under mass privatisation (%)	Complementary stock for sale by SOF (% of companies capital) ⁶	Amount for refunding by SOF (% of complementary stock)	Intervals of gratuitousness of privatisation (% total nominal capital)	
				(4)= (2)x(3)	(5)= (D)+(4)
(0)	0)	(2)	(3)	(4)=	(5)=
Normal	60.0	40.0	min. 40.0 max. 60.0	16.0	76.0
				24.0	84.0
Strategic	49.0	51.0	min. 40.0 max. 60.0	20.4	69.4
				30.6	79.6

* The estimation refers to nominal capital, by Governmental Decision 500/1994, without taking into account SOF shares price bigger or smaller than this value.

Source: *Tribuna economica*, 1996, 26, p. 24.

If at this level of gratuitousness we add another legal facilities for Romanian privatisation, like instalment sale, regarding to a small advance, a short repayment period (no more that 10 years) a lower interest (no more than 10 percent) as compared with the interest of commercial banks, it can say that for privatisation and for private sector in Romania exist a legal framework and stimulating facilities. All these represent a big trust for power and potential that it must be proved.

Given the complexity and the specifics of the ample and sensible process of property rights transfer it is difficult to appreciate which of the methods is more adequate. Such are the results from a comparative study made by the World Bank: each method satisfy in a different way the main objectives: a better corporate governance; rapidity and feasibility of application, better access to capital and professionalism, bigger incomes for government, most equity (Table 3).

Table 3

Advantages and disadvantages of different methods of enterprise privatisation

Methods	Better corporate governance	Rapidity and feasibility	Better access to capital and professionalism	Bigger incomes for government	More equity
Selling assets to buyers outside the enterprises	+	-	+	+	-
MEBO	-	+	-	-	-
Mass-Privatisation	?	+	?	-	+
Spontaneous-Privatisation	?	?	-	-	-

Source: De l'économie planifiée à l'économie de marché, Rapport sur le développement dans le monde, Banque Mondiale, Washington, 1996, p. 63.

Romanian experience confirms to a great extent these opinions (Nanes (1995)). Thus:

- **Privatisation by MEBO** in addition that proved to be attractive in a period when the private sector was quasi non-existent, politically and technically represented a rapid and easy method of privatisation, especially under the conditions of scarcity demand of privatised capital. To this it can add that theoretically and even practically in frequent cases it stimulated, by its nature, the local initiative (of employees and/or enterprises managers), contributed to the increase of motivation and also to changing mentality of employees, that become owners, and by “connecting” them and managers to the enterprise profit, opened the way to increase enterprise efficiency and competitiveness. For example, according to the SOF data financial profitability evolution at 261 commercial companies privatised by this method in 1993 (at 97.75% from total number of privatised in this year commercial companies) is favourable, during all the analysed period, in the majority of cases. Per total the situation is: 3.07% in 1992, 4.03% in 1993 and 7.43% in 1994.

Beyond of these incontestable advantages, MEBO presents however a number of limits and disadvantages, which are not negligible as well of the point of view of exigencies regarding enterprise restructuring and reengineering, as of that of implementing of a real corporate governance. In the case of a transition economy, the mechanisms for control over the enterprise management are less developed, than in the countries with consolidated market economy, where the market can impose some discipline. We have in view the following:

- MEBO does not contribute consistently to the enterprise capitalisation, because employees - buyers were not able - as a rule - to inject consistent capitals in the

enterprise and the SEA has a reduced capacity of investment, at least, in the first, years when the profit and dividends were utilised especially for the payment of credits that were necessary to buy shares;

- it does not offer an equality of chances for the ensemble of citizens detaining ownership certificates favouring only some categories of population (former or present employees of the enterprises, their managers and the members of GMS). It implemented therefore a preferential privatisation that limited the freedom of participation for the citizens belonging to others enterprises or institutions;
- MEBO determines a complication of the relation shareholding - trade unions - managers given the new employees quality (shareholders and trade - union members) and of managers who also are shareholders of respective companies. This fact influence on decisional process because of multitudes and differences in interests which have to harmonise;
- some rigidities in selling and buying shares, including the formation of controlling stake because of fact that: though the shares are nominative they can be transmitted during the association existence only under the terms established by the GMS, giving pre-emption rights to the members of association and constitute as pledge till the integral payment by SOF of the negotiated price and value of these;
- the obtaining, often, of the controlling stake - in a more or less orthodox way - by the enterprise manager that in the field of governance does not mean an essential change as compared with the previous privatisation situation, and sometimes by the GMS members (representatives of SOF or POF) or even by outside enterprise persons by intermediary of some SEA members;
- difficulties and conflicts of interests between the management and employees generated by an insufficient transparency with implications on the organisational climate;
- the reluctance of SEA when it do not detain or can not buy more than a part from the total enterprise shares - as compared with the outside investors, from the one hand, and, the hesitant attitude of the latter to invest where SEA obtained major participation fearing a possible conflict of interests, from the other hand.

Nevertheless, the **Mass Privatisation** offers a number of advantages like material and moral compensation of the citizens efforts made in the socialist period, restoring social equity, rapidity in attracting population in the privatisation process, the high level of the amounts reimbursed to commercial companies after the selling of complementary package of shares, that can constitute an important source of reengineering and modernisation of commercial companies in post-privatisation period. It can add also others facilities like those practised in the case of instalment sale, mentioned above. At the same time we must not forget the possibility that this method of privatisation create in what concern the outside control of managers, carried on by the citizens - shareholders and thus of institute of a corporate governance system.

To these aspects, favourable, they could be added others, of which legal regulations do not refer or are associated or derived from Privatisation process, but will influence, in our opinion, the economic agents and management behaviour. Namely:

- leads at least in the first stage, to the creation of a numerous shareholding (of hundreds thousands persons) dispersed and atomised, insufficient informed about the rights and responsibilities that come back to it, with a weak influence power over enterprise management because of reduced parcel of shares that every shareholder obtain and the low interest regarding the long term growth and development of the enterprises;
- because is normal and expected, that in spite of management contracts already concluded with the representatives of SOF and POF in GMS, at the level of privatised commercial companies, the managerial teams can be revalidated, function of the will of new shareholders that, at least theoretically will want to establish their own managerial team, and to redefine the strategic orientations of respective enterprises, all that mentioned aspects can generate a state of waiting period, with implications on economic activity performances, and the impact of respective transformations could be sufficient hard, especially under conditions of non existing of regulations of any kind, regarding the package of blockage - control stake or the mode of work with a atomised shareholding;
- facilities and free ways stipulated by legal framework of mass-Privatisation are not specific to market economy, because they can badly change market rules. That's why, in our opinion these incentives and facilities of privatisation are justify only on first step of Romanian transition to market economy, when extern and intern capital lack and management experience on private sector and capital market lack, make needed a real financial support from state. Their character must be temporary, because keeping using this kind of extra-economic instruments encourage an inefficient allocation of resources and inefficient use of those;
- finally, strategic investors, domestic or foreign have, generally, reserves in buying enterprise where participate a big number of owners, especially when they are tighter in majority.

Mechanisms for Conversion of Privatisation Titles) into Shares

According to the initial privatisation scheme (Law no. 58/1991), book-notes of OC were distributed to the authorised Romanian citizens providing their free of charge transfer for a 30% quota from the nominal capital of a number of 6500 state enterprises.

OC were represent privatisation titles freely distributed, but exist only a small tax for covering distribution costs. Every justified person received a 5% OC stock (un-nominalised), one for every of the five POF. Distribution process finished at the end of 1992. So, almost 15.54 millions Romanian persons became "de jure" shareholders of the five POF. They were justified to receive the dividends, if POF had a profitable activity. POF statute provide that the benefit on first 3 years be capitalise and after this period Board of Directors of these funds decide dividends distribution. This provides was determinate by.

- many of commercial companies were not very profitable at that time and for the next few years because of unfavourable economic environment. The possibility of obtaining

small benefits or zero benefits in the next few years, and also dividends or small dividends, was sure if we think at highest inflation rate;

- the huge investments demand for restructuring, in the majority of CC, that required to use potential benefits for direct investments or credits for investments;
- from strictly technical point, distribution costs of small amounts that represented dividends for 15.54 millions OC owners, made the operation inefficient and could damage of OC market value;

These problems had a bigger importance then the population loss of trust about OC, that did not bring for at least 3 years' dividends. The experts of National Agency of Privatisation thought that using OC for buying privatised commercial companies' shares was a stimulation for maintaining and increasing population interest in keeping and exchanging OC into privatised commercial companies shares.

Considering that uncertain preliminary estimation of commercial companies, 5,000 value units was given for each ownership certificate. NAP collected statistical data about 6,280 privatised commercial companies. Total nominal capital of commercial companies was estimated at almost 1,500 billions on the middle of 1992. However, this figure can not represent total nominal capital thpt can be part 70% to SOF and 30% to POF, and so it be use like estimation base for ownership certificate. That it is happened, first because that figure does not represent the market value, but the accounting value of commercial companies shares; and second, because inflation rate was modified at different times, by at least two legal rules enforced.

In spite of these difficulties, in order to urge privatisation of small commercial companies, on 20 April 1993 Board of Directors of the five POF announced OC value, following:

POF I (Banat-Crisana) - 23,000 lei; POF II (Moldova) - 29,000 lei; POF III (Transilvania) - 29,000 lei; POF IV (Muntenia) - 27,000 lei; POF V (Oltenia) - 27,000 lei. Later, up to the appearance of the law no 55/1995 regarding the accelerating privatisation, the value were periodically bring up to date, so that, in the quarter III of 1995, a book notes of OC utilised in the privatisation process by MEBO method amounted to a with a value of about 875,000 lei.

According the law in the privatisation process OC could be: sold to some natural or legal persons Romanian or foreign or exchanged into share that it was in the privatisation program. For buying commercial company shares, company that was going to be sold, could be used only OC issued by POF that owned 30% of these commercial companies shares and not all book notes of OC. The law did not stipulate a limit number of OC that a buyer could use for buying commercial company shares, so long as the shares were not issued by POF that owned 30%o of respective commercial company. Board of Directors of POF settled the OC number that could be changed in commercial company shares, but no more than 30% of all shares off it. An exception were the privatisations by MEBO method, situation in which the management and

employees had the right to use, in association, all the book-notes of OC in order to buy the company shares, according to the provisions regarding the small companies.

Due to the delayed start of an effective process and due to the prevalence of the MEBO techniques discriminating the population access to the commercial companies privatisation a negative phenomenon took place: loss of the reliance in the OC by population. In the absence of an organised securities market that determined their selling on an unorganised speculative market and, followed by their concentration in the hands of a reduced number of natural and even legal persons. On this market, the price permanently varied largely in relation with the demand, which was a function of the number of enterprises proposed for MEBO privatisation.

With a view to re-establish the initial equity in the distribution of that quota to the population and to attract the huge amount of OC (millions) to the effective privatisation process, a new formula of transfer was adopted simultaneously with the promulgation of the Law no. 55/1995 participation in free of charge privatisation. This formula was materialised in the *nominative privatisation coupons (NC)*, issued and distributed to the all authorised Romanian citizens, who did not use the entire OC book-notes in the privatisation process or alienated them, these coupons were added to the already existing OC, called unnominalized.

- According to new settlements the book-notes of OC and the NC are utilised to establish, by Government, SOF and POF, the unique value that is to say, 25,000 lei for a book-notes of 5 OC (a OC is worth 5,000 lei) and 975,000 for a coupon (the equivalent of 39 of 25,000 lei each of them).

The value of a book-notes of OC is based on their average transaction value at unorganised market (20,000), bring up to date, function of the economic evolutions that took place from the moment of each transaction accomplishment and the determination moment of this level. The difference of 5,000 lei in the favour of the owner is considered as representing the risk coefficient assumed by the person who invested different amounts of money to buy book-notes of OC; The unique exchange value of NC was settled as a difference between the value equivalent of the quota of 30% from the commercial companies nominal capital (according the accounting reports from the end of the year 1994) divided to the number of persons authorised to receive such coupons, on the one side, and the unique value of exchange of the OC book-notes (25,000).

The variants for individual subscription to exchange of the privatisation titles (OC and NC) in shares were:

- in one commercial company when the nominative coupon is used or in many of 4,000 companies included in the privatisation list when is used OC;
- in one or many of the 5 POF reorganised meanwhile as FIS;
- in any other state-owned company with majority state capital that is not included on The mass-privatisation list, excepting of the commercial banks and the former State Agricultural Enterprises that will be privatised through special laws.

According to utilised mechanism, depending on the quantum of deposited options for a company, we can have the next⁶ free share allocation situations: when the options with privatisation titles for a company situated till the limit of free transferable capital, the allocated number of shares was equal with the number of privatisation titles in OC book-notes equivalent, deposited by every citizen; when the options placed were under the limit of the available nominal capital the allocation was made within the deposited demands; in case when the exchange demand exceeded the available nominal capital the nominative value of a share was reduced from 25,000 lei to 1,000 lei and the number of allocated shares was decided on the basis of an allocation index (calculated as a relation between the total OC and NC placed for the respective enterprise and the number of free of charge shares offered by this commercial company).

Thus, two ways of determination and allocation of free of charge shares resulted:

- first way, arithmetic one, when one obtains an equal number of shares indifferently if the demand is equal or inferior to the supply of privatised capital; the shares uncovered by the privatisation titles (under-subscription case), remain in the SOF ownership and should be sold by different methods;
- second way based on so called demand-supply report, when the nominal value of a share is being reduced to 1,000 lei and the number of shares diminished concomitant with the exceed of the demand (the cases of over-subscription). This made that in the case of more citizens, the privatisation titles they had, with a nominal value of one million lei (one NC and one OC) “metamorphose” into shares of only some hundreds thousands lei, by the subscription phenomenon, and by way of solving this situation, by an administrative proceedings, and no by a normal market mechanisms.

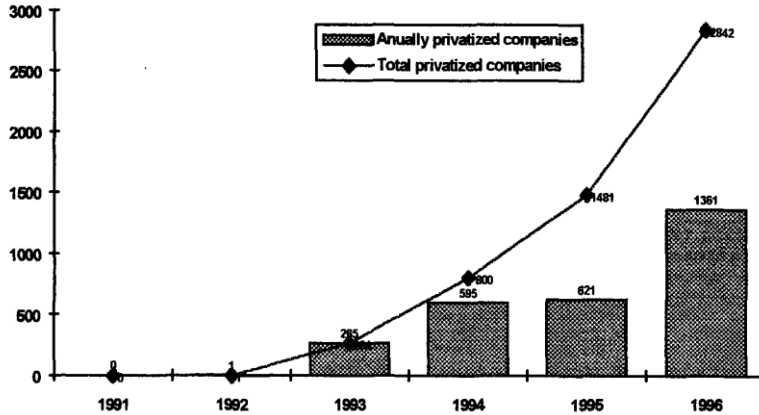
Development of the Privatisation Process

Retrospective analysis of the privatisation show its ascending evolution, even though the advance to a new property structure was not exempt of the difficulties and contradictions, some of these known in the others countries of Central and Eastern Europe. Thus, at the end of 1996, the number of commercial companies with majority state capital was 2,842 (about 45% of the initially registered in the SOF portfolio) totalling a nominal capital corresponding to the sold shares of over 4,145 billions lei (approximately 33% from the nominal capital submitted to privatisation) and in which are working 857 000 employees. Out of these 75.6% are small commercial companies, 21.3% middle sized and 3.1% big ones.

An emphasise of privatisation process was ascertain beginning with the second half of the year 1995 and especially in 1996 (Chart 1) as a result of re-opening of the free of charge privatisation under changed legal framework. Respectively transition to the mass privatisation stage that at the end will represent, probably, a leap in the property structure transformation, since the value of acquired assets by the popular shareholders is estimated at about 25,000 billions lei.

Chart 1

Privatised companies in the period 1992-1996



Source: SOF data

According to SOF data, in the period 19.06.1995 - 31.12.1996 was privatised 1,747 companies out of 3,944 included on the accelerated privatisation list, totalling a nominal capital of 3,069 billions lei and 405 618 employees (Table 4).

Table 4

Commercial companies privatised in the period 19 June 1995 - 31 December 1996

	Commercial Companies		Nominal capital corresponding of the sold shares		Employees	
	Number	% of the total	Millions lei	% of the total	Number	% of the total
Big C.C.	61	3.5	1060475	34.6	99818	24.6
Middle sized C.C.	393	22.5	1250052	40.7	231443	57.1
Small C.C.	1293	74.0	758598	24.7	74357	18.3
Total	1747	100.0	3069125	100.0	405618	100.0

Source: SOF Activity Report 1996

Generally, the branch approach of privatisation was made with priority for the sectors with less structural problems, with bigger attractiveness for strategic investors, with higher profitability or potential profitability, or with a more sustainable dynamic development especially: trade, building, building materials, tourism, local industry or local interest industry, agriculture, food industry, textile and ready-made clothes industry, wood processing. Gradually, it extended to privatised commercial companies from more “difficult” sectors like: engineering, chemistry, petrochemistry etc. See Table 5.

Table 5

The distribution of privatised commercial companies in the period 1992-1996 by the main sectors of activity

	Commercial Companies		Nominal capital corresponding to the sold shares		Number of employees	
	Number	% of the total	Total billions lei	% of the total	Total thousands	% of the total
Commercial	688	24.2	248.9	6.0	38.2	4.5
Building	325	11.4	364.6	8.8	180.5	21.1
Services	361	12.7	140.9	3.4	31.2	3.6
Agriculture	209	7.4	139.4	3.4	27.1	3.2
Tourism	192	6.8	627.5	15.1	10.6	1.2
Food industry	162	5.7	440.1	10.6	73.4	8.6
Ready made clothes, textiles	140	4.9	339.1	8.2	139.2	16.2
Transportation	95	3.3	60.0	1.5	19.3	2.3
Wood, cellulose, paper	88	3.1	317.5	7.7	76.2	8.8
Engineering	60	2.1	221.6	5.3	35.0	4.1
Others branches	522	18.4	1245.5	30.1	226.3	26.4
Total	2842	100.0	4145.1	100.0	857	100.0

Source: Calculated based on the data from SOF Activity

As a general characteristic the privatisation supply exceeded the demand during all the period 1992 - 1996. Thus, though in 1996 SOF launched a privatisation offer for

3,941CC (1,702 small, 1,716 middle sized and 523 big companies) from both lists that approved by the governmental Decision no. 626/1995 and that under the Law no. 58/1991, not more than 1,361 companies (34.5%) had been privatised by the end of the year.

From the data disclosed, it comes up that the process of subscription of privatisation titles and of delivery of OC at those about 4,000 CC, included on accelerating privatisation list, finalised, and now the CC concerning oneself with the deployment of GMS, and elaboration of consolidated registers of shareholders.

Referring to estimation of covering nominal capital available for exchange on privatisation titles, the following three “typical” situations should be pointed: the subscription exceeding the value of the capital submitted to mass privatisation; the subscription covering the most part of this capital; the subscription not covering the volume of nominal capital. According to some estimations of Informatics and Management Institute, the first situation exists in 10% of the 4,000 enterprises included in the list, the second situation appeared in 65% of them. The remaining 25% are in the third situation.

This situation generated one of the most controversial problems - what is going to happen if the total of privatised companies will not fulfil the 30% quota, which is envisaged for free transfer to citizens, and all privatisation titles lose their validity? According to the experts (Zaman (1996b)) this could interfere the shareholders structure in regard of the SOF weight in the nominal capital after the final regulations that will take place between SOF and POFs. In other words, it is possible that SOF will raise its own weight in the capital of a great number of less attractive commercial companies developing a kind of “nationalisation” provoked by the privatisation process itself.

Aspects Regarding the Post-Privatisation Efficiency

Though, not among its purpose, the privatisation is, or may be, a way to ensure an increase of enterprises efficiency, profitability and competitiveness. From this perspective, the analysis of some relevant indicators⁷ for a sample of 509 companies privatised in 1994 (85% from the all 595 companies privatised in that year) show that privatisation led to some positive results. Table 6. Although, among the various groups of enterprises exist yet significant differences-side by side with the companies that improved post-privatisation performance exist such which preserved the before privatisation level, and such which registered a reduction of profitability after privatisation, or even losses. This fact points out that, in the Romanian economy, still marked with many imbalances and non-correlation (economic, financial, legislative, institutional etc.), the privatisation, in the lack of performing management and of corporate well consolidated governance system do not always lead to improved performance.

Table 6

Evolution of some post-privatisation indicators

	1994 (comparable with 1995 figures)		1995	Differences ±1995 comparatively with 1994 (%)
Nominal capital	bill, lei	701.0	813.3	+ 16.01
Personnel	number	156348	145180	-7.15
Total incomes	bill, lei	4439.7	4198.1	-5.44
Net profit	bill, lei	333.8	417.3	+50.01
Debts	bill, lei	1237.3	965.4	-21.98
Indebtedness	bill, lei	1374.3	1375.9	+0.12
Financial profitability	%	7.608	9.94	+2.332
Economic profitability	%	33.18	51.31	+18.13
Degree of indebtedness	%	30.95	32.77	+1.82
Rate of immediate liquidity	%	1.479	0.970	-0.509

Source: SOF data.

Structural Changes Resulting from Privatisation

As a result of the privatisation/restructuring process unfolded in Romanian economy took place important structural mutations which offer an image on the covering “steps” and on the impact of this process of a distinguished proportion and signification. Thus:

a) Economic agents structure by forms of property significantly changed in the sense of increasing of economic agents number with private capital (commercial companies and private entrepreneurs) simultaneously with the reduction of those with integral or majority state capital (Table 7).

In this context, predominance of small and middle sized enterprises constitute a main structural characteristic, at the end of 1994 only 1,613, respectively 0.6%, from the total number of 278,130 economic agents with private capital with effectively deployed activity having over 100 employees. See Gogoneata (1996).

Table 7

Economic agents structure by forms of ownership

	Number				%
	1992	1993	1994	Sept. 1995	1995/ 1992
Regies autonomus					
Total	390	494	486	448	114.6
<i>of which</i> :					
- of national interest	84	79	82	83	98.8
Commercial companies					
Total ³	220284	323309	437710	478553	217.2
<i>of which</i> :					
- with state capital	7928	8455	6963	6233	78.6
- with private capital	199902	308795	421678	468207	234.2
<i>of which</i> :					
• privatised by SOF	1	264	840	1372	137.2
Private entrepreneurs					
Total	144709	160416	200800	224700	155.3
<i>of which</i> :					
- family partnership	28942	32084	38346	58388	201.7
- individual persons	115767	128332	162454	166312	143.7
Economic agents					
Total	352929	478160	629925	699588	198.2
<i>of which</i> :					
- with state capital	8318	8949	7449	6681	80.3
- with private capital	344611	469211	622476	692907	201.1

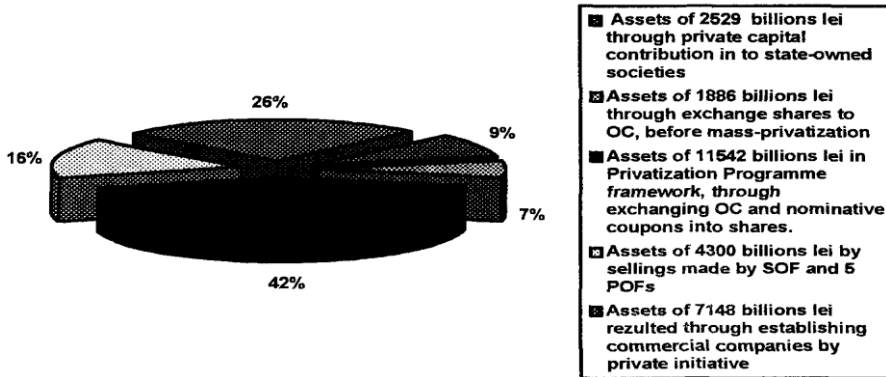
a. Registered at Commercial Register.

Source: *Adevarul economic* 6 (204), Febr. 9-15,1996.

Practically, at the present moment, the total value of the private property assets arise to 27,405 billions lei of which: 11,542 billions lei (42.1%) resulted by changing OC and NC for shares in the frame of mass privatisation program; 7,148 billions lei (26.1%) by the creation of commercial companies by private initiative; 4300 billions lei (15.7%) by selling accomplished by SOF and POF_s; 2,529 billions lei (9.2%) brought private capital to the state commercial societies and 1,886 billions lei (6.9%) by changing OC for shares before the beginning of accelerated privatisation process (Chart 2).

Chart 2

Assets structure existing in the private property by the mode of the Privatisation



Source: *Adevarul* 2124, March 18, 1996, p. 6.

b) The private sector consolidated especially in agriculture (the branch with the most accentuated dynamic of private sector) and in the field of services (commerce, hotels and restaurants, banking - financial and insurance activities etc.), accessible for small capital investment and more flexible in relations to demand evolution, and in building where registered considerable annual average rhythms of growth of approximately 140% (Gogoneata (1996)).

c) A strong private sector constituted also in foreign trade activity, this covering in 1996 approximately 50% of the total exports and imports together taking, in comparison of less than 0.5% in 1990 (Table 8). Concentrating the activity especially over large consumer goods, the activity of foreign trade deployed by private sector had a rapid evolution, more rapid than that registered on the whole field. The fact that this achieved especially in the field of imports, which degree of covering by exports was sub-unitary during traversing of all period 1990-1995 had however an unfavourable impact on the balance of trade, registering constantly commercial debt balance, tendency that continued in 1996.

d) In industry private sector evolved more slowly being prevalent oriented to small units from consumer goods producing branches, more attractive from the point of view of commercial speed of the capital and of the possibilities of the access on the market. So, though the number of enterprises with private capital from industry was in 1995 of 32,323 representing 92.2% of the total number of enterprises from this branch, they detained only 16.6% from the average number of employees and approximately 21% from the value of output. (Table 9).

Table 8

The weight of private sector in the total volume of main economic activities (%)

	1990	1991	1992	1993	1994	1995	1996
Industrial output.	-	1.3	3.2	6.2	12.9	20.7	24.0
Agricultural output	56.1	79.3	80.8	84.5	86.4	86.1	87.0
Building	3.1	4.5	13.0	30.2	25.5	70.8	71.1
Transport of goods	-	0.7	1.4	2.6	9.0	16.5	
Retail sales	0.8	21.7	45.8	65.0	71.1	76.4	78.5
Commercial services for population	3.9	20.1	35.4	42.6	54.0	73.7	74.5
Export FOB	0.2	15.9	27.5	27.9	40.3	41.2	50.7
Import FOB	0.4	16.1	32.8	27.2	39.2	45.4	47.7

Source: Romanian Government: Four years of government, Nov. 1996, p. 83;
Buletin Statistic 12, 1996, p. II.

In spite of its more slow evolution in industry, in the opinion of specialists from the Industry Ministry, the private sector position can be characterised at present as follows:

- the dominant position (over 50% of the turnover of the branch) in the industries of the telecommunication equipment, calculating technique, televisions, ready made clothes and knitwear, footwear, soap, detergents, cosmetics and perfumes, material recycling, publishers, printing and records on supports;
- competitive position (33-50% of the turnover of the branch) in fine ceramics and house keeping ceramics, lacquers and paints, furniture, rubber and plastics processing;
- minority or weak represented in metallurgy, oil processing, chemistry and petrochemistry, machinery and equipment, means of road transport (excluding cars), means of naval and air transport, machines and electric devices etc.

