
Mass Privatization Funds – the New Institutional Investors in the East? A Comparative Study of CEE Mass Privatization Schemes*

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1. Introduction: The Process and the Problem

Most authors and policy makers agree on the necessity to carry out large-scale privatization as a main mechanism for private sector development in the countries of Central and Eastern Europe. The implementation of the privatization policy, however, requires making choices with huge economic, political and social implications, such as: how to privatize - by sale or by free distribution; who should be the new owners - the incumbent managers and employees, the general population, or business entities, what should the balance between foreign and domestic buyers be, etc. Each of these alternatives has its relative advantages or disadvantages both from the point of view of general economic theory and of the economic and political reality in individual countries.

Privatization by sale to outside investors has been often hailed as the most attractive policy option. Indeed, it has been the standard method of privatization in the West. Firstly, it results in the most efficient allocation of ownership rights because the new people in control will be those willing to bid the most and will have the highest motivation to exercise their rights (Bolton and Roland, 1992). Thus, the sale of large blocks of shares to selected buyers will provide for the best corporate governance arrangements. Secondly, sales methods bring highest government revenue.

In the context of CEE, however, sales methods reveal substantial problems. The latter are connected with the evaluation of assets in the conditions of underdeveloped capital markets and poor accounting records; with the lack of experience of the institutions involved, and with the time-consuming nature of the procedure. Most important, in all CEECs the value of the objects for sale grossly exceeds the domestic buying potential: the levels of domestic capital, accumulated either through savings or private business activities, are insufficient. In

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addition, in all countries apart from Hungary, the foreign investment inflows are very low. Lastly, popular demands for a share in the industrial property inherited from communism as well as the existence of "vested" property interests on the part of incumbent insiders, raise issues of social justice which prevail in political decision-making over those of economic efficiency.

In view of the disadvantages of standard privatization methods and of the obstacles to their successful application, the novel mechanism of privatization through distribution of assets to the wide population has been proposed (Lewandowski and Szomburg, 1989). Share distribution avoids some of the problems of the lack of pre-privatization capital markets, of proper evaluation, of finding buyers, of time, and of popular legitimacy. As Nuti (1994, p.6). puts it, "mass privatization has been seen as method for implementing instant, irreversible, politically self-supporting, large-scale capitalism"

Indeed, Mass Privatization Schemes (MPS) seem more appropriate to effect a swift and less costly change in ownership titles where the speed of the reform is crucial, as well as where there is a large number of entities for divestment and a small number of buyers. For implementation of those schemes all the countries created a specific kind of institutions – financial intermediaries, often called Privatization Funds (PFs). Although, those very institutions raise a lot of associated problems and its solution comprise the real challenge not only for the success of the mass but the whole privatization programs in the CEE. The PFs' regulation and economic behavior, their present and future development, shortly their economic nature will impose strong influence on the type and character of the market systems, which are created in the CEE countries.

At the early stages of setting out the programs for mass privatization the question seemed to be what kind of institutions are needed. The well-known reluctance of the financial intermediaries to undertake controlling actions in the companies from their portfolio raised questions as that - are PFs going to be involved in the corporate governance? And how should they be motivated for that purpose? Frydman *et al.* (1993) discussed this problem extensively arguing that the new financial intermediaries in the East Europe might be "locked" in the privatized companies by various restrictions on their portfolios. While this concerns have been reflected in designing the privatization schemes as showed bellow, the other suggestions for further securing the active behavior of the newcomers through their future development as universal banking institutions have not received future elaboration.

Instead, some MPS adopted rather opposing possibilities for the future development of those institutions, Bulgarian for instance, allowing them to register as a normal holding companies ruled by the Commercial code. Inspirations for such a development might be found in the suggestions revealed by Blanchard *et al.* (1991) and elsewhere, but no matter, how it is motivated, such mixing of different approaches reasoned by different perceptions on the whole system of privatizing institutions is a source for a lot of concern on the eventual outcome of the process.

If looked more carefully the actual MPS and the privatization funds itself this concern seems even more justified. Large stockholders with extremely dispersed own shareholdings, controlled by various groups of interest, which do not have secured their property rights within the funds; that seems another dimension of the uncertainty associated with the actual PFs' behavior.

This way we believe, that at the current stage of the development of the PFs, the big question is - what kind of institutions we actually have? The task does not seem simple if one tries to differentiate the PFs from all feasible economic agents. This paper tries to challenge just one relation, perhaps the most spread belief, that PFs are type of institutional investors, or mutual funds. Although not giving direct answers, that approach provides some space for speculating on the most important issue concerning the institutions in question, their relevance to the changing corporate governance system in the transforming economies.

Believing that the PFs differentiation could be completed only within the maximum large framework on the whole Mass Privatization Programs we review them extensively in section 2. Bulgarian, Czech, Polish and Romanian schemes are the observed examples. The third section is devoted to the privatization intermediaries themselves and the fourth to their investment strategies. The fifth relates them to the institutional investors in the developed market economies and the sixth concludes.

2. The Schemes

2.1. MPS Within the Context of Overall Privatization

The mass privatization schemes were introduced in the privatization programs in order to tackle the problems of lack of domestic capital, of valuation of assets and underdeveloped capital markets, and of speed. There was also a strong social justification - granting the wide population a share in the industrial property inherited from communism. Each of the countries under consideration, however, placed a different emphasis on the transformation of state ownership through free distribution of vouchers in terms of scope and timing of this privatization method. A variety of reasons such as different socio-political legacy and national consensus for carrying out industrial reform have been identified in the country reports. It is also important to consider the link between the privatization programs and other measures specifically designed for restructuring of enterprises allocated to mass privatization. Where some restructuring was carried out before the transformation of state ownership, mass privatization has some specific characteristics reflected in the institutions of the scheme.

In the Czech republic, voucher privatization was envisaged as one of the methods for large-scale privatization of state-owned enterprises in a coherent programme of 1991. The design implied that any restructuring measures, apart from the commercialization of enterprises, will be left to the new owners. It was the specially created Ministry for Privatization (MP) that had the ultimate choice on the enterprises and the amount of their shares to be included in the voucher programme. Certain decentralized elements existed in defining the scope of the method and its combination with other methods in that the MP decided on the basis of privatization plans submitted by the firm's management, after the approval of the branch minister, as well as by any other interested party such as potential buyers, etc. The Czech contribution states that the several plans were prepared per enterprise, and that managerial plans often took precedence. On the whole, the public authorities in charge had a sufficient idea about the amount of assets they would like to distribute through vouchers. As a result, at about 41% of the firms in the first wave of the large privatization, or 7.5% of the capital assets in the country, had allocated to the voucher programme on average 61.4% of their capital. Nearly 23.3% of the industrial capital was retained at that point by the state Fund of National Property. Unlike the situation in other CEEC, banks were included in the scheme

too, which led to some specific developments as it will be pointed out further below. During the second wave another 861 companies became subject to mass privatization, which established the scheme as a main mechanism for large scale privatization in the Czech Republic.

The Polish large scale privatization demonstrates substantial differences from the Czech one. The debates on the mass privatization started in 1991 as well. The necessary legal basis, however, was passed by the Sejm only in April 1993. The mass privatization programme was adopted as an alternative method to that of privatization through sales, employee and management buy-outs, and liquidations. It was largely called as a reaction to the slowness and some of the problems that the other methods present. Its introduction, however, was delayed because of the opposition of the workers' councils to various sensitive issues, such as the participation of foreigners and others. Also unlike the Czech case, some restructuring was intended to be carried out before the privatization. In such a way any further recombination of the former state property on the free market could be carried out at prices approximate to its real value, notes the Polish contributor. The selection of enterprises to be covered by the programme was completed only in September 1995. These were commercialized enterprises wholly owned by the Ministry for Ownership Transformation (the MOT). Unlike the Czech case, the proposals were made by the Ministry, but the ultimate choice for participation in the programme was left to the enterprises. The MOT invited large companies in a healthy financial position. The firms' management and the employee councils, however, could withdraw within 45 days forwarding a reasoned objection. Also, 25% of the shares of the enterprises in the scheme were to be retained by the state, and 15% were to be distributed to the employees. Eventually, at about 10% of the total state property was included for mass privatization.

Similarly to the above countries, Romania started early preparations for carrying out mass privatization. In 1991, a special Law was passed which set up a scheme combining free distribution methods and sales methods. Certain preferential rights for employees were provided too. At about 6280 enterprises were commercialized and their shares were designated for divestment through both methods in proportion 70% for sales or detainment by the state and 30% for mass privatization. The institutions entrusted with the ownership of the enterprises were, like in Poland, supposed to carry out some restructuring. However, a certain slowness and dissatisfaction with the scheme were felt among the population. It was only in 1995 that the legislative basis was completed, some of the perceived problems remedied, and new consensus sought for acceleration of the privatization process.

Mass privatization in Bulgaria, like in Poland was applied as a second stage of the privatization policy. The scheme was firstly introduced in the middle of 1994 but it was actually put in motion only in the beginning of 1996. Thus, Bulgaria was the latest to embark on the distribution scheme. Its adoption was largely due to the recognition of the extreme slowness of the sales privatization model in the context of increasing deterioration of the macro- and micro- financial situation of the country, and a number of governmental obligations undertaken in front of the international financial authorities. As the Bulgarian report shows, there was no comprehensive overall privatization strategy adopted, but the mass privatization scheme was rather gradually accommodated within the existing networks of interests of the powerful economic groups, who used their political lobbies. The number of enterprises to be included in the programme, the proportion of shares to be distributed

and to be retained by the state, as well as the parallel application of other privatization methods was decided on an entirely centralized basis by the Council of Ministers. The latter took consideration of a number of criteria, such as strategic position of the enterprise, prospects for "cash" privatization, etc., mostly made in the context of political bargaining behind closed doors. As a result, after numerous corrections to the list, 1050 enterprises with a total capital of 201.85 billion Bulgarian leva (BGL) were included with an average of 42.7% of their capital to be privatized in the first mass privatization round.

2.2. Forms of Participation in the Mass Privatization Scheme

An essential element in the design of all mass privatization schemes is the distribution of entitlements to the industrial property included in them to the wide portion of the population. This is exactly the mechanism with which the problems of lack of domestic savings, of solvent domestic core investors and of sufficient and publicly acceptable foreign interest are to be avoided. For that purpose a certain type of security is offered against a token value, which materializes a bundle of rights belonging to its bearer. The contents of this bundle of rights as well as the times and forms of their satisfaction, however, vary from a country to country.

In the Czech Republic vouchers were distributed, which had a nominal value determined in advance at 1000 voucher points. The vouchers entitled their bearers to two main rights: to direct use of the vouchers at auctions in order to acquire enterprise shares, and to indirect use, i.e. investing them in the capital of privatization intermediaries specially created to acquire and manage enterprise shares on portfolio principles. The choice between the two forms of participation is completely decentralized and depends on the will of the individual participants as well as on the marketing abilities of the intermediaries. In practice, the indirect participation was the preferred way: at about 72% of all voucher points were placed with the Investment Privatization Funds (the IPFs). During the second wave there is a reduction in this trend, only 64% of the voucher points were attracted by IPFs, by the indirect participation still remains significant. The Slovak experience shows similar results; according to the Slovak report about 74% of the points were used indirectly.