It appreciate also that the acceleration in the immediate next period of the privatisation process, by selling shares, will lead to significant changes of the weight of private sector as well on the whole industry and at the level of every sub-branch, so that till the year 2004 approximately 75% of the nominal capital of processing industry will be private property and 85% of the output of this industry will realise in the private sector.

b) Similar to industry, another branch in which private sector had a slow evolution represent transports, which deliver services as well for economic agents and for population.

Table 9

The industrial enterprises and employees structure by the property form

	1990	1991	1992	1993	1994	1995
	Enterprises number					
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
Public property	75.1	20.9	12.4	10.6	6.5	5.9
- of national interest	71.9	20.3	12.1	8.9	5.4	4.7
- of local interest	3.2	0.6	0.3	1.7	1.1	1.2
Mixed property	-	-	0.2	0.4	0.7	0.7
Private property	-	71.6	83.2	86.3	91.2	92.2
Cooperative property	24.9	7.5	4.2	2.7	1.6	1.2
	Average employees number					
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
Public property	90.0	90.5	90.0	87.9	84.3	74.9
- of national interest	89.1	89.6	89.3	85.4	81.5	72.5
- of local interest	1.8	0.9	0.7	2.5	2.8	2.4
Mixed property	-	-	1.0	1.1	2.4	5.5
Private property	-	1.4	3.4	6.4	10.0	16.6
Cooperative property	9.1	8.1	5.6	4.6	3.3	3.0

c) The weight of private sector in the gross value added increased year by year so as to in 1995 this represented 89% in agriculture, about 60.6% in building, 60% in services and 29% in industry as compared with 69.8; 3.7; 2.6%; 3.7% in 1989.

d) As a consequence of the extension and consolidation of private property the contribution of private sector to the creation of GNP increased four times as compared with 1989, respectively from 12.8% in 1989 to 52% in 1996.

e) Took place a dimensional restructuring in all the sectors (public, mixed, private, cooperative) process which outlines in the frame of de-monopolisation and reduction of concentration degree of industry, of increase of the small and middle sized enterprises role as factors of competing climate growth and of implementing a new structural - dimensional configuration of Romanian economy and industry. Consequently at the end of 1995, small and middle sized enterprises had a weight of 96.3% of the total

industrial enterprises, while the big and very big ones represented only 3.7% comparatively with 25.5% and respectively 74.5% in 1989.

The increase of over 3.7 times of the weight of small and middle sized industrial enterprises comparatively with 1989 was followed of increase of 5 respectively 4 times of the their weight in the total number of employees and of the production value. Nevertheless enterprises of big and very big dimension though significantly reduced as numerical weight concentrate over 79% of employees number and realise approximately 75%) of the industrial production volume.

Under dimensional respect, can be also evidence some other aspects and namely:

- the average dimension of industrial enterprises (expressed by average number of employees on an enterprise) reduced from 1652 in 1990 to 75 in 1995 (of 22 times);
- in the public sector which concentrate the major part of the big and very big enterprises in the increase context of 1.2 times of the enterprises number, take place a reduction of over 2 times of the average dimension of these (from about 2,000 employees in 1990 to 949 employees in 1995);
- in exchange take place an increase of 2 times of the average dimension of small and middle sized private enterprises (from about 7 employees in 1991 to over 13 employees in 1995).

Impediments of the Privatisation

A process of outstanding proportion and profoundness the Romanian economy privatisation did not exempt from difficulties blockages and limits, which either slow down or generate dysfunction and/or denaturalised to a some degree the content and the finality of this process. Some of them have a general character deriving from the way the economic reform is conceived and from the phenomena associated to the present period of transition, others are more specific being connected mainly to the design and implementation of privatisation projects. See Nanes (1996).

Impediments and Difficulties of General Character

Among the main impediments and difficulties of general order, that affected the dynamic of privatisation process and, of course, the purpose and the integrity of this process we can count:

- a) The lack of a coherent concept and strategy⁸ of the transition to the market economy, that assure harmonisation of different components of economic reform as well as some objectives and instruments of industrial policy that have to orient the economic agents behaviour in the “thicket” of the new exigencies and opportunities. Here may be pointed:
 - the dysfunction manifested by excessive emphasis on mass privatisation of majority state capital and delays in others fields, like, for example privatisation of the banking system, and regulation of portfolio investments;

- the delays in creating and making operational the capital markets - stock exchange and over the counter and the lack of clear regulations regarding authorising of securities societies, types of institutional investors and their obligations, prudential rules necessary to prevent the risks and defrauds etc;
 - the insufficient correlation of the restructuring/privatisation programs with those of local or regional development, as well as social protection and reorientation of labour force that is under the competence of Ministry of Labour and Social Protection;
 - the way of conceiving price liberalisation policy that stimulated a behaviour orientated to survival and not to privatisation and restructuring etc.
- b) the insufficiencies, complexity and mobility of the legal and normative framework that lead to divergent interpretations and amplification of the disputes between the different institutions involved in privatisation, and sometimes, to a disturbed perception of potential Romanian or foreign investors on the privatisation process, and to a significant and increasing number of litigation regarding the ways of Privatisation and the commercial aspects of selling-buying shares. (178 cases only in 11 months of 1996) were submitted to solve by the courts of justice of civil law (at their turn without sufficient experience and juridical practice in this new field);
- c) the imperfections of institutional framework consisting in a proliferation of institutions and organisations endowed to monitor privatisation process, in superposition, bureaucratic rivalries on decision power, which, finally, led to dilution of responsibilities in what concern the development of the process;
- Such as an example, even through, according the Law no 58.1991, the co-ordination of the privatisation process and the elaboration of the methodological norms of selling shares - including criteria of advisability of loosing control by the SOF - come back to NAP, till the end of the year 1996 the respective norms were not elaborated, SOF being in the situation to elaborate by itself, practically, all the methodologies and proceedings regarding its own activity.
- d) the financial blockage and the great volume of arrears from the economy, which affected investment capacity of the economic agents (especially in the public sector) and, at the same time, determined a some retention of potential investors , in the appreciation of the degree of attractiveness of commercial companies.

According to the data provided by SOF commercial companies from its portfolio detained 47% from the total gross arrears of which the most important part (75%) come back to overdue payment between commercial companies from its portfolio. In the frame of these commercial companies involved in the network of financial blockage it can distinguish two category and namely:

- 5,960 (about 90%) from the total number of commercial companies concentrate 20% from the gross and net arrears, even though detain 53% from the turnover. They can be considered not as generators of financial blockage, but as contaminated by the driving effect of co-operation relations;

- 633 (about 10%) from the total number of commercial companies concentrate about 80% of the gross and net arrears. This in the nucleus of the financial blockage;

e) the discordance of monetary and banking policy, characterised by practice of an expensive and unselective credit, by frequent changes in the rate of exchange regime with the objectives of economy restructuring/privatisation, especially taking into account the situation of undercapitalization of economic agents, and the importance of implementing of a good corporate governance. According to the investigations by experts (Croitoru (1996)) 55% from the interviewee think that banking system has an autonomous movement, opposed to Romanian economy priorities regarding the investment stimulation, long term credit support, regarding financial privatisation/ restructuring at the sectoral level and the enforcement of financial discipline;

f) fiscal policy maintaining some average and marginal rates of taxation on salaries and relative big on profits, proved to be non-incentive for savings and investment. According to some official estimates the rate was 35.5% in 1990; 33.2% in 1991; 33.5% in 1992; 31.3% in 1993; 28.2% in 1994; 28.8% in 1995 and 29% in 1996;

g) the insufficiency of domestic capital in both structural and qualitative aspect, and the relatively low interest of foreign investors for Romanian economy.

Thus in relation with the hopes of decision factors regarding foreign capital infusion but even with the created facilities by legal framework (tax exemptions, the possibility of repatriation of profit etc.), as well as the advantages offered by Romania (cheap labour force, and, generally, suitable skilled, production spaces etc) the foreign capital infusion in Romanian economy remain still modest (about 2 billions dollars in the period 1990 - august 1996) but increasingly. It seems that foreign investors manifest some prudence generated by a number of criteria that they had in sight (reliability of our national economy, respectively its degree of solvency, political risk, economy structure, the dimension of domestic market, the management quality, internal investment behaviour etc.) as well as the fact even the logic of world competitive economy radically changed signification of financial flows (interests of investments, political interests, the integration in regional or world strategies etc), and the international resources are limited in relation with the "capital hunger" that manifest at the present (Nanes (1995)). To this it can add the difficult bureaucratic proceedings and the big number of institutions and persons that interfere in decision making regarding foreign capital investment that constitute a difficult to traverse labyrinth for the potential foreign investors.

Specific Difficulties and Blockages

Besides difficulties and impediments of general order, the privatisation dynamic and purpose were affected by a number of specific difficulties and blockages which marked its different components. Among them are:

a) the prevalence of the MEBO type methods, till 1995, that limited the access of citizens to the privatisation of the commercial companies and slowed down the process and determined the loss of population reliance;

b) the difficulties in the estimating commercial companies and controversies regarding the selling price of their shares. The mentality according to which the accounting inventory value must be an inferior limit of the price of share persisted long time and had a non-productive influence on the privatisation rhythm because the congruity between accounting value and market value is, practically, a rare phenomenon

The evaluation problem of privatised state enterprises assets appeared especially after adopting the government Decision no. 500/1994 when the corporate immobilisation of respective enterprise was increased as average of over six times, the bring up to date coefficients oscillated between 4.966 and 15.088 times, as compared to the value from 1992. The increase of the nominal capital of commercial companies with majority state capital was justified by the necessity to take into account the influence of the inflation - strong enough in the last three years. This updating of the corporate assets which, practically was equivalent with a quasi-mechanical increase of the capital goods had a number of discouraging influences on the privatisation process.

Supposing the accounting value as a rigid base for the privatisation decision is equivalent with an automatic increase of the selling price of companies, indifferently of profitability and, consequently, with a decrease of potential number of buyers and investors.

This negative impact could be observed in the immediate next period after the application of the bring up to date. If in the period January - June 1994, SOF succeeded to sell a monthly average of over 50 enterprises (with a record of 120 privatised enterprises in July) in the period September - November 1994 the privatised number of enterprises felt dramatically (a monthly average of 5-6), even though more enterprises were in and advanced stage of arrangements for privatisation.

After an unfolding period of privatisation of two and half years, the opinion began to develop, that the market price in the determining factor of the property transfer and not the accounting value of assets. This opinion outline even more powerful after the coming into function of the over the counter market (OTC).

The persisting problem is - taking into account the emergent character of the market of capital - if the selling price obtained at stock exchange or at over the counter market represent a real, objective dimension of transferred shares. This dilemma is connected of 25,000 lei per share, the average price obtained on these markets was, in frequent cases, much less (of 2.2-20.8 times in the case of OTC, respectively with 78.9%-43.2% in the case of stock exchange) but the SOF succeeded to obtain superior market values, or at least equal with the nominal value of shares (Zaman (1997b)).

c) The fact, that in the companies privatised by public offer POFs did not offer in exchange of OC the whole quota that they detained. They kept for themselves about 10% from the stake of the profitable and very profitable companies in order to dispose of a big capital in the moment of their transformation in FISs. It led to the fact, that a part of state property instead of arriving to the population to remain at an institution.

And this profile to be a giant financial monopoly, that would not differ from that detained by the state till yesterday, by anything else, than by the luck of efforts to promote the general interest, like that of long term investments in basic branches, of the economy, the new job creating etc.

- d) frequent dysfunction regarding partnership relation between commercial companies (management, trade-unions) and the private investor outsider of company;
- e) manifestation by some managers of a reserved attitude, prudential, facing the privatisation, because of fear of not to lose their jobs or to be confronted with original new situations, and a new economic environment, characterised by the loss of state support and intensification of competition;
- f) difficulties in obtaining the privatisation titles for land, previous to privatisation, and the existence of some litigation regarding the property right of buildings and lands, between state enterprises, or between last ones, and local administration, or private persons, especially in trading and tourism;
- g) the existence to some commercial companies of some leasing contracts or renting especially in trading, tourism with influence over the privatisation decision, duration and the necessary organisational effort;
- h) difficulties met by SOF in selling the complementary stock of shares, which are not subject of mass privatisation, because as well of insufficiency of capital resources, as of reserve generally manifested by strategic Romanian or foreign investors, regarding the buying of overburden debts enterprises, or to which participate a big number of owners (shareholders), resulted from mass privatisation, especially when they together taken are majority;
- i) superposition of controls exercised by different control organs enabled (High Court, Finance Ministry, economic police etc) in all the phases of privatisation (preparation, implementation and post-privatisation). In many cases, these controls led to unimportant or arbitrary adjustments of the nominal capital or of some balance sheet elements so determining delays in finalising of privatisation documentation and contract selling - buying shares, or imposed the negotiation of additional papers to concluded contracts, and the results of controls effectuated by different organisations were not always convergent. This led to delays in making clear situations of some commercial companies and sometimes to giving up to buy shares by some investors;
- j) difficulties and controversies connected with the concession of remaining state participation. There is in question not only the complementary stock of shares but also the fact that 25% from the commercial companies, due, to the reduced degree of attractiveness, the titles of privatisation subscription did not cover the nominal capital quota afferent to free of charge transfer. But, in the case that after the adjustments between SOF and POFs would nor cover the quota of 30% from the nominal capital established by the in force regulations to free of charge transfer it is possible that at the commercial companies in which the level of subscription is weak or non-existent, SOF

(the state) increase the weight in their nominal capital. The legal framework does not offer solution in this sense, in the Law no 55/1995 stipulating only that at the commercial companies with partially state capital, SOF have to indicate in the Board of Directors of them a number of members proportional with the detained part of capital;

k) non adoption in time of the law of transforming the POFs in FISs that had to establish the size of their portfolios and the passing to the next stage of accelerating privatisation process, after finalising by free of charge transfer by the adjustment of capital quotas detained by POFs and SOF;

l) delays in ownership certificates inscription and not-finished share allocation operations due to: the existence of some unclear situations of nominal capital as a consequence of errors from accounting evidence and of controversial ways of evaluation; delays in data and information transmission to The Institute of Management and Informatics where finalising the allocation operations of shares etc.

Mass Privatisation and Corporate Governance System

In Romania like in others Central and East Europe countries, a corporate governance system based on private property did not exist till the revolution. As it is well known, the mechanism for control of Romanian enterprises was very centralised before 1989. Under the so called system of class workers self-management, almost employees influence upon important decisions regarding enterprises did not exist; the managing and control role was exercised by state.

Reorganisation of state enterprises in “regies autonomus” and joint stock companies (Law no. 15/1990 and no. 31/1990) that released the corporatisation process of Romanian economy and laid the foundations of the private sector, led to transitory corporate governance types. Thus, at the beginning of reform (1990 - September 1993), when state was the only enterprises owner, management and administration were made through:

State Representatives Board (SRB) (later State Mandate Representatives Board SMRB), an institution that includes two representatives from Ministry of Finance and one representative from competent ministry which represented state owner interests;

Board of Directors that included one representative from Ministry of Finance, and one from Ministry of Industries, and other activity areas specialists.

Adopted solution did not prove an efficient one, in our opinion, because of the way of settling competence and duties, and of the way of settling responsibilities and incentives (allowance dependant on meetings participation).

SMRB diluted much from its action force that must detain as state representatives, being in frequent cases near of private groups of interest. On the other side this first period was characterised of an non-precise status of Board of Directors of CC, respectively their attributions, competencies and responsibilities regarding property administration, that remained practically “suspended: between SRB (SMRB) and the

director or the executive management, the most often Board of Directors not being those which effectively managed, but rather, approved and advised the executive decisions frequently post-factum (Nanes (1994)).

After the establishment of SOF and POF being the only shareholders and owning respectively 70% and 30% of privatising companies a new formula was adopted. At companies' level General Meetings of Shareholders (GMS) were constituted, consisting of representatives of the two shareholders (experts selected from SOF and POFs clerks from ministries and others organs). They represent the interests of the two funds relying on representation contract concluded with them. The management contract is relying on adopted Law no. 66/1993, regarding management contract and methodological norms and sets the procedure of managers' selection, their competencies and duties, targets and performance criteria for their remuneration, participation in the profit, and others. An auditing committee was founded as an organ entitled to supervise and to control society administration.

“De jure”, this new formula could constitute an important lever for a better interests representation of the two shareholders, but especially for the state like main shareholder. This formulation could also be a lever for managers motivation and better performance because the relations between owner (SOF and POF) and manager or team managers are based on a legal agreement, and the remuneration depends on the financial and performance criteria.

“De facto” the problems continue to exist. They are the limited power and the few levers for a real, not formal practising of the GMS members as representatives of the two shareholders; the interests, sometimes are weak, economic and managerial training of one of those are not enough; the impact of external factors that not depend on decision maker; sometimes very good specialists are not at all good managers; the insufficient complementarity of different styles of authority and competencies inside team managers (Nanes (1995)).

Besides, the practice of developed countries show that this kind of relations between state and its representatives and public enterprises did not drive to efficient enterprises, but did drive in many cases to financial deficits and even difficulties in maintaining external market within the increasing competition. That means extra expenditures from state budget. The only solution proved to be privatisation.

The mass-privatisation target, state ownership transfer to private one, presumes not only legal transfer of state enterprises assets, but also decision power and control transfer to new owners and decreasing state role and interference in economic units activity. This ownership transfer and founding new private enterprises involve a new corporate governance system of enterprises, comprising the creation of appropriate mechanisms allowing the enterprises control by those who have the interests in their good performance: owners, shareholders, managers, employees, clients, suppliers, banks and others financial intermediaries, state, local communities, others.

Theoretically, control mechanisms of shareholders can be grouped into two categories:

a) an external control through market and legal framework, which principally have three forms through which managers can be motivated to act regarding their interests:

- selling shares to punish inefficient managers and not enough dividends delivered;
- bankruptcy imposed by creditors who have rights to ask for bankrupt enterprises liquidation;
- labour contract between shareholders and managers that can be revised according to enterprises results;

b) an internal control, based on:

- shareholders vote in GMS, they approve or sanction managers activity and Board of Directors activity and can maintain or revoke in function;
- operational control exercised by managers;
- employees control.

Of course, interests and targets of actors involved in corporate governance are different, but sometimes contradictory. For example, shareholders are interested in obtaining dividends and in increasing share value while managers have as targets keeping in function, wages rise and getting other advantages. Banks are interested that enterprises become enough profitable for possibility to refund credits and afferent interests and others. By the same token, corporate governance has the role to prevent and to avoid interests conflicts between actors mentioned, which could have damages upon enterprises and upon whole business community. As professor Marek P. Hessel from Fordham University - New York said “private investments depend strongly on corporate governance quality, which is based on legal system and on business behaviour norms”.

Implications on Shareholding Structure and Managerial Configuration

Structure, Behaviour and Shareholders Rights

As a result of state enterprises privatisation process through different methods and techniques, a numerous shareholders emerged, which comprise: Romanian citizens which subscribe privatisation titles at commercial companies or at POFs; Romanian or foreign citizens which bought shares offered for sale by SOF; former and present employees and enterprises managers, participating in MEBO privatisations; the state, represented by SOF that keep yet important participations in numerous enterprises and which remained “regies autonomes” owner, respectively enterprises owner which did not constitute privatisation target because their activity belong to strategic fields; POFs, changed recently in Financial Investments Societies, which in limit of the subscription made directly to them are shareholders in the commercial companies of their profiles.

The transfer state ownership to private economic agents presumes full practising of the whole ownership, (shareholder) of all property rights prerogatives (possession, disposition and usufruct), as well as power and control rights associated to them.

In this way, Romanian experience emphasises that if in case of privatisation by founding new societies and by liquidation, the things are clear, the prerogatives returning to new owners, in case of other privatisation forms, ownership rights of the new owners are either attenuated (thus incomplete) or exist yet some misunderstandings in that sense. It can be meet the following situations:

- the citizens that subscribed privatisation titles (OC and NC), either to POFs, or to commercial companies included on the accelerate privatisation list, could not exercise till this year the right of vote, in order to designate the new administrators, because as well at the level of POFs (FISs), as of the majority of CC, the GMS did not take place, because of the problem complexity, connected with their proceeding of convocation and deployment provoked at its turn, by the big number of shareholders, resulted after the mass-privatisation and by the lack of complete regulations in this sense. On the other side, there where begin to deploy such meetings, ascertain cases of infringing legal provisions in force (even through incomplete) either from not knowing them, or dictated by some interests, In this way existed situations of anticipated buying of NC and/or shareholders certificates, and basing of them, and of some mandates, elaborated without respecting the Securities Committee regulations, but using in the same time some relations with the administrators. Thus could convoke general meetings of shareholders, that succeeded to elect the own representatives in Board of Directors and the modification of the respective companies statute, according the own interests.
- even though delivered shareholders certificates - as non-materialised form of detained shares to FISs or to one or another commercial company they choose, the great majority of citizens - shareholders could not exercise the disposition right over these shares, because, did not finalise all the preliminary operations, that give the possibility of shares transaction on the organised securities market.
- though a big part of population became the single shareholder of POFs (FISs) after the subscription of privatisation titles, those citizens did not profit by dividends that they ought to have in their quality of owners of OC because they were not distributed. The statutes of POFs make precise in this sense that in the first three years the funds will not distribute dividends and that only Board of Directors of funds will decide on dividends. The problem becomes more complicated because these money was invested on long- and middle- term goals and because not all the companies transferred dividends to POF. So, the money could not be return at once if the problem is put in this way.

In order to remedy such situations, according to some provisions of recent regulations (urgency Order of Government no 5/ 1st March 1997) commercial companies submitted to mass-privatisation process (MPP) come back the obligations, as, by care of administrators and under FIS supervision to work out - on the base of owners of shares

list resulted after MPP transmitted by NAP as well to them and to FISs - consolidated registers of shareholders, and to retransmit them, till the end of March to NAP and to private independent authorised register, with which concluded contract of keeping the shareholders evidence. Based on this consolidated register the shareholders had to be convoke till 30 April to the general meetings of shareholders. With this occasion followed to be elected the new administrators and adopted the modifications to the statute that have to include, between other, provisions referring to the organised securities market on which would be transact the shares of companies, submitted MPP, and provisions regarding the private independent authorised register, that keep the evidence of company shareholders. Merely from this moment it can say that the shareholders can exercise the control power over managers, and at the same time, to dispose according their will of the quota-part of the detained nominal capital. In what concern usufruct rights, the legal dispositions stipulate that the dividends afferent to 1996 come back to the shareholders registered at the date of taking over consolidated registers of shareholders, without making precise when and how would be obtain.

At its turn Law no 133/8 October 1996 regarding the transformation of POFs in FIS stipulate that the citizens who received personal OC based on the Law no 58/1991 and who took part with one or more OC to MPP are authorised to receive with title of dividends, under the form of shares the quota - part from the incomes that come back to POFs till 31st March 1996, resulted from the collected dividends or that will be cashed from the awarded commercial companies, and from the utilisation of these dividends, and also from selling shares of afferent quota to the funds. The argument in supporting this solution refers to the reduced level of dividends that must bestow to the citizens, estimated at about 15-30,000 lei.

- The shareholdings resulted from the MEBO privatisation characterised by a statute combination (shareholder-employee; shareholder-manager) corresponding to the same person make heavier the to governance because of to many different interests that require to harmonise, creating confuse and sometimes conflict situations;

At the same time, there exist some rigidities on trade in shares, which limit the right of free disposal from them. They are connected with the fact that shares can be transferred only under the conditions settled by general meeting, and they include as well the preemption rights of the members of the Shareholders Employees Association. Another obstacle is the fact that shares are bought on credit by SEA and they serve as a pledge for those credits (Nanes (1995)).

Besides the misunderstandings regarding the ownership rights, because shareholders, resulted after mass-privatisation are too many and dispersed, and it is hard to presume that they will have decisional influence upon commercial companies management. The manifold interests, often diverging and needing a harmonisation will make difficult the decisional process and the good enterprise governance. At least at the first stage, the “outside” shareholders, the large mass of population that subscribed privatisation titles, will not have the wish to associate and to nominate their own representatives in the

General Meeting Shareholders, and thus, they will not have any influence and control power upon the enterprise management. As regarding the “inside” shareholders, the employees that subscribed to own commercial companies, they will have decisional influence power only if they will nominate their representatives in General Meeting Shareholders.

On the other side as in the case MEBO privatised companies, it will be very hard for shareholder-employee to keep a balance between targets and diverging interests which result from his double quality that of shareholder and employee, and all will depend on the position he places first, that of employee or that of shareholder. This situation is somehow a paradox and it will have a negative influence upon the management, and of course, upon the governance, especially that the current regulations, do not clear enough the problems regarding the status of the new type of shareholder.

Practically, a large mass of small shareholders is created through the mass-privatisation, as a rule passive ones, which are interested in obtaining dividends and not in long-term development and strengthening of the enterprises. Though, as whole these shareholders own, in some cases, a big part of the nominal capital of the companies they subscribed in, the small size of the everyone’s stake, does not bring possibility of influencing the decisional process. Because of precarious standard of living, many shareholders will easy give up at allocated shares. They sell to some enterprises, on the stock market, and over the counter market at real or not real money value. Although, it will lead to stock concentration in the hands of some speculative persons, (without impact upon decisional and managerial area), or in the hands of the real shareholders, those interested in their companies’ performance (active shareholders).

As a rule, decreasing dispersion of an atomised shareholdings, by capital concentration in hands of a small number shareholders is a favourable phenomenon for decisional process. But, this agreed “dispossession” of shares can drive to conflicts and contradictions between the interests of share-owners and not owners. As following, whatever the initial behaviour of the small shareholders is, a convergence of interests between owners (shareholders), employees and managers, through proper corporate governance mechanism in privatised enterprises is necessary to assure.

The final shareholders structure will contain more categories having in mind, that mass-privatisation process combines the free transfer of a shares against OC and NC with the sale of complementary stock shares by SOF⁹ (Table 10). Obviously, while, the small shareholders will exist, maybe in all privatised companies, the others categories of shareholders are not obligatory for all the companies; the new power structure model will depend on subscription level, on complementary stock size, offered for sale, and on the quality of who takes up this stock (package). For example, in many cases of state- owned companies privatisation, shareholders will be constituted from the Shareholders Employees Association, buying majority package from SOF and obtaining majority position, and small shareholders, subscribing their privatisation nominative coupons in the respective society. It can be that a strategic investor to take up a shares stock at

respective society, which drive to another shareholders structure, and of course to another vote dispersion in GMS.