Bulgaria opted for a similar scheme, distributing investment vouchers with a nominal value of 1 investment BGL, equal to 1 BGL of the offered stock. The vouchers could be used in a direct or in an indirect way too. The latter was predominant, and the Privatization Funds (the PFs) accounted for four times more vouchers than those in individual participants.

Poland and Romania, however, went for quite a different approach. In Poland participation certificates (PCs) were distributed to the population. They, however, do not possess a nominal value and do not entitle their bearers to any form of direct ownership of the enterprises included in the scheme. The ownership of the enterprises was allocated between a number of state created National Investment Funds (NIFs), which represented the first stage of the mass privatization programme. The PCs were received only after November 1995. Their bearers could, firstly, exchange them for an equal number of shares in each of the NIFs after the admission of their shares to trading by the stock-exchange, i.e. 1 PC for 1 share of each of the 15 NIFs, by the intermediary of brokerage houses in the National Depository of Securities. After that, the share certificate holders will become bearers to all the rights vested in the share holders of joint-stock companies. The PCs also materialized the right to obtain dividends, liquidation proceeds and interest corresponding to the shares

of funds. As the Polish report underlines, at the time, the holders of share certificates do not possess any corporation rights in relation to the funds, which are owned by the State Treasury. In addition, the rights in question are of a temporary character and if not exchanged for funds' shares within a given period, they will expire. Secondly, the share certificate holder could freely sell for cash it before carrying out the above mentioned exchange at a price settled by the market. In such way, a concentration of the ownership of funds becomes possible.

The Romanian approach resembled the Polish one but also evolved with time to include more market elements. Ownership certificates (OCs) were distributed to the population by the end of 1992. The OCs had no nominal value, but represented 5 units of stock for each of the Private Ownership Funds (POFs) created to hold the 30% of enterprise shares designated for mass privatization. Thus, direct participation of citizens in mass privatization, in the way it was possible in Bulgaria and the Czech Republic, was excluded. Each citizen immediately became a stakeholder in the five POFs. Because of the character of Romanian privatization combining several methods, the OCs are much more multipurpose than the privatization securities in other countries. The OCs could be sold through the stock exchange or directly to another party. They could be exchanged at a market price for the shares of a certain commercial company. The Law, however, limits this right to exchanging only the OCs in a POF for the shares of enterprises in its 30% portfolio. The OC also entitle their bearers to 10% discount if they decide to use them for purchase of shares of companies offered to the public by the State Owned Fund. If the OCs holder decides to keep them, naturally, they will entitle him to receive dividends from the POFs and to exercise certain shareholders' rights with regard to them.

The most emphasized right of the POFs' shareholders was the opportunity to receive dividends. Since, this was not the case for three years many people exchanged them for cash and a concentration of OC in private hands appeared. At the same time the OC were not exchanged for company's stock by POFs for a long time.

Those peculiarities of the process were considered unsatisfying and with the 1995 Law, the scheme was changed essentially. They were issued privatization vouchers with the nominal value (975 000 Lei for 1 voucher), called accordingly Nominal Coupons (NC), added to the old '*unnominal*' OCs. The latter were also given a nominal value to the new scheme a specific value was given to a stock of OCs based on their transaction value at the unorganized market (25 000 lei each). This time, the nominal vouchers based on their transaction value at the unorganized market (25 000 lei each). This time, the nominal vouchers entitled their bearer to use them under certain conditions in exchange of shares of a large number of commercial companies. At the same time, a list of about 4000 companies was launched, which allowed a direct conversion of certificates for shares, resembling much the process in Czech Republic and Bulgaria.

3. The Privatization Intermediaries

As mentioned, all the schemes are based on the special kind of privatization intermediaries. Although, there essential differences in their concepts among the countries, in the regulation of the formation, longevity, organization and functioning of these institutions. Those differences are an outstanding proof for the specific problems encountered by their

designers. They witness as for the extent the government bodies in the different countries recognize the problem of the eventual behavior of privatization intermediaries as well as their abilities to manage that behavior. In final account those very differences will determine the eventual success or failure of the proposed mass privatization schemes.

3.1.1. Formation

Certain prognoses have been made in the literature that central organization of funds is more likely to contribute to their political dependency and bureaucratization. On the contrary, where PIs are formed by free entrants on a competitive basis, there is more scope for entrepreneurship rather than for subsidization (Frydman *at al.* (1993)). Indeed, one of the most striking differences in the regulation of privatization intermediaries refers to the system of their formation, and mainly, to the extent and the forms of the participation of the state in the process, as well as the extent of private initiative allowed.

In Poland and Romania, the state created the funds, and provided for all the elements of the organizational and patrimonial structure needed for their existence. Thus, in Poland, the NIFs were founded as one- man joint-stock companies by the Ministry for Ownership Transformation. During the first stage of the programme, it was to be their sole shareholder. As the country report clarifies, the State Treasury deposits the initial capital of the NIFs in the form of the non-monetary contribution - the commercialized companies wholly owned by it. The deposit was based on a special procedure for the calculation of the values of the enterprise shares. During the second stage of the programme, the NIFs are to be privatized and to function as a joint-stock company with shares listed on the stock exchange.