Table 10

Possible structure of the shareholders after the mass-Privatisation

Shareholders types	Percent of nominal capital	Characteristics	Observations
Small shareholders	Hold a small number of titles even one company's share	Shareholders' general rights, i.e. right on dividends and right to vote.	Regarding right to vote, the common action means 1 share = 1 vote, the person's opportunity for control is proportional to the owned number of shares
Important shareholders	Hold a sufficiently large number of shares of above 5 percent according to the law.	Rights that exceed those of the small shareholders: - to ask for inclusion of a problems on the agenda of the general meeting; - to convene an extraordinary general meeting. - to ask a neutral inspection of the management, access to company's financial documents.	In case of exceeding 5 percent of company's shares, the law stipulates an obligation to inform the organ supervising the capital market about the held position.
Strategic investors	Hold more than 30 percent of firm's shares.	This kind of investor are characterised by maintaining its position for a long time and by active participation in strategy conception and application, company's management is, also, one of its engagement.	These persons make investments in a firm with a high enough quota for being strongly connected on it destiny and for a longterm strategy approach.
Control position (block minority)	Hold at least 1/3 of rights to vote.	Through number of owned titles, has the possibility to stop some decisions, like changing company's object of activity, changing nominal capital or any kind of measures like that.	Importance that comes not only from owner possibility of taking some decisions, but from allowing owner to stop taking decisions that need for adoption at least 2/3 of votes.
Majority position	Hold more than half of rights to vote.	This quality offers possibility to control upon all decisions that are taken by simple majority. The owner of this position can choose, revoke or replace Board of Directors members.	

At its turn, a small shareholders union in an association can change the shareholders from “passive” ones into “active” ones and they will constitute, thus, a force in GMS or in Board of Directors, if they will nominate a representative to sustain proper interests. Such an example is the Shareholders Employees Association, because it represents employees association in a company and have as its target to sustain the employees interests inside GMS if they succeed to obtain through buying of a certain shares package. Romanian legislation does not stipulate details regarding the small shareholders association, and do not make precision neither regarding blockage-control package nor, the rights deriving from owning its possession.

Besides, MEBO privatisation practice pointed out, that in some cases, through commercial companies statute it is stated that a shareholder can not be authorised to represent, in GMS, more than 30 others shareholders interests. This situation is not a favourable one for shareholders employees (owners of a small number of shares) and is favourable for the companies’ managers, who hold in their hands in some cases, a very big number of shares, acquiring this way discretionary powers (Nanes (1996)).

Finally, it may be mentioned that till the selling of complementary shares stock, a number of commercial companies will remain under the state control, through the SOF, which will own majority shareholder position at some of these companies. And, obviously, it may not omit, that the Financial Investments Societies can detain the position owned by the POFs.

Changes in Managerial Configuration of Privatised Enterprises

Before beginning of privatisation, commercial companies had, more or less, a “closed” society character, with only two shareholders SOF and POF. In the new mass- privatisation conditions, through changing privatisation titles (NC and OC) in shares at commercial companies or at one of 5 POFs, commercial companies the state will be changed. These companies will become open societies, being controlled by new shareholders and by persons interested in their good function. This situation determine or should determine a separation between nominal capital ownership and business management or in other words, between shareholders and the managers team. But it is not only that. It will lead to, probably, substantial changing privatised commercial companies management through founding new managerial structures at the same time with best suited managers selection and introducing their stimulation and control mechanisms that determined and motivated for action suitable with new shareholders interests. And this from different reasons:

- the most enterprises being inside privatisation process, follow Law no. 66/1993- regarding management contract application, are managed by a managers team or by a single manager, nominalized through competition by GMS, constituted from the two shareholders representatives (POF and SOF), which even have non-declared Board of Directors role;
- some of present managers do not have enough knowledge and experience for resolving problems of private enterprises function;

- finally, because new shareholders of privatised enterprises will want to settle a new managerial team and in other situations to redefine enterprises strategic orientations.

So, by changing shareholders structure in the favour of private one, the present GMS, constituted from representatives of POF and SOF, will be replaced with a general meeting of new jointly and co-participation shareholders that gradually will exercise all acquired ownership rights. At the same time, new GMS will choose probably for a new administrating formula of commercial companies suitable to the experience of the developed market economy firms. In this way, Law no. 55/1995 stipulates that when 51% of nominal capital of private commercial company is overtaken, in a period of 60 days, a GMS must be convened for changing statute and settling new managers, and the government, taking into account that, in the majority of cases, these legal provisions had not been followed, adopted an urgent order (no. 5/1st March 1997) that make precise the proceedings of organisation and deployment of GMS.

The problem of establishing a new administration and management structures is still controversial. Thus, some specialists think for a more traditional formula, respectively The Board of Directors whose president has prerogatives regarding all enterprises management, French model, a formula stipulated by Law no. 31/1990 regarding commercial companies. Others pronounce for a system made by Board of Directors and Committee of Directors, German model, as another way of resolving companies' administration problem, which puts in practice a separation between management and control functions.

Information that we owned by now, do not let us to say exactly which are the most suitable formula for privatised companies or for companies under privatisation. Whatever choosing alternative is, mass-privatisation will bring a "mass" revalidation of managers teams by some of the new shareholders, a simultaneous change of management and, probably, in a long term, management contracts between representatives of SOF and POF will be worthless in a very large number of commercial companies. Since it is possible that the state continues to hold a share for a period in some companies, the SOF have to appoint representatives in the Board of Directors of the respective enterprises.

This changes generated by mass-privatisation on management commercial companies level will bring new specific elements to market economy, like: increasing decisional autonomy and initiative of private enterprises; direct and indirect control exercised by new shareholders; increasing engagement in the enterprises performance because of possibility of quotation on the Stock Exchange for mobilisation of capital.

An indispensable condition for applying and efficient corporate governance system in the adoption, by the new shareholders, of a policy which induce and motivate the managers of privatised commercial companies to act according shareholders interest and not only to maximise their own utility function. Of course, this is not simple to achieve, since in many privatised commercial companies the employees and managers are shareholders and in this quality can have influence upon some major decisions of the GMS.

It is to presume, that managerial changes, which are going to happen at many enterprises can generate perturbing and unfavourable elements for long time and

because of their uncertainty to maintain their position. Hence, the necessity that all the factors interested in a good enterprise governance must act for finding the most adequate ways and means to prevent, remove or minimise potential negative effects, that can exist in this period, characterised by important or less important changes of commercial companies management and of power structure existing on their level.

Introducing a new corporate governance enterprises system suppose: market mechanism function that offers right signals regarding resources allocation and utilisation, a proper legal framework, clarified ownership rights, and not at last, financial market institution function.

The Role of Financial Institutions in Privatisation and Corporate Governance

Financial Investments Societies (FIS)

According to the Law nr. 133/1 Nov. 1996 the former POF had been reorganised as Financial Investments Societies that function as joint stock companies. They have the following tasks:

- administrating shares at commercial companies for that issued their own shares according to privatisation OC and NC subscribed by citizens to POF;
- managing shares portfolio and realising financial investments for maximising their own shares value;

FIS issue on their own name ordinary nominal shares within the limits of their participation in privatised commercial companies and societies transfer them to citizens that made an option for subscription of privatisation titles at POF. These can not be bought back by FIS, but also they can be transacted an organised securities market by the owners.

The new FIS will make an assessment of new assets for giving a first shares value. Initial nominal capital of every FIS followed to be determined after finalising of allocation of the companies' shares by direct subscriptions made by justified Romanian citizens through adding nominal value of shares get by POF in exchange of complete or incomplete book-notes of OC or NC.

Up to date of the meeting of the first GMS, the attributions regarding patrimony administration of new institutions came back to the Board of Directors of POFs, appointed by the Romanian Parliament in 1994. After that they follow to be take-over by a new Board of Directors elected by the FIS shareholders fact that happened in the half of this year.

Although, adopted law came to encounter some imperfections perceived by us, regarding shareholders ownership rights, however, some aspects are still remaining vague. In this way:

- it is not specify if Financial Investments Societies are not allowed to have access at commercial companies shares, companies not included on mass-privatisation list, some of these being more profitable than ones included on the list;

- although more commercial companies did not transfer the part of dividends that come back to POF in quality of shareholder side by side with SOF, law does not stipulate any punishment in this way, but only payment obligation till 31st December this year;
- it is not doing, also, specifications regarding founder shareholders rights and others that not have these quality rights.

Near by the mentioned aspects, remain under discussion also others problems connected with the FIS statute and function in the post-subscription period, problems which solved could stimulate the capital market development in Romania. Between them we can mention:

a) POFs received the right to exchange into shares, deposited by citizens coupons and certificates. Normally, these coupons and certificates had to exchange with shares, to the companies where by subscription did not exhaust the afferent quota of the mass- privatisation program. But POFs constituted in advance assets from the shares to profitable companies, previously privatised, by different methods (especially by MEBO), in the limit of till 10% from the nominal capital of a commercial company. In this way succeeded the POFs consolidation at the expense of the state. This question can not be suitable solved, than in the process of regularisation of participations to capital to commercial companies, FISs and SOF and of implementing the compensation between them;

b) According the law of transformation of POFs in FISs the citizens that received personally ownership certificates are authorised to receive with dividend title, in the form of shares, the quota-part from the incomes that come back to POFs till March, 31 1996.

According some calculations, resulted that every citizen would have to receive approximately 30 shares of 1,000 per share. This legal provision seem to favour the capitalisation process of FISs at the expense of citizens, by transferring the risks on last ones, because the market quotation of these shares with a nominal value of 1,000 lei is unknown;

c) FISs must to assure professional administration of some collective portfolios, by a permanent presence on the capital market, acting in quality of institutional investor. But the manifested apparent tendency is that, in a first period, FISs can action as strategic investors. In this sense, is exert pressures that in the compensation process with SOF, FISs to obtain the majority parcels of shares to commercial companies, that would permit a direct intervention in respective companies restructuring and management. But this is not something else that a misappropriation from the nature, and the FISs functions respectively, that of financial investment funds, shut investment funds (Popa (1997)). The consequence deriving from here for the capital market development are visible - the manifestation of FISs like strategic investors and the diminution of their activity as institutional investors will restrict the capital market development in Romania.

At present time, FISs are draw along of many problems, between which:

- the shareholder certificate distribution to the citizens that deposited coupons and ownership certificates, activity that, according the law must finalise till the end of March;
- the regularisation of capital quotas between FISs and SOF, consequently of mass privatisation programs results (over-subscription, equal subscription with the POF

quota, and under-subscription, as compared with the quota). This process that implies negotiations between FISs and SOF is long, and would be implemented by the NAP mediation, because has as finality the settlement of commercial companies at which the FISs will remain shareholders.

Probably in the next months could be clarified all the aspects connected to definitive transfer of former POFs in FISs and the inscription of last ones on the capital market. Only from this moment the owners of shareholders certificates to FISs could take advantage of all rights conferred by this quality.

Mutual Funds and Investments Societies - Financial Intermediary Institutions

Next to the banks, on financial market, appeared relatively recently other forms of capitalising the money availability of population. Thus, according the government Order no. 24/1993, natural and legal persons can found an open investment fund subject to Securities Committee authorisation. The fund is set up by a contract of civil society without juridical personality. It is including both money contributions received by a public offer of participation titles bearing the property rights to the fund, and the assets purchased under the form of a diversified portfolio of transferable securities.

Launched on the financial market in a favourable juncture - the reduction of banking interests of population deposits - and taking advantage of an aggressive publicity, these funds succeeded, in relative short time, to attract a big number of investors. Thus the Mutual Fund of Business - men (MFB) had in March 1995 about 170,000 holders of participation titles. At the same time, increased the number of these mutual funds, between them setting up a strong competition, for attracting the holders of such titles.

After the success registered in a first stage, the Securities Committee intervened at the end of 1995 to put in order the activity of these funds of the capital market, especially in what concern the calculation ways of up to day value of participation titles. This was necessary because a good period of time manifested a lack of professionalism in supervising and controlling investment funds, that led to adopting of some unorthodox proceedings of market operations. Between them, we mention only the issue of participation titles with a value that was not according to net assets (effective value up to day) of the funds that determined with an anticipate rate on the results of the operations accomplished by the funds on the financial market (masked loans, with high degree of risk, covered by investments in overvalued securities).

The Securities Committee intervention and the lack of professionalism of some societies that administrate these funds, drove to the appearance of some severe economic phenomena. Thus, in a very short period of time, the investors lost about 300 billions lei, with influences on their incomes and the loss of the savings of a big number of citizens (Baltes (1997)).

In the last period, the substantial increase of the bank interest on the population deposits emphasised the lack of reliance in the mutual investment funds. Consequently,

their activity on the financial market permanently decreased; in the middle of March 1997 cease of activity was announcing the activity of one of the important fund that operated on the Romanian capital market.

As mentioned above results that Romanian capital market meet a particular tendency opposed to manifested now in the world tendencies and namely of transforming financial savings in banking savings. The defeat of this tendency is connected of the rapid diversification of the capital market. The more this capital market would quicker develop, the more would diversify the possibilities of investment of mutual market funds. Offering more flexible possibilities of investments for population as well as more simple proceedings of savings attracting, as possibilities of better administration of their investment portfolio by investment in a wide category of financial titles, investment funds could in a near perspective to have an important role in capital market function in Romania.

Banks and Corporate Governance

Within control made by outsiders, an important role goes to banking system. In Romania, the restructured banking system includes: the National Bank of Romania (NBR) and Commercial Banks (37 banks, out of which 7 are with state capital).

Because in the whole period 1990-1993 benefit of cheap refinancing from NBR and practice negative interests, state banks implicitly gave subsidies to their main clients: state enterprises. At the same time one of adopted measures at the end of the year 1991, like as, for example, measures regarding total compensation that go to an important increasing new credits, given by banks, for stand-by credits payment (non-serviced credits). By total compensation, a share of credits between enterprises had changed, practically, in banking credit. So, banks resources are used for temporary resolving debts of enterprises.

This financial sustaining of state enterprises did not stop yet arrears in economy. In addition, this sustaining drives to a slowly economic reform process and on first, to a slowly privatisation process, decreases banks interest for exercising control upon enterprises. In this way is delayed real corporate governance establishment. Regarding to experts remarks, in 1993, banks where most state enterprises from industry and agriculture had accounts (Romanian Commercial Bank and Agricultural Bank), transferred through rates of interest, implicit subsidies of 4.8% of GDP (calculated based on production prices) and respectively 9.1% (calculated based on consumption prices).

The year 1994 marks a change in banks behaviour regarding enterprises, simultaneously with the pass to real positive interests. Practically, to sustain the shock determined by transfer to real positive interests, banks must choose between deteriorating their own assets portfolio and supporting state enterprises that had losses. As a consequence, banks began to exercise more control upon enterprises to make them having a profitable performance and being solvent, or to restrict their activity.

The banks prudence increase, against giving new credits to economic agents that have losses and they use a forced fulfilment of liens on assets for given credits when do not exist ways of quick bringing to normal or when are paid refunds. In the last time,

doubtful credits treatment becomes more important in credits portfolio administration of every banking society. In case of easy treatment, commercial banks can be punished by National Bank of Romania.

Also, some special regimes are established for financial supervision of some of the state capital economic agents including 151 units, 9 “of which regimes autonomous” and 142 commercial companies, which had negative financial results or affected a normal economic process. These supervising regimes instituted by government Order no. 13/1995, contained measures for a strong financial discipline, for decreasing and eliminating payments and debts, decreasing public funds finance and obtaining positive financial flows so that finally, arrive to deploy a profitable activity. One of key mechanism of Order no. 13/1995 constituted the conciliation of debts between debtors and creditors in order to reschedule and cancel the debts, credits, debts to suppliers, taxes and duties, interests.

The main instrument conceived to have a contribution for obtaining targets included in Order no 13/1995 was Financial Restructuring and Bringing to normal Program (FRBP) which every supervised enterprises had obligation to elaborate and to obey to qualified organs for approval. The conciliation was co-ordinated and supervised permanently by the Finance Ministry, Restructuring Agency and SOF by the Direction of Selective Restructuring.

In essence, the targets of Order go. 13/1995 and of conciliation were to send a signal for creditors that the new loans must be given only to economic agents that can reimburse debts and to offer new mechanisms and possibilities of control exercised by banks upon enterprises. New facilities, mechanisms and ways of supervision made that conciliation chart changed in an indirect way of subsidies for state enterprises from industry and agriculture and of banks adherence to enterprises problems. According to experts estimations (Croitoru (1996)), this is adequate rather to corporate governance weakness than to its strengthening. In supervised enterprises, the increase of losses and decrease of profitability are possible because of the banks’ support, through indirect transfer of resources by rescheduled credits and especially by lowered interests and cancelled punishments. In this way, although the article 13 of Order no. 13/1995 stipulates that banks can invalidate and decrease interests of credits (in optional way), more than 87.1% of interests were invalidated. Practically, implicit subsidies (indirect) given in 1995 only through remained debts invalidation represented 1,050 billions lei (50% of public budget deficit for 1995). To these, it must be added, 12 billions like implicit subsidies through reduction of debts as well as those resulted from rescheduling debts, which depend on maturity period and which according to some estimations amount to 471 billions lei only for 1996.

Romanian Post-Privatisation Fund (RPF)

Post-privatisation Fund was constituted by PHARE and European Bank for Reconstruction and Development initiative and represents a risk fund for supporting privatised enterprises with credits in favourable conditions.

Amounts necessary to found this fund (44 millions ECU) was given by: PHARE, European Bank for Reconstruction and Development and Manager Fund, that means Spanish group of banks SEPI who will assure and will administrate the fund. Because funds allocated by PHARE can not go directly for credit activity, was created Romanian Foundation for Post-privatisation with NAP like founder member, as Romanian Government representative.

RPF will function based on strictly commercial principles. This means that administration society will decide financing only in profitable situations. The working way of Fund Manager will be one of investment by increasing capital. One of, conditions for the enterprises that follow to receive funds, is to have a majority private shareholder. The enterprises would be selected by the Manager Fund and by a Investment Committee being preferred the societies with certain perspectives of development and possibilities of reimbursement of credits. RPF will function for a period of ten years. The decisions of the administration of the fund would be approved by an Investment Committee (in which BERD would have the veto right) and by a Board of Directors consisting of Romanian Foundation of Post-privatisation representatives and BERD.

Founding and Development of the Capital Market

Under the pressure of the accelerated mass privatisation program, and with the delay of 4-5 years, as compared to the experience of Poland, Hungary or Czech Republic, they where emphasised the efforts for founding and developing of the capital markets, regulating their specific operations and their institutions. The Transferable Securities Agency was transformed in the National Committee of Transferable Securities (NCTS or Committee of Securities) as an autonomous administrative authority for capital market regulation, supervision and control; public offers authorisation; organisation of the Stock Exchange; secondary market creation; securities companies foundation and their partnership (National Association of Transferable Securities - ATSA).

The general framework for the development of capital market's activity in Romania, is ensured by the Law no 52/1994 regarding the transferable securities and stock exchanges. This law settles, besides the (NCTS) activity, the next issues: public offer, stocks and shares mediation activity, stock exchange investments protections, foreign censors, investments counsellor, compensation and collective depository systems for the transferable securities.

The National Committee of Transferable Securities

According to the Law NCTS has the mission:

- to favour stock and shares market good function;
- to assure investors protection against unfair practices, abuses and defrauds;
- to achieve the information of the stocks and shares owners and the public opinion about the persons making public appeals for money savings and about the values issued by these;

- to settle an activity framework for intermediaries and agents of the stocks and shares, regime of professional associations constituted by them and organisms that have as task stocks and shares market function.

The NCTS is composed by 5 members, including the president and the vice-president. They are named and can be revoked by the Parliament in the common session of the chambers. The appointment is made based on the common list proposed by the Privatisation Commission and the Budget and Finances Commission of the Senate and the Economical Policy, Reform and Privatisation Commission and Budget, Finances and Banks Commission of the Chamber of Deputies. The length of the NCTS member's seat is of 5 years, each member having the possibility to be re-invested only one time. The firsts NCTS members were named for different length seats, thus that every year one of them seat expires. The president was named length seats, thus that every year one of them seat expires, The president was named for a 5 years seat and the vice-president for a 4 years seat. The NCTS members must be Romanian citizens, residents in Romania, with special training in economics, finances, banking or law branches. They can not exercise another paid job, excepting the job of professor; they cannot be members of some political party and neither of the Board of Directors in legal entities, subjects of NCTS or National Bank supervision or major shareholder to these legal entities.

In the spirit of the competencies granted by the Law, the NCTS is watching for the establishment of an organised capital market, supervised and transparent; the achievement of an equilibrium between the demand of investors protection and those of market expansion; promoting in a greater size of the principle of non-materialisation; supporting the transition to a new governance system of the companies based on the shareholders sovereignty. In view of disciplining the participants to the capital market, the NCTS is achieving through Supervision, Control and Inquiry Department, a permanent activity of monitoring and controlling these in order to prevent and/or to find out different misbehaviours from the actual regulations concerning the functioning of the capital market. The contravention made by intention or by fault are sanctioned with:

- warning, when the facts made by fault didn't determined major patrimony damage or other nature prejudices to the natural or legal persons;
- the withdrawal of the functioning authorisation;
- the cancellation of the authorisation, case in which is applied also the ban of stocks and shares mediation for a minimum 5 years period;
- the temporary or definitive ban for the natural or legal persons for securities mediation for a category, for some or for all the categories of operations included by this.

The sanction can be applied cumulative with any of other sanction. At their turn, the withdrawal sanction, and also the cancellation of the authorisation is applied cumulative with the temporary or definitive ban of securities mediation exercising.

In conditions in which is estimated that the shares who produced prejudices were made by intention or by negligence, besides the mentioned sanctions can be requested the

support of the penal investigation authorities to establish the prejudices value and the guiltiness degree of the involved persons.

- prison from 3 month to 2 years or amercement for the securities mediation without NCTS authorisation, made by the administrators or CC directors or other natural persons.

The Stock Exchange

In the framework of the creation process of the capital market in Romania major event was the establishment as a public institution of the Stock Exchange in June 1995.

The management of the Stock Exchange was entrusted to a Stock Exchange Committee, elected by the members of Stock Exchange Association and confirmed by the NCTS and his administration is ensured by a general manager having a 5 year seat.

Stock exchange bears yet the characteristics of an emerging, but developing institution being in competition with OTC. Consequently, even through at present the number of CC quoted at Stock Exchange is still reduced, the more and more CC, despite that they are continuing to be listed on OTC, manifest the desire to be quoted at Stock Exchange (Dadu, 1997). At its turn, the SOF management manifest the option for shares transaction of CC from their portfolio by Stock Exchange, and only 3-5% remain for transactions on the over the counter market.

The Over-the-Counter Market

For shares transaction of 4,000 companies resulted from mass-privatisation programme, at 25 April 1996 was created over the counter capital market through CC RASDAQ - limited liability company establishment, company that administrates transaction system. His only shareholder is National Association of Securities Companies, (NASC).

Unlike the Stock Exchange, the over the counter market has 4 entities drawn into: RASDAQ, which is the technological support company for the quotation operations ensuring the mediation and trading of the shares, following the NASDAQ example; the system of compensation, discount and depository; the Romanian Register of Shareholders and NASC. His activity began with a few commercial companies quoted to allow integrity and functionality system assurance.

In the period 25 October 1996 - 1 February 1997 continued to activate new companies, thus today the number of commercial companies enrolled is about 2,700, of which 415 are in transaction operations.

The programme will be developed further on, following the increase of the stocks and shares companies number, having an active participation, and also the commercial companies number, whose shares will be traded. In the strategy, of this market, will be emphasised: the synchronous development of those 3 information systems (the transaction one, the registering one and the compensation (discount) one), the improvement of its transparency and therefore the increase of the attractiveness degree

for the investors; the diversification of the quoted commercial companies universe on the OTC market and the increase of its liquidity applying a minimal demands set for quotation of other commercial limited companies then those from MPP. It will be planned, also, the change of the legal statute of the RASDAQ company by its transformation from a limited liability company into a joint stock company by to attract new financial resources in the offering, to obtain the USAID financial support.

One of the institutions that serve secondary market of securities - market of shares resulted from mass-privatisation program - is Romanian Register of Shareholders (RRS). The Romanian Register of Shareholders project belongs on assistance program offered by Intradoss Group financed by USAID, based on Memorandum of Agreement signed in 1995 between Romanian and USA government. The role of this institution, inside of a gearing made for starting and assuring a good function of one of the biggest securities market from the world (1.2 billions shares, owned by 17 millions shareholders) is very important in the development of the OTC market it offering a large gamut of services to the shareholders and thirds.

Romanian Register of Shareholders is constituted as a joint stock company with a capital of 1.1 billions lei, having for the moment 8 commercial banks as shareholders. Organisational structure of Romanian Register of Shareholders is determined by its function: continue supervisory of respecting laws and rules regarding securities transfer and maintaining commercial companies registers and also of shareholders; active marketing for settling register contracts with issuer companies; a whole gamut of securities transfer operations; notification of dividends and representing orders; changes in nominal structure of issuer companies; information technology - system planning; applications development; recovery of dates in case of damage etc.

Problems of the Capital Market Development

Practically, from new created stock exchange and over the counter system is expecting not only domestic capital activation, but also investment behaviour activation needed for mass-privatisation and economic reform success - setting up adjustment mechanisms of market economy.

Mass-privatisation program stages from certificates distribution to their subscription did not represent anything else than steps of a process, rather technical than economical one. Privatisation process offered stocks and shares like raw materials for exchange market. In this aspect the action can be seen as a success. Romanian privatisation, where almost 17 millions persons received 30% of state ownership through freely transfer, goes to a big number of shareholders, to one of biggest markets in the world.

As showed above, the main players and also necessary mechanisms for the market economy appeared in Romania. For a real successful function of a market economy, it is very important that market players get into the role. Currently, a discrepancy is observed, between the modern transaction system and perceptions of the population, and even of some managers regarding the capital market. Many managers do not

understand yet the opportunity of having access to capital and other funds by Stock Exchange institutions. This fact is proved by their lack of desire of making the necessary applications for their own companies quotation at stock Exchange. That is why it is necessary to pay some attention to the education of the population and economic agents in that field and warning the next investors about advantages, but also to investment and securities risks.

Acceleration of stocks and shares transaction process represents a national problem, because, we have a very dispersed ownership, which does not allow the administration of companies even at minimal level. A shareholders concentration can be realised in 2 ways: through one person mandate, person that represents more shareholders or through shares concentration in fewest hands by their sale.

It is to mention that, relying on law, selling shares can be done only through a stocks and shares company (OTC and Stock Exchange). This market rule can not be violated.

Ownership transfer from seller to buyer can be done only after RRS checks shares transactional validity, but only if buying order was issued through a stocks and shares company.

The fraud it is easy to discover, and the punishment is the transaction cancellation. More than that! The stocks and shares mediation without an authorisation from NCTS, made by the superintendents (i.e. managers) of commercial companies and any natural persons is a minor offence and it is punished with prison in order to protect the interests of all the shareholders and eliminating someone's possibility of obtaining profits, speculating or someone's credulity, or the others lack of information and revenues.

In spite, in practice appeared cases of buying shares outside of regulated framework of secondary market. Some managers or other interest groups proceeded accumulation of shareholder certificates, based on some non-loyal agreements or of another nature so becoming owners of some commercial companies. Ignoring the law the persons in question made registers of shareholders that transmitted to Commerce Register in the new nominal capital structure (in which they appear like majority shareholders) "legislating" in this way committed illegality (Oanta (1997)).

Of course, it is of Romanian economy interest, that the concentration process of the shareholding, and, therefore of the capital, to concentrate in the hands of men with entrepreneurship spirit and necessary experience of the true owners but this must be a legal process, transparent and protecting the interests of all shareholders and eliminating the possibility of some people to obtain earnings, speculating on either peoples' credulity, or on the lack of information.