In Romania, the state established two types of funds: a State Owned Fund (SOF) and five Privately Owned Funds (POFs). The POFs were organized as joint-stock companies. A time period of five years was envisaged for their existence, after which they were to be transformed into mutual funds. The government, under the approval of the Parliament unlike the Polish case, is responsible for the formation of the portfolio and the organs of the state as well as the private funds.

Therefore, in these countries the principle of formation of PIs provides for a closer and more permanent link with the Executive, under the control of Parliament in Romania. It also allows the creation of institutions with relatively equal sizes, organizational and patrimonial conditions, as well as founding interests during the first stages of their existence.

It has to be noted that major changes were introduced in the regulation of the Romanian POFs with a special Law #133/1 of November 1996. The latter provides for the transformation of the POFs in financial investment societies(FIS) which will present the features of a standard public company limited by shares.

In the Czech Republic and Bulgaria, the participation of the state in the formation of privatization intermediaries was largely limited. Private agents, founders, were left the initiative to freely establish special joint-stock companies after obtaining a license from a designated governmental agency upon the satisfaction of a certain number of legislative requirements. Thus, in both countries the state retained a controlling role in the process. Nonetheless, a certain difference between the two states can be observed.

In the Czech Republic, it was the Ministry of Finance that performed that role. In Bulgaria, the state agency created in order to supervise the issue and trade with securities, and the formation and functioning of investment companies and investment intermediaries, the Commission of Securities and Stock Exchange (the CSSE), was the organ to license the privatization funds. The members of the CSSE are appointed by the Council of Ministers acting on the proposal of the Minister of Finance. This provided for a more coherent link between the regime and the requirements for founding an investment company and a privatization fund. The private persons entitled to set up IPFs were to be legal persons. In the Czech Republic and Bulgaria the parties entitled to set up an IPF had to be legal as well as physical persons. In Bulgaria, however, the legal persons who are eligible to form a PF must be with less than 50% state participation in them, with the exception of banking and insurance institutions. Foreign financial institutions satisfying certain conditions can also set up funds. The minimum legislative requirements for licensing in both countries bear certain similarities. a certain similarity. The Czech founders had to submit to the Ministry investment plan, managerial contract with the IPF, proof of the minimum capital subscribed and paid in by them, and a contract with a depository banking institution. In Bulgaria, they had to prepare an issuance prospectus, outlining the investment strategy of the PF, to be approved by the Commission. They also had to show a proof of the investment of the initial founders' capital, in cash or state securities, sufficient information on the founders' identity, and a contract with a depository bank. There is a specific legislative requirement in the Bulgarian case about the structure of the minimum capital, no less than 70% of it, has to be raised through attracting the investment vouchers of the population.

The Czech Ministry of Finance, according to the observers, adopted a largely laissez-faire attitude to granting the licenses. The procedure amounted to a simple registration. In fact, no requirements to the professional qualifications of founders, for example, have been enforced as a practical matter, and no application satisfying the basic requirements was rejected. The Ministry acted mostly on a *post factum* basis trying to regulate the behavior of funds during the advertising campaign, such as requiring the disclosure of financial promises and costs made for attraction of vouchers in order to monitor the maintenance of a sufficient degree of liquidity. Despite of some threats, however, no licenses have been revoked. (Coffee, 1996)

The Bulgarian CSSE granted licenses for acting as a privatization fund only after the founding general meeting of all shareholders, established the amount of capital subscribed, elected the managerial bodies, and decided on the formation of the PF. It played a substantial role in regulating the behavior of PFs during the advertising campaign, using its right to impose fines on almost all funds. It is a popular opinion that the CSSE exercised a stricter control on the PFs at all stages of their formation than the Czech Ministry of Finance, and that the licensing procedure was complicated and a cumbersome one.

Court registration was also mandatory in both countries for completion of the founding procedure of the privatization funds. A specific provision in the Bulgarian legislation allows the funds to transform themselves into investment companies or holding companies 6 months after the last auction.

It is possible to see that such a decentralized form of formation of funds is to be responsible for characteristics very different from those of the Polish and Romanian PIs. The new intermediaries will have differing sizes and more dispersed ownership structure at least in

the initial period, which will have implications for their internal governance and control. There will be also differing leading private interests behind them. In Bulgaria 81 funds were formed ranging from PFs with a nearly the minimum required capital to "giants" accumulating a very large amount of investment vouchers. In fact, the 11 largest PFs have in total nearly 25% more capital than the total capital of the remaining 70 PFs. In the Czech Republic the proliferation of PFs was even greater: 429 IPFs during the first wave and 349 IPFs during the second one. During the first wave, the disproportionate concentration of vouchers in the largest funds was the case in the Czech Republic like the situation in Bulgaria. The second wave, however, demonstrates a significant mitigation of that trend.

It becomes very clear from the Bulgarian contribution that the varieties between funds in terms of investment strategy and ownership behavior are likely to follow the varieties of dominant founders' interests. It is possible to distinguish six differing groups of funds according to their dominant founders. Among them there are state controlled financial institutions and private financial institutions, as it was in the Czech case. There were, however, also private industry-based companies as well as private financial-economic groups with more or less complex economic activities. Most specifically, there are number of PFs dominated by "insiders", i.e. legal entities dominated by managers of companies under privatization or by public officials closely connected with them.

In the context of the Czech Republic a similar issue has been raised too. Two main types of funds were identified: those founded by investment companies, wholly owned by the country's largest banks, and "independent" private ones. Such founders clearly have a totally different incentive structure, and thus are likely to impose different behavior to the IPFs they manage. Thus, the first group of funds could be influenced by the specific interests of the financial institutions they are affiliated to, and might seek to maximize the bank-lending opportunities for their parents instead of the profits for all shareholders. Further on, there are objective conditions for wider heterogeneity, and sometimes real conflicts, of interests between the shareholders of a single intermediary, because of the difference in the types of the stakes invested, the risks born, and the position during the promotion and the advertising campaign. The great disparities within a fund call for the adoption of special rules for protection of minority shareholders if the "mass" character of the scheme is to be preserved.

3.1.2. Explicit Corporate Governance Provisions

The mass privatization programs in the CEECs also differ with respect to extent to which they envisage in advance a particular corporate governance structure of the enterprises included in them. In the way the privatization intermediaries in all countries have been created may be find some provisions designed with the specific purpose of affecting the ownership structures in the country.

One of the examples is Poland where the Law determines ex ante the distribution of control rights of the enterprises. Therefore, the Polish legislators place a stronger emphasis on the value of the "lead" fund in the newly privatized companies. The NIFs can not also acquire more than 33% of the shares of any company, with certain exceptions. There are certain restrictions, to the amounts that the NIFs can sell for a period of three years, on the grounds of maintaining a certain standard of corporate governance of the companies. Thus, where a fund owns more than 20% of the share capital of the company and is at the same time its

largest shareholder, it can not sell if its holding would fall under 20% unless it introduces the company to the market or finds another strategic investor for the company.

The Romanian scheme in its initial phase also provided for a strict distribution of control rights. That distribution, as it was indicated earlier on, was in the proportion of 70% held by the SOF, and 30% - by the 5 POFs. Later, it allowed privatization through voucher conversion up to 60% for not strategic companies and up to 49% for the strategic ones. There is procedure for setting up the packages between the SOF and POFs but it is not clear how the new regulation will match the previous one.

The Czech and the Bulgarian schemes differ from the above approach. The funds acquire packages on the competitive base and distribute between themselves the control rights according to the acquired stakes. Both countries have the maximum level for a single shareholding. These are 20 and 34% of the capital of any single company respectively for the Czech and Bulgarian PIs. Such a rule clearly aims at avoiding excessive concentration and domination of a single fund over the enterprises. The Bulgarian scheme avoids the above problem by raising the threshold to 34% of the capital of the companies included in it.

Bulgarian MPS has another important provision: PIs are free to decide how to develop further and they may register as a holding company or as an investment intermediary, both ruled by the relevant general legal frameworks.

3.1.3. Regulation on Investment Activity

Various aspects of the specific regulation of PIs which influence their role as corporate governance actors have been raised in the debates. Firstly, concerning the degree of diversification and concentration of funds' portfolios allowed. On the one hand, diversification is necessary for the financial stability of the financial intermediary. On the other hand, excessive liquidity and diversification will represent a disincentive for corporate activism. Secondly, the functions that the PIs are allowed to perform with regard to their portfolio companies will also influence their incentives. Thus, Frydman *at al.* (1993) argue that allowing the PIs to hold equity as well as debt claims and to perform other financial services will increase their monitoring leverage. Other scholars, however, object to the development of PIs in the direction of the German universal banking institutions pointing at the conflict of interest such a system leads to and to the danger of creating too powerful institutions.

In Poland, as it was underlined in the beginning, carrying out restructuring of the enterprises was embedded in the programme. Therefore, the main task of the NIFs before their privatization was to manage the shares of enterprises in their portfolio in a way to enhance their value "in particular for the purpose of improving the management of the companies in which the Fund has a substantial shareholding, including the strengthening of their position in the market and obtaining new technologies and loans for the companies" (Art. 4 the Law of NIFs of April 30, 1993). Secondly, the NIFs can purchase and sell the shares of their portfolio companies.

The third right of the fund sharply distinguishes it from the comparable institutions in the other CEECs. The NIFs can obtain as well as grant loans for the accomplishment of the above tasks. The maximum amount which the NIF can borrow, or raise through issuance of

debt securities, is limited to 50% of the net value of the Fund. The NIFs can also trade with state securities and securities issued by other companies. There are, however, certain restrictions imposed on their investment activities imposed by the Law for reasons of reducing the levels of risk, preventing excessive dispersion of shares, and protecting the interests of the Polish state and shareholders. Thus, the NIFs can not participate in general partnerships or other entities as unlimited liability partners, they can not sell securities that they do not own at the time of making the agreement, etc. They can possess shares of other companies as long as they are issued by entities having their seats in Poland or primarily engaged in business there, and state securities. At any case, the fund can not hold more than 25% of its net asset value in securities of one issuer. If the issuer is another fund, then, the restriction is greater: the maximum amount should not represent more than 5% of the net asset value of the fund. The NIFs can also invest up to 5% of their assets in immovable property.

The Bulgarian PFs have also the primary task of acquisition and management of shares of enterprises included in the mass privatization programme. There are restrictions to the ability of the PFs to sell these shares within a period of 6 months after the end of the final auction round.

The PFs can invest in shares of other issuers too. No restrictions with regard to the nationality exist, as it is in the Polish case. The Law, however, requires that the securities issued are traded on the stock exchange. Such an investment can represent much smaller part of the PFs' capital compared to the Polish funds - only 10 %, which also should not be more than 10% of the capital of one issuer. State securities represent an exception and can account for 25% of the fund's capital. There is no specific limit to the part of the assets that can be invested in real property. The only qualification in the Law is that it has to correspond to the needs of the PF.