In conclusion, the preoccupation of decision factors must concentrate on the objective of transition from the present situation, when the infantile character of capital market make uninteresting the transactions for investors, and maintain in reserve the firms that could require the stock exchange quotation, which maintains the stock exchange in an experimental stage. It should stimulate interest of investors, at first of the institutional

ones for the stock exchange, and supporting firms that want to mobilise funds by mediation of capital market, and give impulse of stock exchange transactions, arousing new investors interest, but at the same time on the more rigorous control of taking over by defraud of commercial companies.

The State and the Corporate Governance

According to some foreign experts (Frydman and Rapaczinsky, 1994), from the main privatisation targets in East Europe countries is de-politicisation of most economic decisions through state enterprises privatisation and the necessity of a new institutional structure of corporate governance favourable for a quick revivification and restructuring of these countries economies.

The necessity of redefining role and functions of the state proved to be more complicated than we thought. Regarding Romania, it could be said that, besides difficulties that are proper to this process and to a certain degree besides strategies and programs of economic reform absence and besides inconsistencies application and so on, there exist clear signals of going to market economy. We must realise progresses in assuring legal and institutional framework, in changing ownership structure, in capital market development and in new game rules for economic units.

Regarding institutional infrastructure, the main institutions nominated to make privatisation are under Parliament subordination. This not means a total break by Government, because some of the Board of Directors of SOF and POF members are nominated by the Parliament. In some experts opinion (Negescu, (1996); Zaman (1996c)), these represent some advantages like:

- minimising risks of some trends to stop and to slow down privatisation because of the interests of some ministries or departments in having in hands for a longer time many commercial companies, as a support of their own managerial prerogatives;
- flexible harmonisation of privatisation strategy with the evolution of the legal framework;
- better arbitration of some institutions interests.

With all these, privatisation control is exercised not only by the Parliament but also by Government that watch privatisation strategy co-ordination with other economic reform strategies through National Agency of Privatisation. This agency has an important role between the two non-governmental institutions (SOF and POFs) and the Government.

Taking into account all the mutations that took place in the last seven years, we can say that in Romania while we advance on privatisation way, structures and mechanisms for diminishing state intervention upon economy, was developed. This does not mean that the state is totally detached by economic agents problems, and anywhere in the world however does not matter how liberal a economy can be, the state does care about enterprises difficulties that otherwise can go to whole economy imbalance. The problem is when, how and through what means the state can intervene without troubling to

exercise a real corporate governance and, of course, efficient allocation in economy of resources according to market economy principles.

From this view, Romanian experience emphasises that, in unclear ownership rights context, the state support given under different types,¹⁰ had constituted one of main factors that undermined enterprises management and determined survival behaviour of some enterprises like a reaction at prices liberalisation, lose of traditional markets and decapitalisation.

A characteristic of state support in Romanian economy is that support is given through a great variety of types (budgetary subsidies and transfers, taking over to public debt of some indebtedness of commercial companies, governmental guarantees for contracting domestic and external credits, restructuring funds etc.). Their sources are very different: besides the state budget, they are involved Romanian National Bank, financing some bonus interests from own profit, SOF, and some economic agents which behaviour can be changed by public authorities.

Outside the types of support mentioned above, some others elements and practices specific to Romanian economy can be taken for indirect and non transparent subsidies. We have in view:

SOF owns in the same time control upon main banks from economy (through which are making 2/3 of bank credits) and upon an important part of enterprises, that make difficulties on credit decisions appreciation taken by state-capital banks based on commercial criteria.

The huge accumulated debts, without interests, for “regies autonomus” suppliers of utilities, by state-owned enterprises or by others “regies autonomus”. It is well-known, situation of outstanding debts uncollected by RENEL, that increase from 400 billions lei at beginning of 1994 to 907 billions lei at the beginning of 1995 and 1,473 billions lei at the beginning of 1996.

Maintaining by different means of lower prices (much under opportunity price) at some important inputs for heavy industry (that comprises almost only state-owned enterprises). It is about supervised prices of fuel and ores, like as export restrictions that split up intern prices of extern ones.¹¹

In conclusion, what is very serious, it is not the existence of state support in Romanian economy because the state must not be impassive regarding enterprises problems in a transition economy, but it is:

Very big size of the support and the fact that it is used in a wrong way with effects that are cancelling each other. For example, electric energy production has the advantage of supplying with energy sources at a lower price than the world one, but the output price is more under this price. The same situation is on agricultural goods. Because of this, the state support has a negative impact over Romanian economy efficiency which come from a weak competitive environment. This impact is becoming stronger through losses

that result from this self-cancelling (so called “dead-weight losses”) which totally spoil the allocation way of resources in economy.

The concentration of the support over some enterprises, that increases the distortions of the environment for the competition;

The fact that the most important support is given sometimes to enterprises with the worst performance, without a serious economic analysis of their viability, what means a financial resources waste;

The State and its organs have an attitude more paternal to some enterprises, instead of making an efficient control upon enterprises management through proper means, which go to a weakness corporate governance.

The New Orientations Concerning the Achievement of a Fast Privatisation Process

The dysfunction and the delays in the privatisation process were the objects of some special analysis at the decisional factors level. In the context of “The government Programme 1997-2000”, the Romanian government has emphasised the necessity of an economic environment creation, favourable and stimulating for the fastening of the privatisation, based on a reform measures. They include: deepening of prices liberalisation; liberalisation of the foreign trade; elimination of the implicit subsidies and of the discretionary credits; promoting a viable governmental policy concerning the competition protection and payment incapacity, bringing back of the assets selling into the main privatisation methods; hardening of the conditions for obtaining the governmental intervention.

According to this programme, the final objective of privatisation process for the state commercial companies can be reached in a short period of time if it is acting, simultaneously, in two directions: 1. fastening of the privatisation’s quantitative progress by urgent sales, until August 1998 of the State Ownership Fund administrated assets and by starting of the demonopolisation and privatisation process for the “regies autonomes” and public utilities. 2. improvement of privatisation process quality, especially through the development of capital market (first of all the OTC market); increasing of the transparency and the liberalisation of the portfolio foreign investments access to the capital market; the stimulation of mutual funds and investments societies creation and development; the endorsement of some measures for the shareholding concentration; the transformation of the POFs into the FIS, the reorganisation of the SOFs activity and his elimination until August 1998.

Regarded as one of the most important components of the reforms, the privatisation aim at a fast transfer of ownership from the public sector to the private one, so to increase strongly its weight, reaching over 80% from the GDP in the year 2000.

To reach this objective, the main co-ordinates of the recent privatisation programme drawn up by the government is centred on three main directions:

- the institutional reform and improvement of the legal framework;
- short-term privatisation measures;
- the revision of proceedings and techniques system of privatisation procedures and techniques in the sense of increasing of their choosing according marketing criteria.

The immediate objective of the privatisation is the transfer of the state enterprise control over the management to the new owners. The final objective is the selling of the entire assets of each enterprise to the private owners. In concordance with these objectives, it won't be a priority to maximise the incomes obtained from the sales of the companies shares, but the fast transfer of their control and of the entire ownership right to the private sector.

By ownership transfer follows an increase of the managerial responsibilities, with positive consequences for the resources use, the increase of the companies productivity and competitiveness.

The Project "Privatisation Programme" in the period 1997-2000, has according to established objective, a complex content. In short, the measures that will be taken, centred on the three main directions, are offering an image of privatisation prospective in Romania in the very next period.

The Institutional Reform and Legal Framework Improvement

It has in view to reorganise the involved institutions in the privatisation' process and firstly of State Ownership Fund and of National Agency for Privatisation.

Reorganisation of the SOF will follow, among others:

- the SOF subordination in relation with the government, to avoid the transfer of the political responsibilities in the privatisation domain towards the Parliament;
- the decentralisation of SOF activity, to allow the fast decisions taking and the competence transfer at his local units level, regarding the privatisation of local interest commercial companies;
- the organisation of data base regarding the privatising commercial companies;
- the supply of offers and promotional materials at the RDA, centres from abroad, including the achievement of auctions regarding the shares selling, according to the Romanian law.

The settlement in short-term, clearly, the National Agency for Privatisation duties is aiming the elimination of those interfering with other institutions tasks like NCTS, concerning the mutual funds or with resort ministries in the granting area. In consequence, the NAP will have a number of duties more clearly specified:

- the elaboration of the privatisation strategy for the state controlled commercial companies and for the regies autonomous;
- the elaboration of the privatisation strategy for the state controlled commercial companies and for the regies autonomous;

- the elaboration of the law projects, government decisions and methodological norms for the real assets and for the state - owned securities;
- the finalisation of special assistance agreements from abroad;
- the consulting services performing for the privatisation area.

Simultaneously with the before mentioned institutions reorganisation, the privatisation programme is following the simplification of the legislation in this area, in view to eliminate the provisions which delayed or blocked until now the privatisation of the owned commercial companies and also the completion of the existing legal framework.

Thus, are aimed: the completion of the laws settling the organisation and the statute of the commercial companies and regies autonomous, especially with foresights regarding the transformation of regies autonomous into commercial companies, their privatisation and creation of the national companies to which the state is the major shareholder; the legal settlement of the leasing operations for the real assets privatisation of the commercial companies to which the state is the single or major shareholder; the drawing of the law project concerning the conversion of the debts with the stocks and bonds; the drawing of the law project regarding the functioning of holdings and of the economic interest groups. At the same time will be repealed certain normative acts which are coming into contradiction or curbs the privatisation process or with the reorganisation procedure and judiciary liquidation.

The Short-Term Measures of Privatisation

They are referring practically to the banks and insurance companies privatisation; to the achievement of the legal and methodological framework privatisation through the conversion of the regies autonomous and commercial companies' debts into stocks and bonds; partial compensation of persons suffering material prejudices by the applications of nationalisation and confiscation acts (Law no. 119/1948; decree no 303/1948 and Decree no 134/1949).

The banks and insurance companies privatisation is considered a priority having in mind the development of credit relations, of Stock Exchange and of secondary capital market (OTC). The objective of this measure is the decrease of the state control over the banking and insurance system, thus, indirectly, over the commercial companies, The obstacle is the high value of the share capital of those financial institutions, which dishearten the investors. Therefore, it's considering that the banks and insurance companies privatisation can be achieved by the prevalent participation of the Romanian and foreign financial intermediaries.

The privatisation by debts conversion is considered a privatisation method that can facilitate the financial blockage elimination, the development of a competition regime, the decrease of the budgetary deficit and of the regies autonomous number by their transformation into commercial companies. The privatisation by the debts conversion is

applied in the same time with other privatisation procedures and is developing after a relative simple mechanism:

- the identification of the commercial companies to which the state is shareholder and of the regies autonomous having debts and the establishment of their structure;
- the transformation of the regies autonomous into joint stock commercial companies;
- the free transfer of shares from the State Ownership Fund to the emitter company, so that one can cancel his debts to the creditor with its shares.

By conversion, the creditor is becoming shareholder to his ex-debtor and if the both parts are owing a sum of money, they are becoming mutual shareholders.

The partial compensation of the persons who suffered material prejudices through the public acts adopted by the Romanian state in 1948-1949 is considered a morale repairing measure. By a special law will be settled this form to transfer with free title, taking into account both the situation and the circulation value of the goods at the nationalisation time, and the present value of goods including the non-paid investments. It has been estimated that through this method will pass in the private property not more than 5% from shares portfolio administrated by the SOF.

The Revision of the Privatisation Techniques

It has in view the introduction of new methods and also the improvement of privatisation mechanisms by external or internal acquisition (managerial or founded by the employees association) settled by the actual legislation, respecting the following principles: the establishment of the selling price according to the relation between demand and offer; the assurance of the transaction's transparency, the protection of the environment and of the investors in the case of damages producing by a company previous the privatisation process.

Starting from the nature of the goods transferred into a private ownership (stocks and shares and real assets), the privatisation methods included in the Government Programme group in this way:

- a) for value titles: the conversion of the debts from the regies autonomous and commercial companies to which the state is a single or major shareholder of securities; the public offer for selling (POS); the public offer for buying (POB); the MEBO and ESOP method (managerial and employees acquisition and also combinations of these); the privatisation through convertible bonds into the term share with or without capital increase; the public debt conversion into shares; the compensation with securities (shares and/or social parts) of natural or legal persons who owned in ownership enterprises, workshops, trade units, chemist's health units and cinemas, nationalised at the beginning of communist period;
- b) for real assets: the real estate leasing with irrevocable rider for selling and the opportunity to replace the management renting contracts; the selling with

integral payment or by instalments of the real assets owned by the commercial companies to which the state is shareholder; the selling of the real assets included in the trust fund of the bankrupt merchant (commercial companies to which the state is owner or regies autonomous).

To specify, that all the mentioned methods, the compensation of the persons which enterprises were nationalised, the debts conversion in stocks and bonds and the selling of the real assets included in the credal fund will not be applied but exceptionally - as a repair method (in the first case) or depending of the financial situation of some commercial companies.

Finally, we mentioned also the fact that the privileged privatisation method will be selling of shares packages at open auctions. In order to facilitate the selling of shares packages, the opening price of the auction will be based on the average of the shares price on the secondary market and it will be adjusted depending on the already proceeded auctions results and on the medium price of shares on the RASADAQ market. This price is not yet a minimum acceptable one, the shares being sold to the best bidder, at any offered price.

Opinions regarding the Recent Orientations

Regarding the directions and recent proposed measures among the specialists (Marinescu (1997), Zaman (1997c)) are manifesting some reserves, and exists a certain distrust regarding the fact that privatisation at any price, without discernment, presents the guarantee of economic recovery and lead to a sustainable economic growth.

The main problems bring into discussion are:

- the lack of domestic capital, who remain a real problem. In consequences, the foreign capital attraction remains a savings solution. The dynamics of the privatisation In Romania becoming dependent, in this situation, of two very important factors - the favourable or unfavourable economic juncture on domestic or international plan, on the one hand and the facilities which will be created to the foreign investors, on the other hand;
- in the absence of the capital, the so called “market value” will be formed from a restrained demand, corresponding to the financial reserves and an offer under the pressure of the privatisation and under-valuation of the offered goods;
- there are not very clear yet all the data of the problem regarding the cancellation of the debts through their conversion into shares and their transfer to the creditors.

The fixing of these share prices, in conditions in which for the other privatisation methods, the market price is accepted one, it would not have to be merely an administrative operation.

- under conditions in which “the best price” is becoming a symbolic price, it is possible the acquisition of shares package with a small amount, which creates inequities both between the investors and the citizens participating to the mass privatisation;

- for lack of a rigorous control, remains open the possibility of a speculative actions. That is possible than only a small number of company's shares are traded in present on the market. Thus, on RASDAQ market entering, for lack of a minimal price pre-establish limit, the shares can suffer major artificial depreciation, of their value. Afterwards, the shares value can have a major increase, without any gain for the exowner (the state) or for the respective commercial company.

Besides these aspects, the actual government decision regarding partial compensation of the persons that suffered prejudices after the nationalisation even though can be considered to some degree and in the social justice spirit - a necessary act of repair, can arouse, at their turn, a series of problems connected with the complexity of goods estimation owned by the former owners, and with physical and value transformation of these goods in the 45 years of communism. At the same time, there are the danger of perception of this act and of privatisation like a reverse of nationalisation by the big mass of population that after the tens years of efforts from the communist period, benefited of privatisation titles (OC and NC) with a value of only 1 million lei that, in the case of over-subscription transformed in shared of only, some hundred thousands lei. This is the more possible taking into account the new governmental orientations regarding privatisation, even though bring in discussion the problem of transformation of regies autonomous and commercial companies with the view of their privatisation does not make any reference regarding the finding of some possibilities of transferring of a part of nominal capital of those, to Romanian citizens (also as a repair act for the efforts made under communism).

But, this aspect must take into account having that in the unleashed mass-privatisation process by the Law no 58/1995 the 30% quota free of charge distributed under the form of privatisation titles referred only to the nominal capital of the 6500 commercial companies and not refer to the nominal capital of regies autonomous (Nanes (1997)).

The elucidation of such problems and also the straightening of NCTS role in what concern the control of the process on the capital market can be favourable conditions for the privatisation process development.

The modalities of settlement the financial investment funds and also the rights and duties of the shareholders must be seriously studied to protect the interest of persons who invested in these funds and also of those who owned the minor participations to the CC, in which these funds or others shareholders are having (as a result of privatisation) a major part from the capital stock but also to achieve a good corporate governance. At the same time we do not lose from our view that privatisation do not represent a purpose in itself, but as other countries practice prove, an ample and difficult action, that must seriously prepared, because an inadequate conceived and organised privatisation, even though on short-term generate the increase of receipts and/or performances, it can be however perceived as inequitable, in the sense that generate economic and political power concentration in the hands of a national elite, or

of foreign investors, instead of promoting the expansion of an independent and numerous middle class. The approach of privatisation implies therefore the establishment, and taking into consideration of priority objectives, that follow to attain by its implementation, and by its way of implementing, it must determine not only a formal change of the ownership rights regime, but also the finding of some motivated owners, by the desire to act with a view to enterprises recovery and that, at the same time, dispose of the necessary means to get an efficient control on enterprises managers. The direct control exercised of some shareholder is more important in this transition period when the capital market is still under creation and strengthening, and the behaviour of managers is not always compliant with a competition economy exigencies, based on the companies profitability and the competition capacity, and also of the shareholders and employees interests satisfaction

Conclusions

In the present study we wanted to evidence mass-privatisation scheme development in Romania and to point out a part of this major component of economic reform implications over the corporate governance plan. In this way, the study underline that in the transition process of Romanian economy from an overcentralised economy to a market economy, the creation and bringing up to date legal, normative and institutional framework of privatisation - was regarded as a priority of economic policy.

Unfortunately, this approach, have neglected a major fact: before any Central and Eastern European country, Romania had the premises to achieve a fast privatisation. We are referring to the fact, that, years after years, the Romanian citizens have contributed to the state-owned companies capitalisation through the so called “social parts” which, except the limited disposal right (the owners can not sold the social parts, but only to transfer them to the legal heirs) granted similar rights to the shareholders resulted after the mass privatisation process, respectively: the right to participate to the general meeting of the employees, the right to vote and the right, of usufruct consisting in some parts receiving from the companies benefit, corresponding to the held social parts.

The restitution of these social parts which means at the national economy level over 30 billions lei at 1990 prices (about 2 billions US dollars) made by popular political interest, instead of their change into shares, cancelled, practically, this advantage of Romania, regarding the privatisation. More than that! This restitution has released the decapitalisation process of the companies, of the unbalance between demand and offer on the consumption goods market, constituting one of the inflation’s causes (inflation through demand) and of the major macroeconomics unbalances.

Private sector development was realised through two main ways, such:

a) founding new private commercial companies by domestic or foreign free initiative stimulation;

b) ownership transfer from state sector to private sector through state-owned commercial companies, resulted after former state enterprises reorganisation. This was realised through:

- freely transfer of 30% of nominal capital of privatised commercial companies to the authorised citizens in the form of OC and later nominal coupons;
- selling shares by cash to natural and legal persons, domestic or foreign.

In spite of a promising beginning under conceptual and normative aspects, state assets transfer to private ownership, or in other words, mass-privatisation, was realised very slow because many and different causes. A step in front is observed beginning with 1995, and especially in 1996 such an effect of adopted Law no. 55/1995 regarding privatisation process acceleration, that completed legal framework given by Law no. 58/1991 and Law no. 77/1994, and wanted to assure an active population implication in privatisation.

As result of mass-privatisation process advance, in Romanian economy appear new economic players and begin to function even though imperfect some mechanisms of market economy, creating the premises for transition to a new governance system of enterprises.

Privatisation has practically a contribution in decreasing direct state influence on economy. However, state did not lose all influence, he is owner of complementary stock shares that represent 40% and 51% of nominal capital of commercial companies included on mass-privatisation list. The selling of these shares will be done in time, taking account that capital offered for privatisation is bigger than the demand. On the other side, taking account of the low level into subscription with OC and nominal coupons at some commercial companies, it is possible that SOF raises its weight in their nominal capital. Finally, through mechanisms as direct and indirect subsidies, state interfere for financial sustaining of enterprises, having a not really justified attachment of some of these enterprises.

So, privatisation of state-owned companies put least two major problems: 1. surrender remaining state participation; 2. privatised or privatising enterprises control.

In what concerns the first problem, the new orientations are emphasising the achievement of a fast ownership transfer in which the market plays the major role. But, having in view the above showed obstacles and blockages, and also other problems making unclear the value of the assets to be privatised and the difficulties regarding the elucidation of every shareholder's quota (state, population, funds, strategic investors etc.) is to suppose that the integral transfer will not be achieved in such a short terms as it intends to.

As regarding the second aspect, as results from analysis made in present study, it can be said that despite realised progress, still do not exist a real and efficient corporate governance. And this is because many causes presented also in this study: non

determination in full of ownership rights, existence of a very numerous, spread relative passive and disinterested shareholding and also an ambiguous statute of some shareholders (employees-shareholder, manager-shareholder and so on). At these causes must add an insufficient mature stock exchange and over the counter system, state paternalism still present and sometimes unjustified.

We appreciate from this perspective that the advance through the market economy and ensuring of an efficient corporate governance, which will assure interests harmonisation and protection of players from inside and outside the enterprises, is requiring a better concentration of the efforts for the private sector in the Romanian economy, the elucidation and explanation of the ownership rights regime and also the further development of an institutional specific infrastructure (law, financial, etc.), able to create new incentives in economy, to discipline the economic agents behaviour and to determine the managers to act according to the shareholders interests. At the same time, the advance through a new ownership structure - sine qua non condition of a better enterprises governance - must be accompanied by a macroeconomic coherent and rigorous strategy and policy, in agreement with the Romanian economy specifics, which can determine the enterprises to adjust to the changing environment, through restructuring and a more active participation on the capital markets to obtain the needed resources.

Notes

¹ Law no. 35/1991 regarding the foreign direct investment was modified and completed by the Law no. 57/1993, as well as by the Law no. 71/1994, regarding some additional facilities, as compared as to the initial ones.

² The category of “critical” industries includes those in difficult economical and financial situation, as well as those of vital importance with a strong impact on the development of the others, like: metallurgy, engineering, chemistry and petrochemistry, financial assurance services.

³ The privatisation in a broad sense includes, besides the state enterprises privatisation (the big privatisation), privatisation by creation, or founding new enterprises in the private sector (small privatisation).

⁴ The initial number of 6300 commercial companies had been modified as a consequence of division, that took place during the analysed period.

⁵ Real gratuitousness of mass privatisation include the free of charge assets transfer, based on OC and NC, as well as the amounts reimbursed by SOF from the complementary stock of sold shares.

⁶ According to legal provisions and to Romanian privatisation strategy, it can obtain shares for cash (in a limited number, depending on own financial resources)

from non-transferable free of charge part of the nominal capital administrated by SOF.

⁷ The pursuit of post-privatisation economic-financial evolution based on indicators system from the balance sheets of the year 1994 (the year of privatisation) and 1995. For comparability, the incomes, the net profit, debts and indebtedness were calculated in 1995 prices by deflation with an index established on the base of exchange rate of Romanian lei against the dollar.

⁸ The draft regarding the strategy of implementing market economy in Romania, finalised in May 1990, by the researcher from National Institute of Economic Research, though containing solid measures, well correlated, destined to assure the direction of the reform on a good way, was considered insufficient and incoherent by the decision factors.

⁹ By now, it does not exist an information regarding the shareholders structure at commercial companies submitted to mass privatisation process, because, the consolidated shareholders register is merely now finalised, and the regularisation of capital quotas, between SOF and FIS has not yet taken place.

¹⁰ Even though in the last years the amounts representing subsidies and budget transfers decreased, they are still important. In 1994 they totalled 2407 billions lei and in 1995, 3537 billions lei, that represent 5.1%, respectively 4.9% of GDP. To these must add some debts taking over to the public debt (210 millions lei in 1994), the postponement of budget payment obligations and exemptions or reduction of afferent penalties for not paying in time these obligations. Also, according to Governmental Order no. 13 provisions, in the framework of “debts conciliation” enterprises under financial supervision regime, the remaining debts to state budget were rescheduling in proportion of 60.1% and penalties were cancel in totality (577 billions lei). The solution of “financial isolation” of enterprises with losses became practically, through the foresee financial facilities, a way of indirect subvention of enterprises and not a way of emphasise the control exerted by the involved actors in the respective corporate governance process, respectively: the state commercial banks and suppliers. In the category of state support are included also the governmental liens given for contracting intern and extern credits. In 1995, only for commercial companies that were under financial supervising was given liens for intern banking credits of 200 billions lei. At its turn, SOF allocated important amounts to enterprises of 18 billions lei in 1993, 247 billions lei in 1994, 514 billions lei in 1995 (of which 70% for the industry) and 765 billions lei in 1996 (of which 73% for industry).

¹¹ From 1st January, the prices for fuel and energy were liberalised. It is also proposed the liberalisation of all prices to the products under supervision and elimination of import and export restrictions. At the same time, they were not granted subventions, except for the fields of vital interest.

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Mass Privatisation in Slovakia, 1991-1997: A Choice of Endogenous Social Regulatory Path

*Marián Vitkovič**

Slovak Economy and Society during Transformation (1991-1997) and the Role of Mass Privatisation

The Slovak Republic as a sovereign, democratic and (still) constitutional state has the youngest history of independence among so-called "Visegrad group" countries and among the eleven CEECs which have signed the Association Agreement with the European Union. This country with 5,38 million inhabitants is today too often characterised as a subject of the *double reform path*, i.e. a peculiar mix of relatively well performing economy and, at the same time (1993-1997), a growing political polarisation and increasing lack of democracy, a combination which is quite incomprehensible for majority of foreign observers. When Slovakia split from the "wealthier" Czech Republic in 1993, Westerners dismissed it as an economic backwater destined to go the way of Ukraine or Romania. Instead, Slovakia is quickly establishing itself as fastest-growing economy among the whole group of CEECs with GDP expanding at 4.9 (1994), 6.8 (1995), 6.9 (1996), and 6.0 (first half of 1997) per cent. Inflation (CPI-measured) has declined sharply from 23.2 per cent (1993) to "record" low level of 5.7 per cent in September 1997 (by year-to-year comparison to September 1996). In 1995, obviously the most successful year of Slovakia's economy, the fiscal deficit of state budget was negligible, official national foreign debt had fallen to a quite comfortable level, and exports to the West were booming. Nevertheless, manufacturing foreign direct investments (FDI) totalled poor 78 mln USD in 1995, as compared to more than 1,500 bln USD in Hungary, 1,183 bln USD in Czech Republic, 1,425 bln USD in Poland, and even more to 154 mln USD in Romania. Slovakia has a problem: nobody seems to notice it.

Of course, the (macro) economic success cannot be an exclusive proof of positive developments in the entire socio-economic transformation (transition). But, it is not a complete picture of this unique mistake of Slovakia's attempts to be accepted abroad and subsequently integrated into the EU structures. It would be very probable that the Slovak Republic is left out as an absolute exception among all 11, with the EU

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associated CEECs, of the processes of official negotiations between the applicants for EU-membership and the EU administration! The ultimate decision on invitation of individual candidates is given to Luxembourg's EU Summit (December 12 and 13, 1997), and if somebody, who is "enough realistic", looks on the three main recommendations containing in the report of European Parliament's official referee to candidature of Slovakia (Dutch social-democracy's MP Jan Marinus Wiersma),¹ then it is very probable (regarding present political and socio-economic structures of power) that Slovakia will be really left out of this process of negotiations on future EU-membership. Although there are some problems in Slovakia's economy and society, which must provoke more criticism than satisfaction, this will be "too much", anyway.

To conclude this introduction, there is one more point to be mentioned. If somebody from abroad asks what is the main reason of this quite incomprehensible schizophrenia, then, given the present state of Slovakia's economy and economic policy, the following answer could be provided:

"It is a dictate of the law of self-preservation to make its particular advancement in power and strength the first principles of its policy, and the more it is advanced in freedom, civilisation, and industry, in comparison with other nations, the more it has to fear by the loss of its independence, the stronger are its inducements to make all possible efforts to increase its political power by increasing its productive powers, and *vice versa*."

This is one of Friedrich List's arguments in his *Outlines of American Political Economy* (Letter 7, July 22, 1827). It would be hard to find out even a single better formulation of that, what Mr. Mečiar's allies, together with loyal business leaders state as the first principle and "natural law" of endogenous independent development which is needed without any doubt for Slovakia's society and (national) economy at present and in future. Even if the present governing powers may be regarded in the West as throwbacks to belligerent leadership and no friends of personal freedom, the justification of their economic policy (especially with respect to privatisation strategy) seems as the above mentioned.

Slovakia's Economy During Transition: An Overview of Main Features of Macroeconomic Development (1991-1997)

Referring to data presented in Table 1, it is easy to see that in comparison with other CEECs, Slovakia, especially since 1994, has achieved really good results in macroeconomic transition, at least with respect to claims on consequent anti-inflationary and public finance stabilising policy. Moreover, the ratio of fixed investment to GDP has been maintained at a very high level, about 30 per cent in the first half of 1990s and 34 per cent in 1996 (the highest among all CEECs); it is very important to mention that in 1996 (and in first half of 1997, too), practically 90-95 per cent of total increase in fixed investment was financed by foreign credits taken by the biggest, both private and public, enterprises, in some cases with guarantees by government.

Table 1

Main indicators of transition progress in Slovakia during 1991-1996

Indicators	1991	1992	1993	1994	1995	1996
GDP real, annual change in %	-14,6	-6,5	-3,7	4,9	6,8	6,0
GDP per employed person, annual change in %	-2,3	-8,0	-4,0	6,7	5,1	5,4
Inflation rate (CPI based) in %	61,2	10,0	23,2	13,4	9,9	5,8
Unemployment rate in %	7,0	11,4	12,7	14,6	13,8	12,8
Current account of balance of payments in % of GDP	2,8	-4,3	-7,3	0,6	-1,1	-1,1
Foreign direct investment, cumulative, USD mln	80	231	366	555	635	828
Official foreign debt as % of GDP	n.a.	28,6	35,5	29,6	26,0	28,3
Deficit of central government budget as % of GDP	1,1	0,1	6,8	5,2	1,6	4,4
Exchange rate (Slovak crowns/USD)	29,49	28,29	30,79	32,04	29,74	30,65
PPP exchange rate (Slovak crowns/USD)	9,42	9,79	11,02	12,19	13,16	13,53
ERDI per capita at PPP (USD based), USD	3,13	2,89	2,79	2,65	2,30	2,34
GDP per capita at PPP (USD based), USD	5 629	6 399	6 302	6 771	7 300	7 997
Level of GDP per capita at PPP in relation to EU (15 countries average) in %	35	37	37	38	41	42
Unit labour costs, PPP based, Austria = 100	19,41	18,17	21,04	21,49	21,91	23,02
Average monthly wages in industry, ER based, USD	127	161	175	196	242	259
Portion of private sector in GDP in %, estimated	n.a.	47	53	58	63	76

Sources: Several publications of Statistical Office of Slovak Republic 1991-1997; International Monetary Fund, World Bank, The Vienna Institute for Comparative Economic Studies WIIW (Havlik P. (1996). Exchange Rates, Competitiveness and Labour Costs in Central and Eastern Europe, WIIW, 19 p.), several own calculations and databases.

Notes: CPI- Consumers Price Index;

PPP - Purchasing Power Parity based indicators;

ERDI - Exchange Rate Deviation Index: nominal ER/ER on PPP based;

N.A. - Those data are not available or trustworthy.

One of the main problems which Slovak policy-makers face today is whether the impressive growth performance achieved after independence can be sustained. In the macroeconomic area, the main issue to be addressed is the recent deterioration of the external accounts - the current account of the balance of payments shifted from a surplus of 0.6 per cent of GDP in 1994 to a deficit of more than 11 per cent of GDP in 1996. The current account deterioration has been due to a fast increase in imports driven by a strong growth of both real private consumption — 18 per cent and real fixed investment - 33.3 per cent in 1996. This development is apologised by government authorities, similar to the situation in the Czech Republic, with the argument that an increase in the import of machinery and new technologies is an important prerequisite for attaining a more effective position in international competition in the future; and, further, with the argument that the disappointing export performance can be partly blamed on the slowdown of West European markets and capacity constraints in some sectors.

By all them, the very low level of FDI² has implied a rapid increase in debt-financing flows and in the ratio of gross external debts to GDP (about 40 per cent at mid-1997). Although Slovakia's relatively low levels of official (government) indebtedness and good credit rating (the level *Baa3* by Moody's Investors Services) allow the country to finance transitory dips in the current account without major difficulties, current account deficits of this size are not sustainable in the longer run, as they would clearly result in excessive increases in indebtedness and possible financing problems in the future.

In this respect, it should be paid attention to the fact that the Slovak economy is very open, with total trade (imports plus exports) accounting for more than 100 per cent of GDP. By them, the share of value added to gross output in both Slovak economy as whole and, especially, in export-determining manufacturing industry was constantly decreasing during 1995 - mid-1997; the share of domestic consumption in gross production has, compared to the end of 1994, raised by two points from 62.5 to 64.5 per cent in mid-1997.³ Such developments mean a decline in efficiency in the field of real economic processes which bring about lower external competitiveness of Slovak production.

Based on the results of a model database of the major Slovak industrial enterprises,⁴ it can be demonstrated that the possibility of extensive production type of recovery has come to end in late 1995, first of all in the medium-tech products part of Slovak manufacturing industry, which was a substantial part of the mass privatisation in Slovakia.

In this sense, each rise by 1 per cent both in the level of capacity utilisation and in the amount of production (as sales) leads to a probable decrease by 5 per cent in earnings rate from those additional production and capacity utilisation intensity in comparison with *status quo* in 1993-1994. For the export sales, that earnings rate decrease is more intensive, not less than 6-7 per cent. However, negative progress on Slovak current account of trade balance ever since the last months of 1995 is a direct result of serious effective production limits by main actors of Slovak export-supply predominantly oriented - large Slovak enterprises in manufacturing industry producing diverse semiproducts (steel, pulp, construction materials, simple machinery tools, etc.).

Attention should be paid as well to some other interesting points and analytical results, which support the opinion about the "super tight (closed)" relationship of the manufacturing industry sector, its ability to export and claim on external equilibrium of Slovak economy: an expertise performed for government purposes (for the Ministry of Finance) in June 1996, demonstrated on the basis of precise and detailed analysis of balance of payments, and the current account of trade balance especially, that very probably an administrative devaluation of the domestic currency (Slovak crown, SK) by 6 per cent (at least) will be necessary by the end of 1996, or in first half of 1997, with respect to the external equilibrium of Slovak balance of payments. See Okali et al (1996).⁵ A recommendation for the implementation of a periodical "crawling peg" exchange rate regime (like Hungarian exchange rate policy in last 2-3 years) for presently still fixed exchange regime of Slovak crown (± 7 per cent floating) is another result in this study.

One of the few common views shared by Slovakian economists is that the nature of economic development in the independent Slovak Republic had its specific features in every transformation year. 1993 was the year of "fine-tuning" of the parameters of the new independent state. 1994 was the first year of economic growth which was fully brought about by external demand. The economic growth continued in 1995. The increase in income strengthened domestic demand and made import more dynamic. Domestic demand became a main growth determinant. Despite this the influence of external demand continued to be significant. 1996 was characterised by a dominant status of domestic demand including investment demand while the external demand dropped.

The economic development simultaneously disclosed structural and efficiency weaknesses of Slovak economy represented by the high unemployment rate, low efficiency of the economy to create income causing this way budgetary tension, high regional concentration of economic development, and excessive intensity of economic growth on the import (in comparison with export efficiency). On the contrary, low inflation expectations of businesses and relatively moderate wage increase can be considered as positive parameters. The discrepancy between export efficiency and import intensity became obvious in 1996 by means of deepening negative balance of trade balance and the current account of the balance of payments. This discrepancy represents one of the basic structural-efficiency imbalances of Slovak economy and a basic risk of its further positive development. A future continuation of those trends would mean either a fast indebtedness of the country, or destabilisation of external and subsequently internal currency circulation.

All these features of development have emerged in a situation when the official statistically published share of the private sector's in the GDP increased from 53 per cent in 1993 to 82 per cent at end of September 1997. So, with a closer consideration of the main subject of this analysis, how can mass privatisation in Slovakia be estimated if it has been presumed that (rapid) mass privatisation leads to greater efficiency and competitiveness from national economy point of view?⁶

It is absolutely certain that from this national economy efficiency point of view, many relationships between the pre-privatisation structure (size parameters of enterprises and sectors, access to management influences and their defects), the character of static concentration and dynamic competition mechanism, as well as the long-term institutional and social preferences, which are decisive to accept or not the capitalist entrepreneurship phenomenon, must be always taken into consideration. Certainly, all these factors and their interdependence have strong country-unique character of impact on the long-term viable model of both ownership structures and corporate governance dynamics, on their effectiveness and shortcomings.

However, the long-term viable ownership structure and corporate governance mechanisms in the national economy depend eventually on the specific political, economic and institutional conditions and will always be connected with their country-specific entrepreneurship environment.⁷ This way the question arises, could the government's policy-makers minimise the extent of some substantial transaction and restructuring costs in privatisation by choosing some more appropriate regulatory regime, restriction set-up logic and overall better application forms of (consistent) transition philosophy?

Slovak Economy during Transition: A Structural View

Some characteristic aspects of the market structure in the Slovak economy are discussed here. It may seem a trivial note that the Slovak pre-transition economy (until 1990) had excessively concentrated branch structures.⁸ In the transition period (1991-1995), the original level of concentration didn't change dramatically, and the market structures in typically scale-intensive industries remained practically unchanged. So, the measure of CR 4 (the share of four largest enterprises in total branch production on 2, or 3-digit level of the SIC classification) ratio of concentration varied (1995) among branches between 12,88 (most branches in food industry) to 81,43 (rubber and plastics products), respectively 99,00 per cent (petroleum refineries). A common, weighted by the importance of single branches in total manufacturing sector, level of concentration in Slovakia maintained a high average value - 54,8 per cent (during 1991-1995 (measured as CR 5). However, the economies of the Czech Republic and Poland are characterised with a sub-optimal average level of concentration (1993-1995), too, 44,3 and 42,1 per cent, respectively. Average CR 5 for EU countries oscillated at the same time about 25 per cent.® There is a substantial difference with respect to deconcentration needs of the economies in transition. In the light of these data, the argument for de-monopolising before privatisation is simple to apologise here, if it is not done then, it will be almost impossible to do it later.

The concentration level in Slovak economy can be examined also by another, more complicated dynamic-structure approach. By this approach, some traditional market structure types stand out of analysis of long-term oriented market economies.¹⁰ In fact, the main question is connected with an estimation of actual behaviour and performance which comes from market structure dynamics in Slovak manufacturing industry. With

respect to validity of market structures theory in most advanced industrialised market economies, we test Slovak data from own database and at the end compare them critically with expected results from traditional assumption about performance of several market structure types. Table 2 demonstrates some summarised results derived from a complex of statistical verification analysis by using own database of 135 enterprises.

Table 2

Impact of rise by 1% in degree of market concentration on some main reaction parameters of each systematised market structure-types (in % of change during 1992-1995) in Slovak manufacturing industry

Market structure	Branches	Gross productivity	Return on sales	Level of capacity utilisation	Dynamics of wages
SES-DP	24,25,30 to 35	0,37	0,81	0,12	0,76
SES-HP	23, 16, 27,28	1,37	1,20	0,51	0,77
LES-DP	29, 30	1,32	—0,76	0,43	0,16
LES-HP	15 to 22, 36	0,10	0,36	-0,10	0,10
Slovak manufacturing industry as whole	15 to 36	0,57	0,76	0,31	0,96

Sources: Analysis of own database about 135 enterprises, own calculations from additional data obtained from Statistical Office of the Slovak Republic (further SO SR) in 1991-1996.

Notes:

SES — DP — branches characterised by significant scale economies and differentiated production;

SES — HP- branches characterised by significant scale economies and homogeneous production;

LES - DP- branches characterised by low scale economies and differentiated production, traditionally so called "monopolistic competition" (E. H. Chamberlin 1933, etc.);

LES — HP- branches characterised by low scale economies and (relatively) homogeneous production.

Numbering of branches is based on *Slovak Standard Classification of Economic Activities ("OKEE")*, that see as follows: 15 - Food and drink industries; 16 - Tobacco industry; 17 - Textile industry; 18 - Clothing industry; 19 - Shoe industry and manufacturing of leather; 20 — Manufacturing of wood and pulp, except furniture; 21 - Manufacturing of paper and paper products; 22 - Printing and publishing; 23

- Petroleum refineries; 24 - Chemical industry; 25 — Rubber and plastics industry; 26 —Non-metallic industry (pottery, china, earthenware, glass and glass products); 27 — Iron and steel basic industries; 28 — Production of metal constructions; 29 - Production of machines; 30 - Production of office equipment; 31

— Production of electrical equipment; 32 - Photographic and optical goods; 33 - Production of medical instruments; 34 - Transport equipment (cars); 35 - Production another transport equipment; 36 - Furniture-making industry. Other

True, some residual differences between Slovak branch classification and the international standards (ISIC Rev. 2 classification) still remain. Anyway, our results acknowledge many traditional expectations and facts in sense of "classic" industrial organisation theories (Bain (1956), Sylos-Labini (1959), Modigliani (1969) etc.), with the exception of one of the most important assumptions, the market expansion

facilitates new entry and the industry (branch) becomes less concentrated. This is not valid in the case of Slovak manufacturing industry. On the common level of market structures and enterprise performance during 1992-1996, in this sector of Slovak economy still exists an important dependency between the market concentration ratio and the efficiency of the enterprises (gross productivity revenues to number of employees) which disclosed by both sides correlation analysis procedures varying in interval 0,5-0,95, statistically significant at 5 per cent test level. This is valid for all single branches as well, including some sub-branches in chemical industry and in rubber and plastic products industry.

This common state may be tempting at first glance to accept the consideration that economies of scale are significant for the nearly whole Slovak manufacturing industry and a tendency to natural monopoly (or co-operative oligopoly - cartel) structure may be, probably, the natural form of appropriate (viable) structural circumstances. This is a false and dangerous misinterpretation.”

From national economy competitiveness point of view, more attention should be paid to results presented in Table 2. Here, with respect to proportions of relative interdependence between single reaction parameters which *ex post* reflect some empirically tested impact of concentration level strengthening, it is clear to state that the remaining level of concentration in Slovak manufacturing industries produces serious discrepancies for equilibrium claims of Slovak economy today, and in the future, too. Note further, that these discrepancies are most significant just in term of non- proportional rise in profit and wage rates in relation with eventually effective strengthening of positive scale economies and productivity dynamics. A potential effect on allocating efficiency may be very significant and long-term negative.

With respect to the above mentioned structural features of the Slovak economy, it will be not surprising that the real progress in mass privatisation tended to the conclusion derived by elaborating the problem of transaction and restructuring costs in mass privatisation in Slovakia (more generally in CEECs).

Further, a mezzo- or nearly macroeconomic approach may be used, too. The "classical" study by Arnold C. Harberger (1954)¹² is among the most inspired works on the relationship between the market structure dynamics and the allocating efficiency from the national economy point of view. I try to apply the Harberger's "dead-weight loss triangle" approach to the case of Slovak economy. However, with respect to a systematic lack of many sorts of data in Slovak statistical data sets, some simplifications and estimates are used in the analysis. Anyway, an estimate of the total "welfare losses" of Slovak economy in volume about 8.7 per cent of GNP (1994) can be produced by using this Harberger's conventional approach. Note that the validity of this estimate is supported by providing some critical adjustments with respect to the capital resources allocation, profit and wages dynamics, and by excluding (or neutralising) some extreme values, too.¹³ During the period 1994-1996, as pointed out further, the scale of these Harberger's social costs has remained unchanged in Slovakia. In this regard, some

considerable inefficiencies are discovered on supply-side of Slovak economy and, what is a more important conclusion, these structures ability to preserve own position in transition economy is very significant.

A kind of allocative market structures very probably has a serious impact progress in privatisation, especially with respect to preserving the initially exiting degree concentration under some influences of stabilising restrictive macroeconomic policy during first stages of the transition period. A due attention should be devoted as well to the problems of market structure dynamics and other important structural features which could have important impact on long-term determination of both national economy competitiveness and changes in ownership.

Privatisation in Slovakia (1991-1997)

Privatisation processes have generated questions and concerns in any economy in transition. Slovakia is no exception as indicated by the really aggressive level of the debate and the internal political tensions that have been generated. The controversy and uncertainty in this area have tarnished completely the image of Slovakia abroad. These perceptions are reflected importantly in the low level of foreign investments compared with other transition economies.

For this part of the analysis, originally the more narrow definition of privatisation will be adopted, which in the "three-point" expression includes:¹⁴

- (i) the sale of state sector assets;
- (ii) the removal of legal barriers to entry to previously protected and exclusively concentrated markets of state sector; and
- (iii) state sector financial provision for private sector production eliminates the two former points.

Whatever this definition means, it cannot be immediately adopted by the former centrally planned economies, it is always instructive and its reduction to the first point might have serious negative implications on transition processes. I argue that the transformation of almost exclusively state-owned enterprises (SOEs) to a "market agents" should not be reduced to ownership change regardless how important is the latter.

I am pessimistic to the concept of the transitional process as of a form of government-linked policy of "market-creation". How market can be created? These thinking defects become more serious when one compare the concepts of different government agencies (or ministries) elaborated during 1991-97. Each of them expresses unambiguous readiness to bring all efforts for a "market-creation" and for a "social-oriented" market economy building. Confronted with the reality however, they resulted only in vague formulated intentions. It is not surprise, that these ended in oblivion; ironically note, Slovak citizens probably have very little remorse, too. Alternatively maybe, those strong long-term (historical) peculiarities in both Slovak social and economic development are

already the most determining causes which enable such privatisation progress which can be observed by transition of Slovak economy.

It is important and useful to give a presentation of the following points which describe some characteristics of former development of Slovakia and Slovak economy and intellectual discussions about them with a decisive (even if some little "dazed and confused") impact on present state of socio-economic environment and on contemporary economic thinking, too.

The Main Stages of Privatisation in Slovakia: A Brief Overview

Generally speaking, in the first half of 1990 two privatisation schemes were discussed in Czecho-Slovakia: rapid and gradual privatisation. According to them, the scope of privatisation might be extremely broad. It was limited only by a paragraph of the (former Federal) Constitution forbidding natural resources from private ownership. The former Federal government privatisation programme assumed to privatise all industries, agriculture, services including health services, banking and insurance sector, public utilities such as electricity, gas, water, etc. It is interesting that the originally assumed scope of privatisation and further on this basis emerging private ownership sector of economy exceeds the scope of private sector in many West European countries.

However, it is disputable whether to start privatising e.g. public utilities at the very early stage of transition; the "traditional" argument against it includes: heavy underproduction, growing income inequality, social inertia, etc. Looking at other major privatisation programmes, it is remarkable that Mrs. Thatcher's governments and French deetatization programmes did not start introducing market mechanisms in social services, education, the health system and communal housing until late 1980's.

At this point, it is reasonable to bring a unified description of privatisation progress in Slovakia as a set of relatively individual stages and their timing. From the institutional economic and political point of view, three main stages in Slovak privatisation can be distinguished.

The first stage represents the privatisation processes accomplished in 1991-1993, which included:

- (i) the restitution of many small units of property to their former owners or heirs (mainly 1991);
- (ii) the sale by public auction of small retail trade and service sector units (mainly 1991);
- (iii) the first wave of large-scale privatisation of state-owned enterprises (mainly 1991). This included some sales by standard methods, i.e. direct sales to new owners of property or of majority stakes in joint-stock companies and some limited use of public tenders, but was undertaken mostly through the first wave of voucher mass privatisation scheme; the issuing and distribution of shares outstanding from this non-standard

privatisation were realised in mid-1993. This first stage of privatisation processes was also accompanied by a slowdown in the privatisation progress in 1993 after the first wave of voucher-privatisation.¹⁵

The second stage took place in 1994 which can be characterised as the peak of the chaotic development in Slovakia's politics and privatisation. In this year, three different governments have changed in Slovakia. Beginning with "record-speed" set of direct sales of SOEs', which were realised in March 1994 few days before the recall initiated by the Slovak parliament (National Council of Slovak Republic - NC SR) of the second Government of the Prime Minister V. Mečiar. Further progress has resulted in ambiguously political twist of so-called "interim Government" (April-September 1994) about the scope and timing of the second wave of voucher-privatisation. It was ended after the defeat of the governing political parties in the parliament elections on October 1-2, 1994.

After the victory of V. Mečiar's political party, Movement for a Democratic Slovakia (MDS), and the formation of a new coalition government with simple majority (MDS with Slovak National Party, SNP, and the Worker's Association of Slovakia, WAS) on November 3-4, 1994 in the so-called "long night",¹⁶ the Slovak Parliament ratified two very important amendments of the main Slovak legal document on privatisation (Act No. 92/1991 Coll.: *On Conditions and Terms Governing the Transfer of state-Owned Property to Other Persons* ("Large-scale Privatisation Act"), which have changed significantly the institutional set-up in the Slovak privatisation.

According to them, one of the central privatisation agents, The Fund of National Property of Slovak Republic (FNP SR) strengthened its position in privatisation process, frankly said, the activity and the decisions on privatisation carried out by the FNP became (nearly) uncontrollable.¹⁷ In the sense of these two controversial amendments to the law, the decisions of the FNP on direct sales in privatisation cannot be controlled neither by HCO SR, nor by the government. In fact only indirect control competence of NC SR may be applied against some decisions of the FNP, since NC SR elected the members of FNP's bodies. The above mentioned changes in legislation brought about the start of the next stage in Slovak privatisation.

The third stage may be appropriately described as a "direct-sales wave" lasted during 1995-1996, and practically till present days. In the mid-1995, the government approved further amendments to the 1991 "Large-scale Privatisation Act" which cancelled voucher privatisation under the second wave. Several amendments were also made to the laws on investment funds and investment companies, and Parliament (NC SR) adopted a law concerning the state interests in enterprises.

Under the new legislation, in the autumn of 1994, the 3,4 million registered voucher holders have, received, in exchange to their vouchers, five-year bonds with a nominal value of 10 000 Slovak crowns (about 330 USD), issued (and guaranteed) by the FNP. The different options provided to the bond holders are be discussed further in this Section.

Finally, after the "fall" of second voucher-privatisation wave, over 600 privatisation proposals by MAPNA with an estimated value of 136 billion Slovak crowns (about 4,5 billion USD) were submitted to the FNP by March 1996 under the second wave of privatisation. It is estimated that nearly 80 per cent of these enterprises had been privatised by November 1996, mostly via direct sales.

The remainder (mostly in agricultural and agribusiness services sector) was intended for sale during the first three months of 1997. It can be pointed out that the large-scale privatisation (and mass privatisation via voucher-scheme as an important part of its first wave) today is practically over. It is not reasonable to expect (from several political and social viewpoints) that many public utilities sectors and typical "natural monopoly" enterprises (electricity, gas and water supply, etc.) will be privatised in Slovakia in the next 2-3 years.

At the end of November 1996, the Slovak Constitutional Court (further SCC) ruled that two of the Articles of Act No. 92/1991 Coll, ("Large-scale Privatisation Act") which moved authority for approval of direct sales of state property from the Slovak government to the Presidium of FNP, contradict the Slovak Constitution. Even if that ruling did not directly suspend previously approved direct sales of state property, it announced a privatisation break which could last even half a year.

In this sense, privatisation via direct sales and few number of public tenders during 1995-1996 was constitutional-contradictory according to the interpretation of SCC about the coherency in Slovak legal system by privatisation of state property: Slovak government cannot cede decisive competencies to smaller authority of law (FNP), even the FNP is an independent legal entity without sufficient state control.¹⁸ The eventual pleasure of Slovak parliament opposition, some of its deputies being motivated by this examine of law before SCC, is most probably premature.

A suspension or revaluation of previous direct sales decisions should have been not given. Prime Minister of the Slovak government Mr. Mečiar said already two weeks before this SCC ruling, that when diction of the Act No. 92/1991 Coll. must be changed in the sense of government's competence on decisions about direct sales comeback, the government is ready for approving all previous FNP decisions *an bloc*.

Note in compliance with this finding of SCC, that in April 1996 the SCC declared that the "golden share" concept of the law on assuring state interests in some strategic enterprises is unconstitutional as well. This law lists 29 companies which will not be privatised (mainly in gas and electricity generation, telecommunications, armaments and special cultivate agriculture). It also lists further 45 companies, some of which have already been partially privatised, and which are defined as "strategically important" (first of all in mining, basic industry like chemicals, partially weapon-engineering, construction).

The state would retain ownership either via shareholding exceeding one-third of the total number of shares,¹⁹ or through a "golden share". Under this proposal, the state would enjoy special voting rights. The Constitutional Court declared the "golden share"

rule unconstitutional on the grounds that it violated the rights of the other shareholders. Further, a subsequent amendment to this law (on state interests), passed in June 1996, added the three major domestic banks to those companies which could not be privatised, the effect of this special "bank" amendment expired at the end of March 1997. In the light of SCC decisions on these two problematical laws, it cannot exactly be expected, how development in further privatisation progress in Slovakia becomes to be actual. Therefore, only radical changes in politics (e.g. a victory of present opposition in the next parliament elections in October 1998) may bring a significant re-estimation of these decisions on direct sales in privatisation taken in 1995-1996 approved. However, such a political development in Slovakia is (with respect to actual electors preferences) hardly probable. Anywise, a profound re-estimation of privatisation decisions from 1995-1996 in future would not contribute positively to development in enterprise

performance, first of all with respect to needs in a stable ownership and corporate

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governance structure.