The borrowing ability of the PFs are more limited than these of their Polish counterparts. The PFs can borrow with a specific purpose - purchase of long-term assets, or short-term loans. That is possible only with the permission of the CSSE, and should not represent more than 10%, or 15% in both cases, of the net capital of the fund. The PF can not give loans, issue bonds. The PFs can not act as an investment intermediary, engage in brokerage, as well as carry out some other activities potentially increasing the amounts of risk.

The Czech funds have a more scarce and liberal regulation with regard to their investment activities. The only provision refers to prohibition of the IPFs to invest more than 10% of their capital in any one security, which must not be more than 20% of the capital of one single issuer. Like the Bulgarian PFs, they can not give loans or issue bonds. An issue of a specific importance in the Czech case represents the requirement that Funds established by a bank or an insurance bank are not allowed to purchase the shares of that bank. The rule clearly aims at prohibition of cross-ownership in a process where enterprises as well as banks are offered for sale. As it will be seen further down, however, this provision has been interpreted in practice in the narrowest possible sense.

Thus, it can be seen that it is the Czech regulators to have chosen to create well-diversified financial intermediaries by requiring them to have at least 10 companies in their portfolios. On the other hand, the creation of such a diffuse portfolio creates many practical obstacles as it will be discussed below.

3.1.4. Internal Governance

The internal governance of the privatization intermediaries and their managerial systems are largely determined by their legal type and the mechanisms for their formation. Several issues will be identified here, namely the rules and criteria for selection of fund managers, the principles of formation of the compensation package, and the types of control and supervision over the activities of the managerial organs. Additional issues, relevant in a specific ways both in the cases of centralized and decentralized formation, can be raised regarding the interests represented by the managing bodies of the PIs.

Management bodies

The Polish scheme pays a particular attention to the quality of the management of the assets of the NIFs. Following closely the provisions of the Polish Commercial Code on joint-stock companies, the privatization intermediaries are to have a two-tier managerial structure. Until the exchange of privatization certificates for shares of the NIFs, the Ministry of State Treasury as a representative of the sole owner of the capital, will perform the functions of the general meeting of shareholders. In view of the potential for political interference, however, the Law envisages that all but the exclusive powers of the general meeting of will be carried out by the Supervisory Board. There are also special rules designed to ensure a more passive role of the state until its participation is reduced to 75%.

The Ministry of State Treasury with the consent of the President of the Council of Ministers appoints for a period of maximum three years the Supervisory Board of the NIFs. Its right of selection is, however, limited in advance in terms of its choice of nominees. According to the scheme, a special Selection Commission, which will function until the privatization of the NIFs, is created to select the candidates. It consists of representatives of the Prime Minister, the Sejm, and the Trade. The Commission is guided by preliminary defined, strict criteria in the selection of the members of the boards, such as: minimum age (30 years), high education in specific subjects, and professional experience in the country of at least 4 years. 60% of the places in the Supervisory Board are to be reserved for Polish citizens. Another provision states that members of parliament can not take part in the managing organs of the funds as well as in the organs of the portfolio companies if the participation of the fund in it is more than 20%.

As it was pointed out above, the Supervisory Board has wider powers. It controls the activities of the fund and adopts its investment strategy. It has the exclusive competence to approve any transactions at a value higher than 15% of the value of the net assets of the Fund. The Supervisory Board has also the power to appoint the members of the Management Board and hold them accountable. It is entrusted with selecting the outside management of the NIF - the management firm.

The management firms as part of the institutions of the mass privatization scheme in Poland are one of its most interesting aspects. These firms were consortia consisting of Polish commercial banks, and foreign investment banks, consultancies, etc. As such they were expected to bring Western know-how, experience, market contacts. The firms were shortlisted by the Selection Commission by way of tender. After that they had to enter into negotiations with the Supervisory Boards of the NIFs. The Supervisory Board selected the managerial firm and concluded managerial contracts with them on behalf of the fund, which

had to be approved by the Minister. Special tripartite contracts were also concluded between the MOT, the fund and the managerial firm determining the relations between them, as well as on compensation for financial results. The firms, beside the statutory managerial bodies of the NIFs, were entrusted with the management of the assets of the funds. They were also expected to advise the Supervisory Board on the goals and the investment policy of the NIF, as well as to assist the short- and medium-term management of the companies of the "lead" part of the NIFs' portfolio.

As the Polish contribution shows, the managerial firms could in law be granted the power of commercial representation. In practice, the principle of the personal union was applied whereby the members of the managerial firms were elected as members of the Managerial Board of the fund. Therefore, there are two types of overlapping relationships created: a contractual one between the NIF and the firm as a legal person, and a statutory one between the NIF and the physical person representing the firm in the Managerial Board.

The Romanian privatization intermediaries are characterized by one-tier system of management. The selection and appointment of the members of the Supervisory Board of POF is by the government with the approval of the parliament of the country. The Supervisory Board has a president, who is a general manager of the POF. With the amendments introduced in 1996, the situation, however, changes significantly. The POFs are obliged to issue shareholders' certificates to all OC bearers. The new shareholders, then, will be able to assemble and choose the managing organs of the FIS along the principles of the general joint stock companies regulation.