Regarding the strategic companies taken out of privatisation, a significant part of the state property was privatised by the end of 1996. Non-privatised property can be divided into three groups:

(i) the FNP SR interests equities in permanent and temporary ownership of FNP SR and so-called co-founder shares: their nominal value at end -1996 was about 92 billion SKK; these can be divided further into:

- the Fund's (FNP SR) stake in Slovenske elektrarne, a.s. (Slovak Power Plants, j.s.c.) amounting to 39,2 billion SKK, which under the NC SR Act No. 192/1995 Coll. cannot be privatised;

- stake in commercial companies in which the FNP SR has majority stake and in which the selection of buyer and sale conditions will be an important condition for their restructuring and development; these account for about 6,8 billion SKK and primarily represent financial institutions and former weapon-engineering companies under specific conversion and bail-out regime of the state (e.g. Podpolianske strojarne Detva, j.s.c.);

- other interests in commercial companies, in which the FNP SR has minority stake and in which the majority stake has been sold; stakes in these companies account for about 46 billion SKK-this is only a "completion-of-privatisation" of the Fund's interests;

(ii) state-owned companies which were included in privatisation without issuing a particular decree on their privatisation - these are about 120 companies with assets amounting to about 6 billion SKK (prevaingly agricultural companies);

(iii) companies which have not been included in privatisation - these are mainly healthcare facilities, passenger bus transportation companies, water plant and sewerage companies.

Given the decisive role of the FNP SR in Slovakia's privatisation and by "interconnections" of its two really different large-scale (mass) waves, it is reasonable to present an overview of the FNP SR assets' acquisition at the end of 1996.

Table 3

**The acquisition of the Fund's of National Property of Slovak Republic (FNP SR)
assets as of December 31, 1996**

	In mln SKK	In %
Stakes in joint stock companies	272 425	78.90
The creation of reserve fund	16 310	X
Other funds	9 812	X
Equity *	246 303	x
Co-founders shares	9 488	x
-in a permanent and temporary ownership of FNP SR	87 178	X
-shares sold by standard methods	60 165	X
-shares sold in voucher privatisation	80 021	X
-shares for restitution fund	6 270	X
-shares given to restituts	56	x
Transfer to national insurance company (community)	1 098	X
Shares sold to agents (RMS, BOSE, BSE)	3 016	X
The sale of property by standard methods	52 712	15.27
Free of charge transfer of property	11 583	3.35
Unrealised outputs and price differences	8 557	2.48
TOTAL	345 277	100.00

Source: Own calculations and estimations based on the Annual Report of the FNP SR - 1991, 1992, 1993, 1994, 1995, 1996.

Notes:

* different nominal price of shares

BSE - Bratislava Stock Exchange; RMS - Slovak OTC-market; BOSE - Bratislava Option's Stock Exchange (existed only to end of 1994).

First Wave of Voucher Privatisation as a Predominant Non-standard Method in Slovak Privatisation Until the mid-1993

Particular realisation of changes in the property rights structures in Slovakia began with two processes which are being ignored very often at present time.

First, property restitution was adopted in former Czecho-Slovakia by two legal norms in 1990 and 1991.²¹ In the Czecho-Slovakia about 30 000 industrial and administrative buildings, forests and agricultural plots, which have to be nationalised during 1948-

1954, as well as 70 000 commercial and residential entities nationalised during 1955- 1959, have been handed back to the original owners.

A further law on restitution covering the former church property was adopted in the Slovak Republic in October 1993. With connection to large-scale privatisation, a special restitution fund ("Restitucny investicny fond - RIF") was established by the FNP in 1993 to provide financial compensation to those claims which could not be met by the return of physical property. The RIF is a joint-stock company and usually receives 3 per cent of shares in each privatised company. Currently, it has stakes in 480 companies with a market value of over 1,8 bln SK (November 1996). Revenues (estimated at 500 mln crowns in 1995) from sales of shares and dividends are used to meet claims. Shares of RIF are traded on Slovak public capital market and this fund has approved a stable dividend-payment strategy: minimum 6-10 per cent of equity stock value were paid during 1994-1997 as dividends (75 SK per share in 1997).

According to the *Small-scale Privatisation Act No. 427/1990 Coll.*, privatisation was achieved in these economic units in state ownership which could be denationalised quickly due to their scale, business activity, and number of employees (business units in services, trade and small-scale production other than agricultural). In late 1992 the small-scale privatisation was almost finished in Slovakia. 9 384 business units have been auctioned (including approximately 6 500 retail shops) until now. Of them, about 2 000 were auctioned by so-called "Dutch" price-depressive auction method, the whole sum of attained purchasing prices was 13,2 bln SKK (about 450 mln USD). However, when we look at currently still poor competitive situation in Slovak retail trade sector, and with respect to the fact that minimum 30 per cent of bank loans granted for small-scale privatisation purposes will never be repaid, calls the "success" of this part of privatisation in question. Other points should be presented as well: first, in many cases after auctioning in small-scale privatisation began too complicated law-suits between the new owners and later subjects with restitution claims; second, the de-concentration of formerly high centralised retail-shops and communal services networks through the small-scale privatisation was exaggerated in respect to the size of Slovak domestic consumers markets - a wave of re-concentration and fusion is ongoing at present time.

The first wave of mass (large-scale) privatisation in the former Czecho-Slovakia was institutionally organised at federal level by means of Voucher Privatisation Centre (VPC) which was established for this purpose by the Federal Ministry of Finance. The Czech (Slovak) voucher privatisation is frequently well appreciated sometimes even as the lesson to be learned and model to be followed for the mass privatisation, especially in the situation of the lack of domestic capital and danger of political and social unacceptable dominance of several insiders within the existing enterprises and just changed political structures.

On the other hand, the main critical points against this "innovative" method of mass privatisation are predominantly based on two main strand of approaches:

(i) using this mass privatisation model leads to strengthening of some negative tradeoffs between the speed of privatisation (as absolutely essential argument for voucher scheme adopting) and the speed of emerging legal and economic order. So, the speed of change can cause also the formal character, superficiality and absence of any self-enforcing features in new emerging property rights and corporate governance structures, in "recombined" form of which the old dysfunction of the former socioeconomic system are reproduced on the principle of "path dependency" (see especially: D. Stark (1992), (1996), D. Stark and L. Bruszt (1995), L. Mleoch (1997));

(ii) if the crucial Coase's theorem ("in the absence of transaction costs, the initial distribution of property rights is irrelevant in terms of allocative efficiency") is non-valid for the case of post-socialist countries at the starting point of mass privatisation, then the extent of transaction costs caused by voucher schemes adopting (especially the size of realignment costs connected with re-concentration of dispersed ownership) would be in any case larger than that by using standard methods in large-scale privatisation, e.g. direct sales for strategic investors. According to them it seems more effective and appropriate to go the way of German *Treuhandanstalt* strategy, especially if in *downsizing* government's fiscal logic of transformation the main criterion in direct negotiating on privatisation must be not the maximising of privatisation revenues but the increasing of productive and dynamic efficiency of privatised enterprises and the allocative efficiency by internalising of "incremental" externalities both from *real* socialism planning logic of tight-profiles in the supply and secured (or better added) investment and employment; it means that it is possible and socially acceptable that privatisation will not be presented as selling of enterprises but purchasing buyers for the survival and rehabilitation of the enterprises and its employment. Moreover, the direct sales privatisation to owners who were determined in advance by the central privatisation agency (the case of Slovak second wave of mass privatisation and the role of FNP SR since 1995 on) cannot erode the transparency of the whole process inherently while bidding competition (i.e. open English auction, public tenders, etc.) decreases as the size and specificity of enterprise assets increases; what is, of course, the case of typical structures in the Slovak pre-transition economy (see the part 2.2 in this study). This kind of criticism on voucher privatisation is presented, among others, in M. von Bismarck-Osten (1996), J. Mladek (1995, 1997), and first of all in excellent analysis of H. Brucker (1995).

Besides all above mentioned criticism, it is important to pay attention to more common political aspects of voucher schemes implementation in the former Czecho-Slovakia's mass privatisation. There was pointed officially that "it is needed reflect on the interests of citizens and form their political opinions just through the voucher privatisation".²² According to them, from political point of view it cannot be forgotten that the first wave of voucher privatisation has begun before the general parliament elections in 1992. In this respect two political cycle aspects of its realisation were important:

first, to insure that the new government, even if parties of different political orientation have been voted to power, could not interrupt the massive privatisation process;

second, to get more support of electorate due the expectations for getting benefits from the voucher privatisation.

The former of the mentioned political aspects proved to be relevant in the Slovak Republic case where right-wing parties lost elections dramatically.²³ These "fast backed" liberals were the main decision actors by the adopting, preparing and governing of the implementation of voucher privatisation, otherwise this innovation idea is in reality a purely "*Czech patent*".

The second aspect should be considered more broadly: Has privatisation policy had an effect on the Czech and Slovak electorate? A comprehensive analysis of the effect of privatisation to the voting is not available. However, strong indications can be traced supporting personal income status impact on voting. From the viewpoints of constitutional economics and public choice theory paradigms, only such a type of redistribution that ideological outcomes are public known before voting can play role.²⁴ From these viewpoints, the effect of large-scale privatisation - predominantly voucher privatisation - does not seem to be of greater importance because the number of individual investors (so-called "DIK" - may be translated as "owner of the investment coupon" - further only OIC) participating in the voucher scheme exceeds significantly the number of voters in the general parliament elections 1992 (at least by 10 per cent in Slovakia). This further implies that individuals took part in a voucher privatisation irrespective of their political preferences. Some additional evidence is also available: the explosion of interest of population in vouchers has come to life when a promise of cash paid as a compensation for vouchers (or after bidding rounds and issuing of shares as a compensation for sold shares) has been made by practically all investment funds (further IFs).²⁵ Promises of high guaranteed rate of return over 10 times the costs of participation were usual here. This evoked expectations of almost all individuals to increase their personal well-being in their direct or indirect (via IFs) participation in the voucher privatisation.

Perhaps the more important reason for adopting of the voucher privatisation approach has followed from significant shortage in domestic disposable money capital. According to several official estimations, domestic sources (savings and deposits) in 1991 amounted to more than 300 bln crowns (about 12,5 bln USD) in Czecho-Slovakia, but more than 60 per cent of all households had no savings, or just an amount of maximum 10 thousands crowns. Further, only 15 per cent of households disposed with savings greater than 100 thousands crowns. These domestic sources would be sufficient only for a privatisation of approximately 10 per cent value of national property in Czecho-Slovakia. The above mentioned points were one of the most important for the adoption of idea of voucher privatisation.

Further on, the quantitative and technical features of this process are examined. Based on Decree No. 443 of the Slovak government dated 13th August 1991, a total of 751 enterprises with an approximated book value of 136 bln SKK was approved for

the first privatisation wave. The privatisation projects as "a complex of economic, technical, timing and other information characterising the object under privatisation" were prepared by a co-operation between management of enterprises under privatisation and responsible bureaucrats from several ministries (in most cases from the Ministry of Economy and from the until 1992 existing Ministry of Industry - so-called "founder of the economic entity". These subjects prepared together so-called "basic" privatisation project bargained by many workshops of special branch commissions. According to the Act No. 92/1991 Coll. any other domestic or foreign individual or group could submit for so-called "competing" privatisation project.

It should be noted, that as in the Czech Republic, in Slovakia much smaller number of these "competing" projects were submitted.²⁶ It could be assumed that intentional information mistakes and several "fine" kind of information blockades were already by first wave of mass privatisation a typical behaviour of Slovak enterprises managers, in most cases fully omitted on the part of central privatisation policymakers (MAPNA) . Privatisation projects were judged by MAPNA in period between December 5, 1991 and April 4, 1992 (deadline). However, there was a traditional source of critique about the quality of this decision process: how can about 60 officials of MAPNA rightly judge in 120 days more than 1000 privatisation projects? Based on my personal experiences and many contacts with these MAPNA officials²⁷ this critical opinion is not irrelevant, however, first of all, the decision about this method and speed of privatisation was not in competence of these "60 officials". Of course, with respect to a proclamation about the privatisation process "as an support to creation of a competitive economic environment", an approval by the Slovak Antimonopoly Office (further SAO) was required before the ultimate approval of a privatisation project by MAPNA, too. Clearly, by the "no-existence of market" and miserable personal and know-how equipment of SAO at this time (and present, too), this process became very quickly a form of sending of copied formulates with worth "approve" (predominant number of cases) or "no approve". Because it was relatively long time a subject of my research interest (competition policy), I have examined direct by SAO on a finding - how methods and criteria were used by certain decision of SAO in this first wave privatisation? Unfortunately, but no surprisingly, representatives of SAO were not ready to present any meaningful criterion here; so, the "competition policy point of view" by first wave of Slovak mass privatisation was actually just a bad joke.

The next step was the process of founding of individual joint-stock companies by former state enterprises. Roughly speaking, this is a deetatization or passive commercialisation of state property. In 1991, this competence was a basic substance of FNP's activity. The role of FNP has at this time only a passive character, the several obstacles and discussions about the permanent owner role of FNP in de-etatized state companies became at that time not actual, what is an important difference in comparison with later situation since 1993.

The decision of MAPNA about a portion of equity capital appointed for privatisation via vouchers in each company was most important for a determination of supply-side in voucher privatisation. Attention should be paid to an important point: it is still one of the most frequented arguments of several critics of voucher privatisation that 97 per cent of equity shares of privatised enterprises were given in all cases to voucher privatisation. In fact, this is just a great myth: only 78.11 per cent of privatized enterprises have given 97 per cent (+3 per cent for RIF that in practice 100 per cent) of their equity shares to be privatised via vouchers. Many, both our detail analysis and further progress in privatisation in Slovakia (the sell of share blocks remained in the portfolio of FNP from first wave of voucher privatisation), too, have demonstrated clearly that in 21.9 per cent of enterprises their equity shares were not fully (97 + 3 per cent) supplied against vouchers; in Slovakia there were many most attractive companies. This is just a further evidence for supporting the hypothesis that in the case of Slovakian privatisation only before 1989 established managers and with them connected and with "consequent" rent-seeking acting central policy makers were the winners of all privatisation processes.

Let's return to the first wave of voucher privatisation. It is well-known that prior to the start of the first round of shares bidding, in so-called "pre-round", the holders of voucher books (at about 33 USD) - OICs, could allocate all, or part of their 1 000 investment points to one or several of the 434 IPFs, or they could keep the points in order to bid for enterprise shares directly. Please, do not forget that the Czech-Slovak Federal Republic at that time still existed, the Slovak OICs could keep the points to both in the Czech Republic and in Slovak Republic registered IPFs and, however, this choice had the Czech OICs, too. This point complicates every .analysis of separately focused mass privatisation progress in both of these presently separated sovereign countries. The "nationality " of both the IPFs and the individual invested OICs refers to the republic in which they were registered and not necessarily the republic in which they had invested their voucher points. It is necessary to note that citizens of the Czech Republic placed most of their points into Czech IPFs, while citizens of Slovak Republic placed less than 90 per cent in Slovak IPFs.²⁸ From the viewpoint of the Czech-Slovak Federal Republic as a whole, 72 per cent of all voucher points were placed with the IPFs (in Slovakia it was about 74 per cent), this outcome signalling the desire of population to diversify risk in a situation of limited and distorted information.

The process of converting investment points into shares took place in five rounds of bidding. In each round the OICs and the IPFs knew the administratively set price of a share in each enterprise (denominated in voucher points per share) and they submitted written bids, using their points. In the first round the starting price was set uniformly and arbitrary at 3 shares of each firm for 100 investment points. At the start, the total value of shares (in points) thus exceeded the total number of points. Within each round most enterprises ended up in a situation of either supply or excess demand. This is not surprising when using one price- adjustment scheme in which the officials from VPC

continued to use the concept of unitary elasticity of demand as a working hypothesis throughout the first wave of Czech-Slovak voucher privatisation. Of course, using one mass privatisation method cannot work with some approach of revealed investors preferences they regarded strategic interests first of all on the side of specific "institutional" investors (here IPFs). So, in these cases where the supply of shares exceeded the demand, the government exchanged shares for points and adjusted the price per share downwards for the next round. In these cases where demand exceeded supply by less than 25 per cent and the sufficient part of the demand was represented by the IPFs, all shares were exchanged for points according to the following procedure: the shares were first used to satisfy completely the bids of individual voucher holders and the remainder was then rationed to the bidding IPFs.

The rationing of the IPFs was proportional to the size of their bid and each IPF had to receive at least 80 per cent of its bid. In cases where demand for shares exceeded supply by more than 25 per cent, or where IPFs would have been rationed below 80 per cent of their bids, the investment points were returned and the price of shares was raised by the government for the next round of bidding.

At the "common" Czech-Slovak level the percentage of shares sold in the five rounds of bidding was 30, 25.9, 10.8, 12.4 and 13.7 per cent respectively. It is interesting that the percentage of shares requested by individuals, which were allocated at once in the first round by the Slovak individual OICs, was 43 per cent compared to Czech individual OICs of only 27 per cent.²⁹

To sum up, in the first wave of voucher privatisation in Slovakia were sold after all five bidding rounds 94.5 per cent of supplied shares of Slovak enterprises. Of 503 Slovak enterprises earmarked to first wave of voucher privatisation were sold completely all supplied shares by 98, by 456 enterprises were sold simple majority (more than 50 per cent of shares) holdings of shares and by 7 enterprises less than 33 per cent ("blocking minority" of shares). IPFs have completed more than 33 per cent of shares in case of 196 Slovak enterprises, yet "Slovak" IPFs were less successful compared to "Czech" IPF by bidding of shares (and vice-versa, Slovak individually invested OICs were relatively more successful than Czech OICs).

It is very important for the further analysis to look at the situation in portfolio of FNP after the first wave of voucher privatisation. The Slovak FNP remained after the first wave of mass privatisation still the greatest "shareholder" in the Slovak economy. Its portfolio was based on several "remainders" resulting both from non-sold portion of shares supplied in voucher privatisation and (first of all) from several holdings of shares in enterprises which were already from the start of voucher privatisation declared a subject of temporary or permanent remaining in FNP's portfolio. Besides, 751 enterprises (not only 503 finally earmarked for voucher privatisation) were approved to privatise in the first wave. The next table presents the composition of FNP's portfolio following the criterion of extent of holding of shares owned by FNP at mid-1993.

Table 4

Portfolio of Slovak FNP by intervals of FNP ownership in shareholders equity of companies (July 1993)

Owners participation of FNP (%)	Numbers of stock companies	Shareholders equity (bln SK)	Portion of FNP on shareholders equity (bln SK)
(0-10)	190	33.385	1.494
(10—33)	193	31.187	5.862
(33—50)	73	35.185	13.508
(50-66)	32	6.521	3.508
(66-100)	69	27.888	23.168
Total	557	136.166	47.737

Source: Fund of National Property of Slovak Republic.

From this table it is clear that FNP of Slovak Republic has not lost its important position for further progress of privatisation after the first wave of voucher privatisation. Moreover, when considering in detail the composition of companies whose portion of shares (more than 33 per cent) have remained in the portfolio of FNP (also were not privatised), it is seen that many of them are in fact companies with more better than average performance. In this sense, one way to further privatisation via management/employees buy-outs has still remained, and a dramatic change in privatisation concept after the defeat of pro-transformation oriented "federalists" in parliamentary elections in 1992 and after the 'divorcing' of Czecho-Slovakia cannot be too much surprising.

Changed Concept of Mass Privatisation During 1993-1997: Cancellation of Voucher Privatisation, Bond Scheme and Direct Sales of state Property

After the first wave of voucher privatisation and the processes of conversion of the acquired investment points (from OICs) and issuance of the shares of privatised companies, a practical cessation in the progress of Slovak privatisation occurred in 1993. However, the government of prime minister V. Mečiar was employed fully with many unique tasks connected with the establishment of new governmental institutions and their competencies after the 'divorce' of the common Czech-Slovak Federal Republic. In the "shadow" of daily discussed and approved decisions on new governmental structures and institutions and their personalization, new opinions and discussions have arisen about further privatisation policy, too. These opinions and the official government standpoints, have implied since late 1992, a predominantly negative

estimation of just finished first wave of voucher privatisation and its effects on enterprises performance.

Practically all these critical approaches to the voucher element in mass privatisation contained, and still contain, the following, nearly "traditional" points:

- The transparency of the ownership is insufficient in the cases of via vouchers privatised enterprises. In this sense, a combination of wide-dispersed small ownership shares of directly invested OICs with just established IPFs (further IFs) without the necessary professional experience of their management cannot act as an effective solution of corporate governance problems in long-term perspective;
- IFs that have collected most of disposable investment points have obtained important ownership positions in many companies cannot bring fresh financial sources to these companies because they don't possess them themselves;
- The result of voucher privatisation could be creation of "ownership without guarantee" phenomenon. Such a unique misinterpretation of one of the six Eucken's (1946) constitutional principles of market-economy order is very expressive; the opponents of voucher privatisation in Slovakia have never expected that public capital markets can play a decisive role by the control of ownership efficiency and its rationalisation;³⁰
- Voucher privatisation is inappropriate method for the establishment of one "stronger domestic entrepreneurs class". Since 1993, this argument is undoubtedly the main publicly presented idea which is used for justification of changes in the privatisation philosophy in Slovakia.³¹

The reverse point in progress of Slovak privatisation was presented sufficiently unambiguous both in the Slovak Republic government's program declaration of July 1992 and on the governmental privatisation workshop in Presov on August 20-21, 1993 (*Elaboration of Further Progress of the Privatisation in the Slovak Republic*. MAPNA, 1991) . At the presence of practically all members of government and all competent officials from MAPNA, FNP, several industry unions and trade unions, it was declared that the second wave of voucher privatisation will be used only as a "residual" method of large-scale privatisation in its second wave (stage) in Slovakia.

According to authentic exposé of prime minister Meciar, only a book value of 50-70 bn SK from the comprehensive book value of enterprises above 200 bn SK which were appointed for the second wave of large-scale privatisation in Slovakia, would have been privatised via vouchers. One restriction more: privatisation projects which would have proposed 97 per cent of shares for a privatisation via vouchers would not be approved in any case. So, only minority blocks of shares had been privatised via vouchers. Majority stakes were to be privatised by means of sale to so-called strategic investors under purchase-sale conditions which were known in advance and which also included liabilities relating to the development of privatised enterprises.

Smaller enterprises were to be sold by standard methods without being transformed into joint-stock companies. Further, several forms of pre-purchase rights for employees and management were proposed and discussed, however, the application of such preferences would have limited only in cases of enterprises with less than 200-300 employees. IFs which took place on this privatisation workshop, agreed with many regulation requirements by the presence of IFs in second wave of voucher privatisation. Interestingly, that only the biggest IFs from the first wave of voucher privatisation have delivered the most intensive requirements on regulation of IFs activity in the second wave. It is clear that after the first wave of voucher privatisation, the interests of most influential IFs on strong regulation of their future "competitors" were significant.

The Government of Prime Minister V. Mečiar was recalled on March, 14, 1994. It is true that many controvertible direct sales of enterprises in February-March 1994 were one of the most important causes which led to this political crisis. The new "interim government" led by Jozef Moravčík consisted from members delegated by three political parties with really diverse orientations. Basically, an analysis of causes which led to failure of second wave of voucher privatisation must start with the problem of inappropriate structure of this Slovak government. Actually, this government had not enough time for the consequent preparation and realisation of such massive privatisation action (April - September 1994). Other causes were most important, however. First of all, the support of voters for this new "all-coloured" coalition was unstable, volatile, and insufficient. The threat of Mečiar's government comeback after the premature parliament election (October 1994) was very actual. In such a complicated situation the typically "two-face"-politics becomes more and more frequent on the part of the most problematic coalition partner - left wing-oriented Party of Democratic Left (PDL).

In this situation political paralysed of this privatisation stage reached more and more serious extent. Decisive officials in MAPNA and FNP, they were delegated by two right wing-partners in coalition (Democratic Union - DU and Christian Democratic Movement - CDM), have prepared abundance of SOEs for voucher privatisation and still have worked on other several technical and registration processes; but Minister of Economy (P. Magvasi) nominated by PDL at the same time led endless discussions about necessity of privatisation in electricity production and gas transportation sectors. These sectors and their 5-6 excessively concentrated enterprises were the greatest "donors" of ownership equity for purposes of second voucher privatisation wave. Besides the fact that this analysis would not contain too many points about several political carousels by privatisation, it is important to note that the failure of second wave of voucher privatisation in Slovakia was caused not at least from the ground of an inefficient structure of government. It is, of course, a lesson not only from the case of Slovak privatisation.

Anyway, before the end of its term of office (November 1994) the "interim" government of J. Moravčík approved property worth 62,7 bln SKK for second wave of voucher privatisation with a prospective increase up to 70 bln SKK. This was composed of two

parts. One part was prepared by the MAPNA and included shares of 156 companies worth 51 bln SKK. The other part was compiled by the FNP, which offered shares of 139 companies from its portfolio with value of 11,7 bln SKK. With 3,39 mln Slovak citizens (OICs) registered to participate in the second wave, the volume of property would have meant some 20 000 SKK per capita.³² This citizens participation rate was significantly greater than in the first wave of voucher privatisation in 1992 (2,59 mln of OICs) even if the volume of property per capita had represented more than 30 000 SKK in this first wave in 1992. At the same time, 166 IPFs were registered for the second wave of voucher privatisation.

After taking office in December 1994, the government of V. Mečiar claimed to continue the actions that were carried out by the government of J. Moravčík in the field of voucher privatisation. At the same time, the Mečiar's new government declared that the possibility of privatising companies in the energy and gas industry cannot be considered for the voucher offerings. Moravčík's cabinet originally offered 30 per cent of the electric energy industry into the voucher privatisation.

Further, in April 1995 the Mečiar's government reduced the property offered for voucher privatisation to 40 bln SK from the originally planned 70 bln SK, which was not only radical deviation from the aims of the previous government, but a radical turn from the statements of the actually governing coalition parties. At the same time, the government ordered the privatisation minister to prepare the organisation and finances for the second wave of voucher privatisation. The preliminary round in which the OICs could assign their investment points to the IFs should have started in the first half of 1995. Before this round started, the government (Ministry of Finance) have planned to amend the legislation concerning voucher privatisation. *The new legislation would have decreased IFs rights within the privatised companies.* Of course, most of the interested IFs have agreed that exclusion of the energy industry companies from the voucher trade will significantly lower the attractiveness of the voucher privatisation program.

There will be no more comments on all these political and social obstacles and tricks which were used clearly with one main goal - stop the voucher privatisation in its originally Czech-Slovak model "fashion". In July 1995, the Act on Large-scale Privatisation (Act No. 92/1991 Coll.) was amended, and the Slovak government introduced a new concept of the second wave of mass privatisation. *The new concept prevents 3,39 mln registered Slovak citizens (OICs) from taking part in the direct privatisation of state property.* Rather than being able to buy (bid) shares in privatised companies, every OIC (owner of an investment voucher - coupon) will receive a bond from the FNP with the face value of 10 000 SKK (330 USD) maturing in 5 years and bearing an interest rate equal to the discount rate of National Bank of Slovakia (in 1996 - to present time it is 8.8 per cent).

By the end of September 1995, the Ministry of Finance has sent to all registered citizens a letter explaining their rights and obligations concerning with the bond privatisation. Citizens, who wish to cancel their registration for second wave of privatisation

(because method was changed dramatically) would have to do so by September 30, 1995. In that case the Ministry of Finance would have returned their registration fee by end of 1995.³³ Privatisation bonds were issued and distributed to OICs in January 1996.

According to the announced scheme, bond-holders face (officially) several options which may be seen interesting in the sense that individuals may choose to gain some durable assets of life-cycle character and immediate use (numbers in columns refer to the number of privatisation bonds which were used for particular purpose during 1996 - to the end of April 1997):³⁴

- individuals holding bonds until maturity have the right to receive the full payout of principal and interest;³⁵
- privatisers with debts to the FNP (e.g. arising from the installment loans by direct sales privatisation) can buy bonds from citizens at their current market price, in exchange for cash or shares, and use these bonds at their full face value to settle obligations to the FNP - thus, eventually, becoming full owners (over 335 thousands of bonds);
- **the three main domestic banks (VUB, SLSP, IRB) can buy bonds from enterprises, municipalities, insurance companies, or each other - either acting as intermediaries between bond-holders and companies desiring bonds to settle debts to the FNP, or in order to add bonds to their own asset portfolios (over 94 thousands of bonds)**
- bonds can be used to purchase complementary health and pension insurance (0.6 thousands of bonds);
- individuals will be able to use bonds to bid for shares in a special auction arranged by the FNP - this process represents the biggest scandal of bond privatisation to present days: there are lots of evidence that FNP offers only minority packages of shares in companies where the major packages have been sold through direct sales, tenders, etc.; moreover, FNP had offered for this auction the shares of companies in liquidation, too;
- individuals can use the bonds to buy their apartments from local municipalities (4.8 thousands of bonds).³⁶

Anyway, the new method of second privatisation wave bodes ill for the investment funds (IFs). It is very useful to note, that some just as relevant as populist-confused arguments too, these were presented in 1994-1995 against the activity of IFs and their negative consequences for both privatised companies performance as well for the shareholders of IF's, have played a significant role as "justification" for canceling of second voucher privatisation wave. According to J. Magula, the state secretary of the Ministry of Finance (1994-1996), an inspection of IFs carried out by the Ministry of Finance in December 1994 revealed "alarming facts": for second wave of voucher privatisation registered IFs have abused the law by acquiring clients (OICs) before pre-

round even started, which was not allowed by the act. The new concept (bond privatisation) had predicted that these IFs would have shut down. The Ministry has even offered 500 000 SK (about 16 500 USD)³⁷ to all funds that request the canceling of their licenses. Out of 166 IFs which registered for the second wave of the voucher privatisation in Slovakia, 90 have asked the Ministry of Finance to cancel their registration and give them an above mentioned lump payment.

At this place it is very useful to recapitulate, how "impressive" was the "coolness" of present Slovak government by principally changing of progress of second wave of Slovak large- scale (mass) privatisation. According to a survey on evaluation of interest on second wave of voucher privatisation in Slovakia conducted by AISA Slovakia³⁸ only about 18 per cent of Slovak citizens were not interested in registration as OIC. Between 55-66 per cent of Slovak citizens wanted to invest their investment points indirectly via one of the 166 registered IFs. Further, I estimate realistic that the costs that were outstanding by acquiring of one OIC (with 1 000 investment points) by several IFs before the preround would been started, were in average about 3 000 SKK. So, the IFs registered for second wave of voucher privatisation has taken totally more than 6 bln SKK in credits for the purposes of acquiring the OICs and paying the advances for dividends for them. It is very probably that one great portion of this "new privatisation's credit amounts" has brought only one unambiguous economic effect - an increase in amount of nonperforming loans by main domestic Slovak banks. So, it is really a "rightly" signal for an appropriate credit expansion-regulating policy of Central Bank in one transition economy which still aspire on further strengthening of price stability. Further, such a dramatic change in privatisation policy cannot contribute for more attractiveness of Slovak economy on the side of foreign investors. Interestingly, at the same time when the foreign investment companies as the founders of IFs for second wave of voucher privatisation were shocked by the government's change in conception of privatisation and approving retroactive laws (amendment of the Act No. 92/1991 Coll.)

On Large-scale Privatisation through the Act No. 190/1995 Coll., the several statements of government still have brought many laments on lack in foreign investment in Slovakia. It could be discussed more about the some other controversial points of bond privatisation concept. But the main problem that has a strongest influence on future development of Slovak corporate governance structures, must be presented as decisive kind of interdependencies between logic of bond privatisation and present direct sales- privatisation policy of Slovak FNP. Note here, first of all that the bonds of FNP can be also used to pay off debts to the FNP, and many owners of privatised companies will buy up bonds for this purpose. The bonds are traded since August 1996 in RM-System Slovakia (one from the two public capital markets in Slovakia, practically a OTC- market) and the lowest limit of acceptable price was predetermined at 7 500 SKK (250 USD) by the Slovak governmental *Ordinance Regarding on the Using of FNM Bonds*. In 1997, the lowest limit of regulated bond price was 8 160 SKK.

Since August 1996 on trading with FNP-bonds was realised predominantly at this lowest price acceptable limit and the market was mostly characterised with significant

supply surplus. Note further that all subjects which are authorised for activities such as acting for an endorser or providing endorsements of FNP-bonds (securities traders, etc.) must have one settlement with the FNP. Also, all FNP-debtors (owners of privatized companies) must be authorised by FNP if they want to pay off their debts (or remained portions of purchase prices) via using of FNP-bonds. It is no surprise that "dauntless" corruption and further rent-seeking twist - theaters arc very probably actual by such an uncontrollable set-up of bond privatisation.³⁹ It can be seen dearly that the role of FNP' was (and still is) absolutely decisive in the progress of second wave of large-scale privatisation in Slovakia because the FNP:

- is responsible for determining and publishing the list of subjects entailed to purchase FNP-bonds from the general public and trading with them;
- is responsible for determining and publishing the list of its debtors which can pay off their debts to FNP by using of FNP-bonds;
- at the same time sell via direct sales the majority holdings of shares of rrtany large profitable companies, both they were just de-etatized in the second wave of large-scale privatisation as the several important remainders of shares from the first wave of voucher privatisation. A typical direct sale entails the purchaser agreeing a price for the company with the FNP; making a down-payment of between 10 and 15 per cent of the purchase price and paying the balance in installments (mostly planned for 10 years); agreeing on an amount which will be invested in the company, and which can be regarded as a contribution towards the loan repayment to the FNP. Further, an amendment in early 1996 to the income tax law (Act No. 286/1992 Coll. in later wording) allows companies to claim tax relief on the amount of investment management agreements with the FNP to make in the company subject to management buy-outs;
- represents the interests of state in Supervisory Boards of partially privatised companies. Here FNP frequently blocks many incentives of IFs representatives and further, in such companies where the state owns not more than a "blocking" minority holdings of shares (minimum one-third of shares) several legal strategies and incentives like a "golden share" concept are applied.

In summary, all requisites of Slovak privatisation "history" must evoke one expressive consideration that in case of Slovak privatisation, it was adopted intentionally such concept of corporate governance and structure of ownership, **which is based on strong internal mechanism and oriented on clientelistic relations to government in longterm perspective.** Few strong groups of managers (previously directors of former SOEs) with stable connections with main still not fully privatised domestic financial institutions and governing political parties, play the main role.

After the first wave of large-scale privatisation with important role of voucher element, the logic of further privatisation progress was presented publicly as a concept with one exclusive actor - FNP, its status is apparently independent from daily-work of government. Of course, this "independence" is only a blunt deception. Anyway, the impact of Slovak mass

privatisation on the present state and future development of corporate governance mechanism may seem absolutely unambiguous today, a coexistence of old-known insiders was established and confirmed. The present governing political parties have brought really any effort for the achievement of this status quo.

Further, it may seem interesting, that according to results of another research of public opinion, conducted in November 1994, approximately 40 per cent of representatives of social elite in Slovakia have stood up for an opinion that "only the state should own the most important strategic enterprises in industry". For comparison, only 28 per cent of Czech respondents have stood up for such opinion (Hartl and Konvieka (1995)). The "creation and strengthening of domestic class of capitalists" - this is the absolutely preferential slogan for realisation of second wave of large-scale privatisation in Slovakia. Openly said, the other actors of corporate governance - first of all *the IFs from the first wave of voucher privatisation and the still predominantly state-owned main domestic banks* (not only with classical depositor and creditor role but as the founders of most important IFs), *are considered only unnecessary and parasitic outsiders whose owner position must be restricted and step-by-step devaluated*. These aspects will be analysed in the next parts of this study.

Investment Funds and Their Role in Privatisation and Corporate Governance During Transition Process of Slovak Economy

The first wave of large-scale privatisation in Slovakia, especially the implementation of the voucher privatisation scheme, was connected with creation of relatively high number of institutional investors in a short period of time. Such kind of rapid changes in the ownership structures and corporate governance lead necessarily to many serious *discrepancies between opinions and interest of managers and those of investment funds*.

However, in the case of Slovak privatisation the other important problem is how can function the system of corporate governance in the case that the FNP is an important owner of shares, too. The former federal Czecho-Slovak government privatisation programme had not assumed originally any important role for the investment funds (IFs) in privatisation, so the appropriate legal institutions were lagged behind. Nevertheless, the acquisition activity of IFs and the extent of their participation in the first wave of voucher privatisation boomed within a very short time. This initiative was exclusively private.

At that time (during the preliminary round of the voucher privatisation), it had been expected often in Slovakia, that the investment funds established by the main commercial banks, big SOEs or with an important involvement of foreign investors would ensure the most important source of control on the enterprises. Depending on their obtained holdings of shares they would divide into "owners" and "investors" and according to it will act more or less actively in corporate governance in the individual enterprises.

Further, it had been expected very frequently that in a case of widely dispersed ownership a dominant minority of the voting stock is rather low, *so that IFs with a*

rather low ownership share would act as "owners". Not surprisingly, the main points of criticism on the implementation of voucher privatisation scheme were risen from the side of former management and employees in just privatised companies: their expectations were that the new corporate owners (IFs) would strengthen their position via buy-back of small shareholder (OICs) shares at very large discount because the expectations of OICs these have invested indirectly via IFs were really predominantly oriented at speed cash gains. A further source of old management structure's fears was connected with expectations that foreign strategic investors and portfolio funds could as well collect sufficiently large holdings of shares. This frequently presented managerial "anxiety" for behaving of national interests in Slovak economy was honoured too good by second wave of large-scale privatisation as was seen in the previous parts of this study.

A consistent analysis complying with the goals of the research project, for identification of the role and position of the Slovak IFs in privatisation and of the newly established corporate governance, should provide a separate evaluation of the development during the two time periods (1991-1994 and 1995-1997) because the progress in privatisation and its consequences on IFs position differ radically.

The following main legal documents are important for the IF's founding and activity regulation in Slovak conditions:

- Order of Government of Slovak Republic No. 134/1994 Coll. *On Using of Investment Coupons* in the later wording (further only OGVIC);
- The Investment Companies and Investment Fund Act No. 248/1992 Col. in the later wording (further only ICFA);
- Act No. 600/1992 Coll. *On Securities* in the later wording (further only SA);
- Act No. 21/1992 Coll. *On Banks* in the later wording (further only BA);
- *Competition Act* No. 188/1994 Coll. (further only CA);
- Act No. 92/1991 *On Conditions and Terms Governing to Transfer of state Owned Property to Other Persons* ("large-scale Privatisation Act") in the later wording.

Regarding the logic of the above mentioned Slovak Acts and other legal documents it is necessary to discuss the legal problems connected with the establishment and activity of IFs with respect to the legal status of three (or four) subjects of law which are defined according to actual law (especially to ICFA):

- (a) investment company or investment fund and their shareholders-founders;
- (b) investment company both as manager (administrator) of one or more investment fund(s) and as trustee of one or more unit trust(s);
- (c) custody of investment funds (IFs) an investment companies (ICs) - in Slovakia this custody-function is allowed only for banks according to the last approved amendment (Act No. 181/1995 Coll.) to ICFA.

According to ICFA (§ 2) investment company (IC) and investment fund (IF) is subject of law targeted on acquisition of cash via public proposal to made a contract. However, the cash means collected by IC or IF has not a character of deposits.

Note, that the continuity between existence of investment privatisation funds (IPFs) from the first wave of voucher privatisation and here mentioned generally legal arrangement of IFs (and ICs) is explained and secured also by the diction of Section 5 in § 1 ICFA which ordered "that for purposes of this Act investment points (from vouchers books) are considered cash means as well". Since the last amendment to ICFA (Act No. 191/1995 Coll.) was approved IF and IC must be founded obligatory as a joint-stock company with required shareholders equity worth at least 1 mln SKK (about 32 000 USD) in case of IF and 20 mln SKK (about 640 000 USD) in case of IC.⁴⁰ ICFA contains further (especially Head 6 of ICFA - "Protection of shareholders and trust units-owners") many prohibitive points preventing the fund-founders, administrators and employees of IF or IC from preserving several advantages for themselves compared to the other shareholders.

Special attention is paid to the obligatory prohibition of such advertising and propagation which contains deceive promises on lucrative dividend and capital gains in the public proposals on purchase of trust units or shares of IFs. Further, with regard to necessity of risk limitation and decomposition, the ICFA in actually wording restraint the allowed capital share of the investment found or unit trust or more funds managed (administered) by one investment company to 10 per cent maximum of the basic capital of any privatised company. Originally it was 20 per cent until the amendment of ICFA was adopted.

It is clear that such a new regulatory attempt blocks access of IFs representatives to managing statutory bodies of companies.⁴¹ Further the IF and IC can neither purchase, nor own the shares of its founder (§ 24 in ICFA). The same kind of restriction is relevant in the case of ownership of custody and in the case of other legal entities ownership, if they owned more than 25 per cent of fund's founders, or its custody as well.

It is very interesting that ICFA contains a regulatory aspiration in the sense of concentration of ownership restriction from global point of view. According to Section 10 in §24 of ICFA the value of property that represents the portfolio of one or more investment fund(s) administered by an individual investment company cannot exceed 10 per cent of the property value which is owned entirely by all investment funds, or trust units-funds their activity is allowed in Slovak Republic. In such a case when several IFs or ICs are interconnected in ownership because they have a common founder, this restriction is relevant for such group of IFs or ICs as entirety.⁴²

Further, it is prohibited that the value of a real estate or mobile asset represents more than 10 per cent of fund's equity. IC or IF cannot acquire shares of other IFs or ICs anyway. IFs and ICs cannot issue bonds and provide loans as well. IFs and ICs may undertake short-term loans only under provision that amount of these loans is not bigger than 10 per cent of IF's or IC's equity.

All the above mentioned rules may seem usual regarding to the similar legal regulations of IFs and ICs in the other transition CEECs. Clearly, that in 1995 changed rules in the sense of *later strengthening of ownership restrictions* are of greatest importance. *The "10 per cent limit" approach is really not sufficient for active access to corporate governance in enterprises with shares involved in the IF's portfolio.*

At present, the Slovak IFs are regulated as closed-end investment funds. According to ICFA, ICs and IFs were during 1994-1996 subjects of Ministry of Finance regulation: each their founding or division, merger or fusion with other IC or IF must be approved by the Ministry. Note, that the supervisory competence was delegated on the Supervisory Office above the Capital Market (further only SOCM). Unfortunately SOCM is still only an organisational body of Ministry of Finance, which is directly administered under the Section of Financial and Economic Policy of this Ministry. Many conceptions for changes in SOCM statute were proposed and promised, but today the SOCM is still a not sufficiently transparent "monopoly" for regulation of the capital markets and IFs in Slovakia, and direct access and representation of other important institutional subjects (e.g. stock exchanges, Association of Investment Funds and Investment Companies, Association of Securities Traders) are still absent in the SOCM.

The last approved amendment to ICFA contains the strengthening and extension of several preconditions which are required by Ministry of Finance (MF) regarding the application for IF or IC license. For example, such an application must contain apart from usual formal properties (e.g. trade name and residence of IF) also the amount of share equity, the specification of its custody, trade name (when company) or name (the physical person) and residence of all its founders who own more than 10 per cent of IF's share equity, complete set of proofs about law integrity, achieved qualification and professional practice of each person proposed for a position in the statutory bodies of IFs or ICs.⁴³

Moreover, a written declaration of IF's founder about an inquiry of fund's equity capital is required, too. When new members of IC's or IF's statutory bodies are elected, the Ministry must be informed about them within 10 days; all above mentioned formal documents must be sent again and Ministry approves these changes in company's or fund's statutory bodies. According to ICFA it is obligatory that in Board of Directors or in Supervisory Boards of ICs or IFs can be only their employees, and, further, members of statutory bodies of IFs or ICs cannot be in the statutory bodies of both other ICs or IFs as well as any joint stock-company and stock exchange, too. *In this way, the problems which may arise regarding the phenomenon of so-called interlocking directorates were excluded.* However, other employees of IFs or ICs can be in statutory bodies of other institutional investors and joint-stock companies.

Another important problem concerns the relations between IF and IC as administrator (trustee) and manager of IF's portfolio. Especially in the case of IFs which were founded originally as IPFs in the first wave of voucher privatisation, the problem of legal regulation of contracts between IFs and ICs and the trustee bonus (or administrator commission) is one of the most important regulatory questions. The contract between IC and IF is subject to termination with six-month period of notice according to ICFA (Section 3 of § 7 in ICFA). However, the period of notice can be determined as another time period by individual contract between IC and IF, too.

The trustee bonus is also contractual but the law does not permit to go higher than 1 per cent of the net real assets value in the IF balance, or alternatively, more than 20 per cent

of IF's profit after taxes (net profit), according to actual wording of ICFA. Further, the trustee bonus cannot be higher than 0.25 per cent of the net real assets value in the IF balance when the performance of IF ended in losses. These legal restrictions are considered as strong injury from the side of Slovak ICs today, with regard to fact that before September 1995 according to previous wording of ICFA the trustee bonus was permitted to go up to 2 per cent of the net real assets value in the IF balance without other restrictions.

These critical opinions of ICs and IFs may seem relevant, especially in cases of IFs (IPFs) and ICs which were established before the first wave of voucher privatisation. It is clear that very asymmetric distribution of completed investment points among individual IFs can cause serious consequences on the relations between IFs and ICs when there is regulatory attempt to limit the trustee bonus at a very low level. To justify such opinion, it is necessary to see first of all with respect to facts that in a situation when the (capital) market becomes more and more "bearish" the economy of big IFs and its impact on the state of fund's net real assets value is depressive overall and the expectations of administering ICs cannot be justified regarding both the development in costs of fund's portfolio management and new regulation of trustee bonus. In this sense it is not surprising that of the 20 largest IFs only 4 have retained the original administrator (ICs as trustee) (end 1996).⁴⁴

The institution of IF's and IC's custody is another important issue of the institutional investors regulation. It was pointed out that custody's function is allowed only for banks according to present wording of ICFA. Custody account charge is subject of contract between IF (or IC) and custodian bank but the ICFA (§ 30) does not permit to go higher than 0.1 per cent of the average net real value of the IF (or IC) assets. The contract on custody is also a subject of termination with six-month period of notice by law, but the individual contract can contain shorter period of notice (Section 3. in § 30 ICFA).

Regarding bank custody exclusivity, it is clear that in a situation when the number of established ICs and IFs expressively exceeds the number of existing banks, the problem of possible abuse of information on portfolio structure and management strategies may be very actual. This kind of regulatory complications is of great importance in Slovakia, especially during 1992-1995, because here was established a mix of ICs and IFs which were founded by banks, and the so-called "non-bank" IFs and ICs. In this sense, the preference of "bank" IFs and ICs interests could rise with time just by dishonest using of data about other custody "non-banks" IFs or ICs.

From this point of view, a fortunate solution is that according to several amendments to Act No. 21/1992 Coll. "On Banks" Slovak banks cannot acquire more than 10 per cent of equity shares in any non-bank company and, further the extent of such ownership cannot exceed more than 25 per cent of bank's equity and reserves value.⁴⁵ The approval of National Bank of Slovakia (NBS) is needed in the case of exceeding the above mentioned limits. Reversibly, according to the Act "On Banks", an acquiring of more than 15 per cent shares of bank's registered capital requires approval by the NBS as well. However, banks can own more than above mentioned limited portion of equity

shares of other companies under the condition that such ownership of holding of share is either a subject of a repurchase agreement connected with pledge securities, or a subject of fiduciary transactions by completing of holding of shares with the aim of future selling to other investors. In any case, bank cannot own for these purposes acquired shares longer than 2 or 1 year, respectively.

An overview of actual Slovak IF's and IC's legal regulation system would not be complete without the presentation of governmental supervision mechanism over the IC's and IF's management and their business activity. The Ministry of Finance carries out its supervisory function through the Supervisory Office above the Capital Market (SOCM). SOCM requires really large scope of information about the legal or physical persons obtained more than 10 per cent of IF's or IC's bearer shares, members of statutory bodies, IF's or IC's founders, custody of IF's or IC's, etc. Officials of SOCM can control the IF's (or IC's) accounting books directly. Further, the IFs and ICs are obliged by law to present results of its business activity and state of assets through six-month and annual reports which must contain great number of data, first of all, the net value of fund's shares.

The extent and operational scope of SOCM were strengthened very expressively by the last approved amendments of ICFA in 1994 and 1995 (Act No. 91/1994 Coll. and Act No. 191/1995 Coll.). SOCM as supervisory authority over the IF's and IC's mandated by Ministry of Finance can order changes of their custody, trustee (IC as administrator of IF), as well as the members of the statutory bodies. Ministry through SOCM can take back the IF's or IC's license. The Ministry of Finance can put a cash penalty worth 15 mln SK for IFs or ICs in the cases when certain legal obligations of ICFA were broken by IF or IC. Other disciplining measure installed by ICFA is the compulsory administration of the IF or IC. *This legal institute in Slovakia is subject to sharp discussions because the ICFA prohibits not the sale out of many lucrative holdings of shares originally obtained in compulsory administered funds portfolio on the side of compulsory administrator.* This is one of the most important shortcomings and inconsistencies in Slovak system of institutional investors regulation.

It is clear from this presentation that the legal environment for the business activity of Slovak ICs and IFs has in its actual fashion a very strict, and generally said, unfavourable character from the IFs and ICs point of view. However, this is not a pleading for IF's and IC's position and their role in Slovak large-scale privatisation because *the sufficiently consistent evidence of really positive funds' contribution on corporate governance and enterprises performance does not exist in Slovakia today.*

Moreover, it does not seem surprising that in a situation of rapid ownership changes via using of inconsistent mix of several privatisation methods and further when at the same time the competing new subjects of capital market were established already, all of these new actors in corporate governance try to change the legislation not only for a transparent regulation of markets, but also for themselves. It is a typical example of the fight for the "right" legislation.

From the viewpoint of IFs' and ICs' portfolio and investment strategies as well as with respect to claims on their effective management, it is absolutely clear that actual Slovak legislation cannot contribute to a generally justified and honest funds and investment companies activity with respect to originally presented goals of voucher privatisation. Moreover, the extremely inconsistent institutional set-up and changes of privatisation methods must be seen as a very serious source of magnifying power regarding the amount of transaction costs which are connected with privatisation in Slovakia.

Further some proportions will be presented of IFs' and ICs' position and role in privatisation which were outstanding from the first wave of voucher privatisation. In 1992, 169 IFs and 68 ICs obtained their licenses for the purposes of participation in voucher privatisation in Slovakia. These Slovak IFs have obtained a total of 1,68 mln investment points, or 65 per cent of all investment points which were granted for Slovak OICs.

Of course, the preferences of Slovak citizens (OICs) to invest their investment points indirectly via IFs was approximately dominant in the similar extent as in case of Czech OICs: the greater attractiveness of Czech IFs has played role probably when we take in consideration that more than 10 per cent of Slovak OICs have invested via Czech IFs in the first wave of voucher privatisation. We are convinced that such predominant interest of Slovak OICs to use their investment points indirectly via one or more IFs is very simple to explain: practically all Czech and Slovak IFs have adopted very quickly the aggressive strategy by collecting of OICs' investment points (or, voucher books) which was introduced at first by the Harvard funds under the slogan "security of 10 times".

Without going into details, there is no reason of explaining the different success of several funds acquisition strategy by comparing their cash-paid promises for OICs. It is clear with respect to definitive proportions in obtained investment points distribution among the individual IFs after the pre-round of voucher privatisation that two kinds of OICs' preferences and expectations could play decisive role. First, it was the ICs' and IFs' founders and co-founders role of main domestic banks and the Slovak Insurance House, Ltd., too, what has attracted great amount of OICs' investment points. Of course, such a development in the pre-round of voucher privatisation cannot surprise in wholly depressive economic situation at the start of massive and quickly transition processes. To my estimate, *no more than 10 IFs originally founded and administered by banks or Slovak Insurance House, Ltd. have obtained not less than 48 per cent of all via IFs indirectly invested OICs' investment points; further, 10 biggest IFs have obtained not less than 63 per cent of all via IFs invested OICs investment points in Slovak voucher privatisation.*

Second, some IFs, having as their founders several groups of managers, industry unions officials and miscellaneous regional elite, have obtained a surprisingly high amount of investment points from individual OICs. An impression of the relative importance of main ICs and IFs which took place in the first wave of voucher privatisation in Slovakia may be obtained from the Table 5. The contemporary situation of IFs is presented, too.

Table 5

An overview of the development of major Slovak IFs from voucher privatisation during 1993 - 1st half of 1997 and their contemporary situation)

Name of IF	Amount of obtained OICs' inv. points, in ths.	Change in NAV Per share during 1993-1997, in %	Discount per share during 1993-1997, in %	Contemporary situation (6/1997)
VÜB Kupôn IF *	500,668 (29.8 %)	-24.5	54.3	1, 2, 5
PSIPS IF	188,041 (11.2%)	-71.5	69.7	1, 2, 3, 5
Ferofond IF	78,409 (4.7 %)	-76.2	72.3	1, 2, 4, 5
Prvý privatizačný IF *	67,812(4.0%)	-24.9	68.3	1, 2, 5
Slov Coupon IF	50,554 (3.0 %)	-52.0	69.7	1, 3
Harvard Dividend IF	40,481 (2.4 %)	-33.8	52.4	1, 2, 5
Puchovský IF	39,764 (2.4 %)	-37.9	62.1	1, 2, 3, 5
IPFIL. Sporiteľ' fta VSZ	37,815(2.3%)	— 84.6	75.3	1, 2, 3, 5
Regiofond SP IF *	37,761 (2.3 %)	-38.9	23.8	1, 2, 5
Karpaty IF *	35,434 (2.1 %)	-29.0	55.1	3, 5
Harvard Growth IF	32,974 (1.9 %)	-42.4	62.1	1, 2, 5
Credit-Fond IF	29,103 (1.7%)	-74.6	81.3	n. a.
Creditanstalt-SIF IF *	27,426 (1.6%)	-20.9	51.2	1, 2, 4, 5
Garantovaný IF *	12,140(0.7%)	-31.9	74.4	1, 2, 3, 5
Tatra Kupôn IF *	11,858(0.7%)	-14.0	52.5	0

Sources: Own calculations and estimates based on ICs' and IFs' prospects and data-sets of Slovak public capital markets. Several data regarding contemporary situation and transformation of Slovak ICs and IFs were drafted from Hajko and Beer (1996).

Notes:

* Investment fonds (IFs) labelled with (*) were founded and originally owned (during 1993- 1994) by banks or Slovak Insurance House, j.s.c., respectively;

¹ Data in column represent the portion of OICs investment points obtained by particular IF on whole amount of OICs investment points obtained by Slovak IF in voucher privatisation;

² Discount is calculated as difference between NAV per share and market price of IFs shares during 1993 (1st half of 1997; calculations were realised basing on complete statistics of Slovak public capital markets (above 1 000 trading days on BSE and RM-System Slovakia) and compared with NAV from quarterly published IFs prospects during observed period (above 50 prospects).