As indicated earlier on, in the Czech Republic, it is the founders who become managers of the IPFs. According to the requirements of the licensing Ministry, however, they have to meet several criteria, namely, to possess appropriate professional qualification and reputation for civic integrity. They also can not occupy at the same time a position as civil officers. Two-tier board system is adopted for the Czech funds as well. The biggest funds were established and managed by the investment companies, specially created and 100% owned by the largest Czech banks. Another characteristic feature specific for the Czech scheme, is the possibility during the second privatization wave to establish or transform IPFs into unit trusts. In fact, out of the 353 IPFs, only 195 remained as joint stock companies. In such a way, voting rights and other internal governance issues were avoided by the founders. They argued that the unit trust form saves on the huge organizational costs of a widely held fund, and provides for a greater efficiency in the management of portfolios. (Coffee, 1996).

The Bulgarian Commercial Code allows a choice between two- and one- tier managerial systems for the privatization funds. The actual system adopted as well as the membership of the organs was practically determined by the founders of the PFs. The legal requirements for the founders were suitable professional qualification, which was left to the CSSE to interpret, and permanent residence in the country. The Bulgarian contribution notes that in the majority of cases, the members suggested by the dominant founders were elected by the general meeting of shareholders without any serious obstructions. It is also possible for the PFs to conclude a managerial contract with an investment intermediary. The organization and the functioning of such an investment intermediary is regulated by the Law on Securities and Stock Exchange. However, engaging as an outside manager of a PF necessitates the satisfaction of several requirements on the capital structure of the

intermediary in order to diminish the risks for the principal. The Law also provides for some essential elements of the managerial contract, such as economic targets and guarantees for their achievement.

Managerial compensation

It is also important to compare the systems of compensation of the managerial organs, which represent a main element of their incentive structure. The lack of sufficient adequate information about the initial value of assets, or of the multiplicity of objectives that the funds will carry out, represent real difficulty for tying up managerial compensation to funds' performance. Nonetheless, most countries have introduced market elements in this respect. In Poland the law regulates the structure as well as the maximum size of the compensation. The remuneration package consists of two parts: an annual fixed management fee and a performance fee, which can be annual or final. The size of performance fee can not be more than 1% of the funds' shares, if it is annual, and more than 0.5% of the funds shares multiplied by the number of years, if it is a final pay.

The Czech Republic envisages also the maximum amount of the compensation. It, however, allows for a choice between two systems: maximum of 2% of the value of the funds' shares, or 20% of its annual profit. According to observers, the first system is more common between the funds. In fact, because of the competition between them it is often less than 2%. Some criticisms have been attracted, on the grounds that such a compensation represents a disincentive in expending time, efforts and resources for costly monitoring activities.

The Bulgarian scheme leaves the definition of the structure as well as of the size of the compensation package to be determined by the contracting parties. The only provision in this respect refers to the compensation of an investment intermediary - it can not be more than 5% of the real assets value of the funds balance sheet, including the costs for the management of the fund.

Control over the management: internal and external

In all countries the control of the activities of the managerial organs is conducted primarily by the bodies that have elected them or have contracted with them. These organs can enforce the obligations resulting from the contractual or statutory liabilities of the managers. Where damage has been caused by intentional wrong or gross negligence, tortuous liability can be sought according to the general civil procedures, it was pointed out in the Polish report. In most countries, the main sanction for mismanagement is the termination of the contract before its expiry. For example, in Bulgaria, the contract with the investment intermediary could be terminated on the part of the PF at any time, after a short notice, during the first five years of the establishment of the fund. In Poland, the contract can be also terminated without giving any reasons for that with no longer than 180 days notice. If the termination is for reasons beyond the responsibility of the management, the latter is still entitled to maximum a half of the annual fixed management fee. The forms of the external supervision in the individual countries vary also. In Bulgaria, the management of the PFs is required to submit to the Commission six- and twelve- months reports, in which it has to disclose major aspects of its investment policy and transactions. The Commission, on the other hand, is given the right to impose disciplinary measures, such as pecuniary penalties or suspending the trade in certain securities, as well as the right to intervene for a deposition

of member from a governing body. It does not, however, have the right to take back the fund's license.

4. The Investment Strategies of Privatization Intermediaries

The investment strategies of the PIs in the various countries is determined by a multiplicity of factors. An important fact, as it has been noted earlier on is the specific regulation for their formation and functioning, the supply of enterprises and the mechanisms for matching the demand and the supply. In the cases of Bulgaria and the Czech Republic, the particular interests and sets of incentives of founders would play an important part in the differentiation of ownership behavior. The research on the strategies of the PIs is still not sufficient. Certain observations, however, can be made in three directions: portfolio formation; portfolio management and reconfiguration, and performance as corporate monitors.

4.1. Allocation of Privatized Stock and Formation of PFs Portfolio

There are two main mechanisms applied in the CEECs for allocation of enterprise shares to the privatization intermediaries specially created for their management - centralized allocation and decentralized formation of portfolios by way of participation in auctions or tenders.

The Romanian scheme is characterized by centralized allocation between the State Ownership Fund (70% of a company's stock), and the five Private Ownership Funds (30%). The creation of balanced portfolios was intended both in terms of size of performance of companies. Ultimately, the POFs concentrated enterprises of particular industries. The enterprises from the critical industries were divided among the POFs, as the Romanian report notes, for reasons of risk distribution and avoidance of monopoly positions. The enterprises from industries such as agriculture, construction and trade, were allocated according to regional principles.

The Polish mass privatization programme pays a particular attention to the allocation of enterprises to the NIFs portfolios in accordance with the intended ex ante distribution of the control rights over the companies. In such a way, the share portfolio of each fund has two parts - one consists of company shares, which are lead ones, and the other, consisting of minority shares. The lead packages of the NIFs are formed after the funds choose the enterprises they would like to hold, after which lots are drawn for individual funds in the first round and an algorithm is used to determine the sequence of selection in further rounds in order to equalize as much as possible the chances of choice.