Numbers in box "Contemporary situation (6/1997)" represent concrete features of individual IFs situation at end of June 1997 as follows: 1 - IF transformed in the form of classic joint-stock company; further outside regulation under provisions of ICFA; 2 - trade name of IF was changed; 3 - IF in liquidation; 4 - fusion of IF with commercial company other as IF; 5 - more than 33 per cent of IF's equity is controlled by 1-3 legal or physical persons; 0 - IF is acting further as IF from voucher privatisation under provisions of ICFA.

It is evident from Table 5 that many of the major Slovak ICs and IFs ran into a problematic situation after privatisation concept was changed and corresponding laws were amended. Most small ICs and IFs ended their activities during 1995-1996; a lot of IFs passing to self-administration or being liquidated.

It may be expected that only the greatest collective investments institutions can survive in the next few years, or those which are supported evidently by executive power via further "cultivating" of several mutually advantageous interconnections with governmental policy actors and strongest groups of managers, too. *In any case, the original idea of IFs from voucher privatisation as a peculiar collective investors-construct with closed- end character was suspended completely in Slovakia.* Today, only 1 (one!) from 169 founded in 1993 IFs is acting at present time (second half of 1997) as "voucher privatisation" IF under the regulation of SOCM and under provisions obtained in actual wording of ICFA (this IF is Tatra Kupon IF).

According to the several representatives of ICs and IFs the main reason why ICs and IFs are felling by the wayside in Slovak privatisation and corporate governance processes is the decisive change of privatisation process after the third Mr. Meciar's government assumed power at the end of 1994, and many amendments to law restricting operations of collective investment institutions, which were presented in this part of the study before. With regard to radical changes in the concept of the Second wave of large-scale privatisation, ICs which had founded 169 IFs for the purposes of finally cancelled second wave of voucher privatisation have thus lost of about 9 bln SK (nearly 300 mln USD), according to data of the Association of Investment Companies and Investment Funds in Slovakia (AICIF), or 6 bln SK (about 200 mln USD), according to my own calculations).

The IFs registered for the second wave of voucher privatisation have sent letters on OICs asking to pay back the money which were paid as advances to OICs during the advertising and acquiring campaign of IFs' in the 1994. It can be considered reasonable that no more than a half of this money will be returned to ICs, and the rest will be listed on the ICs and IFs ledgers as definitive losses.

Further, the determination of the majority shareholder via direct sales of shares of only partly privatised companies caused massive depreciation of other shareholders (among them first of all the IFs) because demand for them (shares) had decreased on the capital markets. Direct sales of majority holdings of shares are really a very unfortunate solution of progress in the second large-scale privatisation wave in Slovakia, especially with regard to claims on capital markets development and their transparency, since the value of eventual effort of ICs' and IFs' managers to improve performance of owned companies will decrease to zero in such uncertain situation when the majority holdings of shares can be sold any moment to other investor with different strategy of corporate governance.

The position of funds' shareholders is also clearly unfavourable, especially in the case when small shareholders have not sold their shares in IFs because they have expected incomes from capital gains which could be considerable as a result of effective IFs management in governed companies.

Regarding the facts and tendencies presented in this part of the study, it is not surprising that practically all Slovak IFs have been transformed into classic stockholding companies, or they are in liquidation today. Advantages of such transformation for IFs' management are clear: since *classic stock-holding company can act on legal conditions which are obligatory in the case of joint-stock company regarding the Slovak Commercial Code, it will not be possible to restrict the size of owned stockholdings in other individual companies, which was the case of IFs and ICs, operating in compliance with the ICFA conditions*. Several restrictions on IFs' credit availability and prohibition of own bond issuing are not actual according to Slovak Commercial Code, too. The chance to evade the ICFA conditions on governmental supervisory competencies by control of IFs' and ICs' is very probably the most attractive motivation for changing the legal status of companies.

There are no illusions that the management and employees of IFs' and ICs' will not exploit each opportunity to strengthen their personal income and (or) shareholder position during such IFs status transformation. It is not new, that different aggressive strategies would be applied here. Because the strategic owner's position of Slovak IFs was strongly depreciated with respect to recent development of the Slovak privatisation policy and regulatory attempt on institutional investor's activity, too, such situation on capital markets is very favourable for the massive repurchase of IF's shares from disappointed IF's small shareholders at a big discount: in many cases this discount equals more than 60 per cent of net real value of IF's assets per share.

The know-how of such repurchase-incentives is not pretentious really - in most of the cases it is necessary to arrange bank loan typically collateralised by repurchase agreement containing pledge securities law for bank. This cash is used next for small shareholder's stock-repurchase. Managers and employees of IF's are active only indirectly as interconnected owners of several securities trader's, they realise such kind of repurchase-actions. The main goal and result of this activity before IFs have been transformed into classic stock-holdings companies is unambiguous: it is only a little more complicated (in comparison to management buy-outs via direct sales of majority holdings of shares) way to achieve a sufficiently concentrated ownership structure in already transforming former IFs.

Of course, the role of well-informed insider is reserved for the IFs' and ICs' management and their "good friends" in still not sufficiently privatised major domestic banks. Moreover, the closed character of such re-concentrations of via voucher privatisation broadly dispersed ownership contributes to further erosion of Slovak public capital markets credibility and transparency while during 1993-1997 not less than 85 per cent of total share trading volume was realised as large-block direct trading with shares at prices significantly differing from prices quoted by the anonymous trading regime.

However, one should not ignore the role, position and expectations of IF's small shareholders, who have acquired their shares originally as a result of voucher privatisation in Slovakia. With respect to the progress of Slovak privatisation, it cannot be great store on the role of small shareholders (individual OICs) for corporate

governance in privatised companies in any case. Note further, that according to the results of several omnibus researches realised among Slovak citizens in 1995, approximately 60 per cent of questioned citizens continued keeping their shares obtained via voucher privatisation. In autumn 1996, this share was not higher than 30 per cent. *Generally, in Slovakia there is no reason to distinguish the role of small shareholders in corporate governance.* This opinion is well justified regarding all facts and analysis in this study.

Finally, I would point only a little amen here. *What can be observed in the case of Slovak IFs and ICs today is nothing else, but a complete collapse and dishonesty of original voucher privatisation backgrounds. Everybody should ask, how it is possible that after four years of IFs existence, in a country where average annual level of deposits interest rate had never fallen below 15 per cent, Slovak IFs have lost not less than 40 per cent of their net assets value in average?* The present portfolio of an "average" Slovak IF consists of no more than 35 per cent of enterprises equity shares. Curiously that only the international financial institutions were able to give a superficial judgement of this development; however, such statements could be excused with respect to serious lack of publicly available information on Slovak capital markets.⁴⁶

Notes

¹ These recommendations are: a) the Slovak governing coalition and opposition need to conclude the preparation of such legislation and executive precautions which will contribute to the "normal" functioning of democratic system; b) that parliamentary clubs of coalition and opposition must meet and enforce the establishment of special control committees for the supervision of secret intelligence agencies in Slovakia; and, c) the preparation of legislative solutions to the question of language rights for national minorities is required.

² Slovakia attracted during 1990 - 1st half of 1996 cumulative foreign capital inflows of 24,2 bln SK (808,4 mln USD). This is a really poor equivalent to 1.5 per cent of GDP especially by comparison with Hungary (10.2 per cent of GDP), the Czech Republic (5.6 per cent) and Estonia (5.8 per cent of GDP). At mid-1996 a total of 9 419 Slovak companies had capital investments from abroad; 3 793 of them were entirely owned by foreign capital. But it cannot be forgotten that in more than 80 per cent (7 573 companies) of them foreign investors have invested less than 100 000 SK (about 3 250 USD). The situation from mid-1996 to mid-1997 had not changed in any important manner.

³ In most developed countries inter-consumption account for about 30 per cent of gross production.

⁴ This database contains 47 quantitative and qualitative parameters about each of the 135 most important enterprises in manufacturing industry that refer to its

development in 1993, 1994, 1995, partially in 1991. 1992. So, 135 enterprises (of them 124 have a legal form of joint-stock company in 1995) in our sample present the following portions in total manufacturing industry in Slovakia in 1995, 65.92 per cent of total sales, 70.16 per cent of total export sales, 75.87 per cent of total imports of production factors, 51.13 per cent of total employment and about 62,50 per cent of total assets.

⁵ There are corresponding results exploited from our own analysis that was on market structure conditions and from this Okali's macroeconomic approach. It is just another strong evidence on the existence of very closed relations in above mentioned sense in a case of a small open transition economy with very irreversible supply-side structures like Slovakia.

⁶ Everybody who believes that the author of this study is enemy of private ownership can end the reading of this study better at this place, and save his time.

⁷ Here especially attention is fruitful to very relevant conclusions containing in (concluding) Section V. of this study - Nunnenkamp (1995, pp. 14-16).

⁸ In former Czechoslovakia in 1988 only 884 enterprises were registered in all manufacturing industry with average employment of 2 930 employees per enterprise. To compare, in United Kingdom (1989) 8 467 enterprises exist in this sector with average employment 35, in Italy (1987) 30 108 enterprises with average employment 96 employee per firm. See Newbery, Kattuman (1992).

⁹ This estimation was published in Davies, Lyons et al (1996).

¹⁰ The used approach and its methodology is mostly comfortable with an inspiring analysis of market structures development and role of competition and regulatory policy which is a part in *OECD Country Report* (1996).

¹¹ A danger can be seen in the sense that many official government concepts of "industry policy" in Slovakia were based just on these "clearly" efficient market structure pre-determination in Slovak manufacturing industry, first of all in period 1992-1994.

¹² It is well-known that A. C. Harberger (1954) used a traditional "dead-weight loss triangle" model for measurement of both consumers and capital-allocation losses resulting from excessive level of market structures concentration. In the role of simplifying assumptions he has worked with one equally marginal utilisation rate of income for both consumers and industry shareholders; another simplification stems from the acceptance of assumption about existence of tendency to unification of return on capital rates.

¹³ Several estimates about "uncovered welfare losses" using this approach varied in cases of most advanced market-oriented economies between 0.5 and 3 per cent. However, we could (not) make experiments with more interesting supplemental assumptions which give an optimised look on realistic extent of this serious economic phenomenon and mostly magnify the size of estimated "losses" resulting from excessive concentration or (inversely) competition. It is well-known that those "supplements" may be seen first of all in a broadening approach based on Leibenstein's X-(In) Efficiency

postulates, or in an analysis using a concept of minimum efficient scale (MES) of production. For more details on these and other approaches, give your attention to last version of decade-periodically published "industrial structure theory-Bible" in Scherer, F. M., D. Ross (1990), especially Chapter "Monopoly and Market Structure".

¹⁴ See Hurl (1988). However, some broad expression of privatisation is contained in representative by OECD too. (Blommestein, Marrese (1991)).

¹⁵ During 1991-1993 the decisions on direct sales of state ownership were in solely competence of government (and not in uncontrollable competence of the FNP SR). Sales by standard methods totalled over 24 billion SKK in 1991-1992 (compare this with only 4,5 billion SKK in 1993 and 16,5 billion SKK in 1994 (and that are given just during 1991-1992 the mostly participants of foreign investors in the Slovak privatisation till present days; namely followed "big deals" (data in columns refers to branch, country of investor's origin, net revenues in 1996 in billion SKK, and the ranking of particular company among biggest non-financial companies in the Slovakia in 1996): Volkswagen Ltd. (cars, GER, 18,2 billion, 6.), Chemlon, j.s.c. (chemicals, FRA, 4,3 billion, 23.), Whirlpool Slovakia, j.s.c. (washing machines, USA, 4,1 billion, 25.), Novácke chemické závody, j.s.c. (chemicals, CZE, 3,7 billion, 29.), Alcatel SEL TLH, j.s.c. (electronics, GER, 2,3 billion, 47.), Jacobs Suchard Figaro, j.s.c. (foods, SUI, 2,1 billion, 52.), Kablo Ltd. (electronics, GER, 1,6 billion, 69.), Henkel Slovakia Ltd. (chemicals, AUT, 1,5 billion, 75.), Hirocem, j.s.c. (cement, SUI, 1,4 billion, 79.), SCA Mólnlyncke Ltd. (chemicals, SWE, 1,3 billion, 82.), Nestlé Food Ltd. (foods, SUI, 1,1 billion, 102.). It is wholly true that this list of the biggest foreign direct investments (FDI) remains unchanged from beginning of 1993 to present days (the end of 1997).

¹⁶ The present Slovak government composed from and supported by the three above mentioned political parties obtained 83 seats in NC SR which gave them a working simple majority against 67 seats of the opposition political parties (the Party of the Democratic Left — PDL, the Hungarian Coalition - HC, the Christian Democratic Movement - CDM, and the Democratic Union - DU). In a marathon session of the newly elected parliament lasting 23 hours (November 3-4, 1994) the newly established coalition concentrated all legislative power as well as power over all institutions controlled by parliament in its own hands. The heads of High Control Office (HCO), the Fund of National Property (FNP SR) and the General Attorney were dismissed without substantial arguments and any chance to defend themselves. The purge proceeded further to the key office holders of the Slovak Radio, the Board of TV, the Slovak Intelligence Service (SIS), as well as key parliamentary committees. The opposition did not have any chance to have its representatives in these bodies and key posts. The allies of Slovak opposition political parties judged this state of affairs as the classic act of the "tyranny of majority" in the constitutional meaning of the word as well as the violation of the minority rights to perform a role of opposition. This political situation persists to present time, and will persist unchanged very probably till new parliamentary elections in autumn 1997. Its represents the main argument for the negative political image of Slovakia in abroad.

¹⁷ The Fund of National Property is an incorporated legal entity established in accordance with Act No. 253/1991 Coll. in the later wording. Its assets are not state-owned and can be used only for purposes defined in legislation. The property includes assets transferred to the FNP according to law, as well as profit generated by companies owned (whole or partially) by the FNP, net revenues generated by sale of investment vouchers and by sale of stock or other shares. The FNP's bodies include the Presidium (9 members), the Executive Board (11 members) and the Supervisory Board (7 members) their members are elected and recalled by NC SR according to proposals of government.

¹⁸ The Find of Slovak Constitutional Court about §10 and §45 in Act No. 92/1991 Co. Kosice at 21.11.1996.

¹⁹ Note that according to *Slovak Commercial Code* (Act No. 513/1991 Coll. in the later wording) an ownership of one-third and more of the total number of shares represents an important "blocking (veto)" minority rule for decisions on most important matters (e.g. lowering of equity, or abolition of company) in the case of joint-stock company (§ 154 - § 220 of the *Slovak Commercial Code*).

²⁰ However, frequent changes in law and privatisation strategies are serious problem not only for Slovakia. Anyway, note that at present more than 50 legal norms with Act-law power are relevant to Slovak legislation on privatisation and capital market. Only Act No. 92/ 1991 Coll. has actually 18 amendments today.

²¹ Act No. 403/1990 Coll. On Mitigating the Consequences of Some Property Injuries (Small Restitution Act) and Act No. 87/1991 Coll. On Extra Judicial Rehabilitation (Large-scale Restitution Act).

²² *Concept and Proposals for Further Progress of Large-Scale Privatisation*. Ministry for Administration and Privatisation of the National Property of Slovak Republic (MAPNA SR), August 1991, p. 4.

²³ Note here that the turnout of voters in the (first democratic) parliamentary elections in 1990 was 95.4 per cent; in 1992 it decreased to 84.2 per cent and in the premature elections in 1994 only 75.7 per cent of Slovak citizens exercised their voting right. In June 1992 two right wing-parties in the Slovakia - Civic Democratic Union (CDU) and Civic Democratic Party in the Slovakia (CDP-S) suffered one scathing defeat in parliamentary elections - together they had won no more than 5 per cent of votes, and were practically liquidated while they have not deputies in new Parliament (Slovak election law required at minimum 5 per cent-quorum of votes to be parliamentary political party. Within these two parties there was organised a predominant part of leaders of Slovak socio-economical transformation during 1991-1992 and administrators and supporters of voucher privatisation, too.

²⁴ It may be very fruitfull as well for the further research on mass privatization progress in CEECs to give more attention for simply but still famous Niskanen's idea that "contemporary economic and political systems use two type of currencies - money and votes". See Niskanen (1989).

²⁵ I estimate that without those "acquisition" practices and promises by IFs at the utmost 40 per cent of finally interested OICs would have registered in first wave of voucher privatisation in Slovakia. In this sense, IFs have play really one decisive activation role in this privatisation process

²⁶ J. Svejnar and M. Singer in their article (1994) mentioned that in first wave of Czech-Slovak voucher privatization the number of submitted privatization projects per enterprise averaged 3.8. Our data obtained from original MAPNA database show that in case of Slovak enterprises only 2 privatization projects (1 basic and 1 competing) per enterprise were submitted in average. However, one possible less attractiveness of Slovak enterprises in comparison to Czech could be play here one important role too, but my opinion is that this factor can not explain those differences as whole.

²⁷ Note here that no less than one half of these officials of MAPNA were just graduates of several Slovak high schools, predominantly from University of Economics in Bratislava. So, my frequent contacts are fully natural here.

²⁸ Of course, these numbers refer only about the point they were placed into IPFs in so called "pre-round" of voucher privatisation, not about all points placed in certain bidding rounds.

²⁹ This is only one further point supporting my working hypothesis about not sufficiently appropriating of voucher privatization as one method in important extent used by first wave of large-scale privatisation in Slovakia. The logic of this argumentation is as follow - the strongest concentrated structure of Slovak economy has in one output-degressive transition situation one important impact on both of these effect: first, on "classic" cash expectations of OICs from the IPFs promises and second on one offering of investment points by individual bidding for obtaining of shares in this some enterprises where is the OIC (or his family member) employed, or in one enterprise where managers promise a "trust-worthy" tactic for establishment one future management-employees owner coalition when the necessary portion of shares via vouchers would be won. Note further that from fundamental analysis point of view there was no reason for OICs in first waves of Slovak voucher privatization to orientate by incomplete data about single enterprises's or branche's financial position, when the profit rate varied in 1991 from 54 per cent decrease in electromechanical and textile industries to 62.2 per cent increase in refrigerating, mineral water and tobacco industries, and the adaption ability of most Slovak enterprises was limited and reduced to the strategy of survival.

³⁰ This "good informed reader" of German ordoliberalism is prof. M. Baranik (1994), today one deputy of Slovak Parliament (NC SR) delegated by MDS (Movement for one Democratic Slovakia — party of present prime minister Mr. Mečiar). Of course, Baranik is one from "fathers" of Slovak bond privatization, too.

³¹ All here in four points presented arguments against voucher privatization in Slovakia were pointed clearly in one interview of A. M. Huska - first minister for

privatization in Slovakia (1990-1991), economic expert of MDS and today deputy-chairman of NC SR in economic and business weekly *Trend*. See Hajko I. (1995).

³² Until September 30, 1994 (the first day of the premature parliamentary elections) about 850 000 people registered privatisation vouchers. Until October 7, 1994 the number grew to one million. It is undoubtedly interesting, that the political parties participating in the interim government of prime minister J. Moraveik got altogether 1 227 418 votes. If we exclude the PDL, the number is 927 912 votes. It is almost the same number who registered before parliamentary elections. However, it is not easy to draw a significant conclusion from these numbers. It is quite possible that voters who were on one side against "the sale of national property", on the other hand can have a really deep interest in voucher privatisation.

³³ Note here that no more than 38 thousands citizens have cancelled their registration for second wave of voucher privatisation. Of course, some 350-400 USD are money too.

³⁴ Such features of bond privatisation can observe at least in Latvia where the privatisation certificates from 1994 may be used also for housing purchases; and, partially in Russia's mass privatisation programme, too.

³⁵ The Institute for the Research of the Public Opinion in the Slovak Statistical Office undertook a research in the middle of February 1996 that implied that more than one third of citizens (36 per cent) do not know yet how they will handle the FNP-bonds. Only every fourth citizen questioned plans to wait until the year 2000 to pay out of them. Among the citizens dominating tendency was to pay on this security when buying a house for oneself. Immediately behind this trend follows the intention to sell the bonds to state determined legal or physical entities (14 per cent of questioned citizens).

³⁶ Slovak Constitutional Court struck down the original provision that, in effect, would have bound municipalities to sell apartments to buyers in exchange for bonds - of course, these transactions can still occur voluntarily.

³⁷ One half of the start-up capital required for participants for expenses incurred for the second wave of (cancelled) voucher privatisation.

³⁸ Results of One Omnibus Research Conducted by AISA Slovakia In Time Between September, 10 and September 26, 1994. 586 respondents. AISA Slovakia (Seffer, Stanova (1994)).

³⁹ Brigita Schmognerova, member of NC SR and deputy chairman for the Party of Democratic Left (PDL) said in an interview: "The FNP is not authorised to select such privatisers, who can pay off their debts against the FNP by using of FNP-bonds. Here the FNP is not acting according to law, but only according to the government's command, exceed the bounds of the law... The bond method was decided upon in order to satisfy the privatisation interests of a small group of people, which is to say that Mečiar's government came to those interested in direct sales to the detriment of the voucher privatisation". In: daily *Sme*, July, 23, 1996.

⁴⁰ Here is important to note that the low limit of the obligatory level of basic capital (shareholders' equity) in the case of IC was during 1992-1995 (before Act No. 191/1995 was approved as an amendment to ICFA) only 5 mln SKK. Regarding on this important change, the managers of many Slovak ICs expect that these restrictions will result in unsurpassed obstacles for most ICs, so they decided to stop their activities in collective investment.

⁴¹ This may be seems as one "unification" in restrictions of extent of "ownership" in case of individual IF. Until September 1995 the law (ICFA) restricted IF holdings in any individual company to no more than 20 per cent of the shares of that company and no more than 10 per cent of the portfolio of the IF. Actually the "10 per cent limit-law" is relevant both as for every individual IF and its portfolio as for every IC. According to law the IC must secure that property of every administered trust units-fund obtained not more than 10 per cent of the shares of any individual company (or another kind of issuer) and further that securities of one individual issuer exceed not more than 10 per cent of property of every administered fund.

⁴² Here described regulatory attempt that is contained in ICFA may be seem as superfluous with regard to fact that *Competition Act* No. 188/1994 Coll. ordered that eventually concentration in "relevant" market is always subject to control by the Authority (Slovak Antimonopoly Office - SAO) when: (a) the combined turnover of the participants of the concentration is at least 300 mln SKK and at least two of the participants of the concentration achieved turnover, each one at least 100 mln SKK for the previous accounting time period or; (b) the joint share of the participant exceeds 20 per cent of the total turnover in identical or interchangeable goods in the market of the Slovak Republic (Section 1 of § 9 in CA). In this respect if investment fund or investment company acquire control over an enterprise or other entrepreneur, the combined turnover of joint share within the meaning of Section 1 of § 9 in CA shall be a total of turnovers of entrepreneurs in which investment funds established by the investment company own more than 10 per cent of the share capital, or have right to exercise more than 10 per cent voting rights, or have the right to manage the enterprise. The obligation of IF or IC is to notify the concentration to the SAO within 15 days after conclusion of the agreement or acquisition of control by other means. During 30 days the SAO can decide that a concentration is in harmony with Competition Act and can be consummated, or can prohibit the concentration, or give a preliminary ruling on prolongation or suspension, if it is necessary to conduct detailed inquiry. Further, the concentration is not considered if the acquiring control is reached in the privatisation process during the transfer of state property to the FNP (first-step transfer of property from the state to the FNP) and in the process of liquidation of enterprise and the process of bankruptcy, too.

⁴³ According to ICFA and Slovak Commercial Code (Act No. 513/1991 Coll. in the later wording) the joint-stock company also the IC and IF, too, have two kinds of statutory bodies - Board of Directors and the Supervisory Board. The General Assembly of shareholders elects and recalls the Board of Directors and the Supervisory Board; alternatively, the statute of company may determine these relations more similar to the

German model when the General Assembly elects and recalls the Supervisory Board and Supervisory Board elects and recalls the Board of Directors but this is very rare practice in Slovakia. Further, the Board of Directors elects and recalls its Chairman as the company's top officials. Here must to given one attention that in the significantly majority of cases of companies analysed within our database of 135 enterprises the Slovak joint-stock companies usually have management consisting of the General Manager and between 3 and 6 other top managers responsible for individual areas; this management, and not the Board of Directors, usually control everyday life of companies. However, the General Manager and other top managers are appointed by the Board of Directors. Finally, the § 200 of Slovak Commercial Code determines that in a company with more than 50 employees one third of members of Supervisory Board is elected by employees. The statute of company can determine also higher number of Supervisory Board members elected by employees but this number can not be higher than the number of members elected by General Assembly of shareholders. One possibility that employees can elect the members of Supervisory Board also in the case of lower number of the employees than 50 is given facultative by law, too, when it is contained in the statute of such company.

⁴⁴ Of course, it is not the simply problem of "saints" (IFs and ICs) and "sinners" (Ministry of Finance and several other "fund's enemies"). Here can to present one another example at least. According to *Report of General Assembly of VUB Kupon IF* (July 5, 1995), this largest Slovak IFs from first wave of voucher privatisation (VUB Kupon obtained nearly 20 per cent of all investment points that were distributed in Slovakia) paid out dividends to its about 320 000 small shareholders (originally OICs in voucher privatisation) in total amount of 265 mln SKK (23 SKK per share). The market value of VUB Kupon portfolio presented at the same time about 14,6 bln SKK. Interestingly that the trustee bonus from VUB Kupon IF to VUB Invest IC reached more than 274 mln SKK for year 1994, so by 10 mln SKK more than amount of dividends for VUB Kupon IF-shareholders. So the dividend per IF-share was forty times smaller than the dividend per IC-share. Here can not surprise that many from VUB Kupon IF-shareholders at this General Assembly have objected against one such dividend policy of VUB Kupon IF. They have argued that VUB Kupon IC as an administrator of VUB Kupon IF lives off on account of small IF-shareholders these have acquired their shares in exchange to investment points in voucher privatisation. Of course, the evaluation of small shareholders as "one herd of stupid and retarding cows" - it is one frequently statements of IC's representatives which is used behind the scenes not only by General Assembly of this biggest Slovak IF. It is really very appropriate description in the light of here presented relations and facts. Data drafted from: *Results of VUB Kupon IF's General Assembly at July, 5, 1995*. The amendment to prospect of shares issuer, RM-System Slovakia, 1995.

⁴⁵ With respect to this legal regulation many Slovak banks (the founders of ICs for the purposes of first wave of voucher privatisation) have lowered their ownership of IC's equity shares below the 10 per cent during 1995-1996.

⁴⁶ For example, the World Bank-mission which visited Slovakia from December 2, 1996 to December 12, 1996 pointed in its Memorandum that: "... funds were not allowed to own more than 10 per cent of the shares of any company and thus were forced into the status of a minority shareholders. In order to protect the value of their investments in these companies, the funds wanted to become strong majority shareholders in a few companies rather than weak minority shareholders in many companies". For more details see *Slovakia — Country Economic Memorandum Mission*. Aide-Memoire of World Bank, December 1996, pp. 11-14.

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