According to the programme the 512 companies will have an ownership structure as follows: 33% to be lead shareholding a NIF which has selected the company. This NIF is the main investor of the enterprise and, as it was indicated earlier on, it can reduce its participation during a certain period only under specific conditions. Another 27% are equally distributed between the other 14 funds, each 1.93%, and thus represent their minority shareholdings. As the Polish contribution shows, the portfolio of each fund consists of 33 to 35 lead packages and 477 to 479 minority packages. The State Treasury reserves 25%, and 15% are distributed to the employees of the given company.

In the Czech Republic the voucher conversion was also based on a complicated auction procedure consisting of multiple rounds of bidding. Price setting mechanism was, however, different from the Bulgarian one. In the first round an identical price was set for the shares in all companies. The prices were adjusted between the rounds by a three-member Price Commission in order to meet the changing supply and demand, based on a complex algorithm. Individuals and IPFs, then, had only to determine the quantity they want to obtain in particular companies. After that, special rules were employed for distribution of shares between individuals bidders and IPFs, if the demand for shares did not meet the number of shares available.

The actual development of the Czech funds shows that in many cases the IPFs have to cooperate between themselves in order to come up with a common platform and establish their control over the enterprise, (Lastovicka, Marcincin and Mejstrik, (1994)). According to some authors, however, it imposes a monitoring difficulties and encourages free riding on the part of the owners. In addition, like the Polish scheme, the Bulgarian one grants 10% of the shares to the employees of the enterprise. Both in Bulgaria and the Czech Republic, the state decides on a case to case basis on the amount of shares to retain for itself or to privatize through other methods.

The greatest amount of information on the investment activities of funds concerns exactly their strategies and criteria for portfolio formation. In Poland, the strategies of the NIFs clearly differ with respect to the "lead" and the minority packages in the portfolios. The "lead" part was formed on the basis of economic-financial quantitative criteria, such as value of sales, gross and net profit, profitability of sales and profitability of assets, supplemented by sectoral analysis. Qualitative criteria, such as the state of technological equipment, technologies in use, management, availability of potential strategic investors, were also employed. It is suggested in the Polish contribution that the prevalence of one criterion is uncertain. The branch principle has been applied more clearly by three of the NIFs. It was generally used, however, at later rounds in order complement selections of the same branches already made.

The process of portfolio formation in the Czech Republic meets to a large extent the predictions for a divergence of the type of behavior of IPFs according to the type of founders. The bank-affiliated IPFs created broad portfolios, aiming at undervalued enterprises, with some of the IPFs acquiring shares in up to 500 companies. Several reasons were advanced for such a strategy ranging from widespread buying in order to reduce the risk of retaining unused vouchers, portfolio risk diversification, desire to extend their banking business to more clients, to mere incompetence and lack of appropriate financial qualifications. (Coffee, 1996). The privately sponsored funds, on the contrary, created small, carefully assembled portfolios, seeking the maximum stake of 20% allowed by the law. [cross-ownership]

In Bulgaria the mechanism for formation of PFs' portfolios, and the mechanism for voucher conversion in general, is completely decentralized. As the Bulgarian report points out, the process is characterized by competitiveness, i.e. each participant bids stating the price and the quantities of shares desired by it, and by acceptability, i.e. an auction commission sets a minimal prices for the shares of each enterprise. The minimal prices are calculated on the basis of the nominal capital at the time of the court registration, corrected with the loss accumulated during the past periods of the company's operation. The orders, then, are

satisfied in a descending order. If there is still stock unsold, it will be distributed proportionally between the bidders, provided it does not exceed a certain amount. Clearly, such a mechanism requires adequate information about the real price of the targeted enterprises, and the adoption of appropriate auction strategies.

The Bulgarian PFs as well had to formulate their strategies in a clearer way than their Polish counterparts as a part of the advertising campaign for the attraction of the investment vouchers of the population. The Bulgarian report classifies their intentions for portfolio formation in two respects: strategic one and branch one.

Three types of strategies were distinguished in the investment intentions of the PFs: to attain a strategic, long-term package of shares in the maximum allowed by the law amount, i.e. 34%. The criteria for selection of the enterprises in that part of the portfolio were mostly qualitative, such as availability of a potential buyer or a strategic investor, relation to the founders' business, formation of a closed production cycle, remaining state participation, region, etc. In such enterprises the PFs intend to play an active governance role, to restructure them and increase their profitability in the long run. to attain a medium-term, earnings maximizing package of shares. The targeted enterprises here are such showing stability, good market potential, and a certain economic relation to the first part. to attain some short-term, "for sale" packages. In this group would belong enterprise shares already "contracted" with potential final buyers, as well as shares acquired for risk diversification reasons.

Most of the PFs combine all strategies in various degrees in their portfolios. Nearly half of the PFs, however, have clearer preferences expressed to one particular strategy, and that the strategic one is the most popular. The review shows that the branch criterion has been more important one for the Bulgarian PFs than for the Polish NIFs. The funds have considered the amount of capital to invest in a sector as well as the total number of industries to invest in and the complementarity between them. It can be seen that more funds have chosen to form balanced portfolios, investing in industries with different risk specificity. There are also examples of highly diversified and highly concentrated portfolios, which have chosen by nearly half of the extra large funds. In spite of the fact that there is still not sufficient information due to the later developments in Bulgaria, it is possible to observe some differences in the strategies of the various types of founders as in the case of the Czech Republic. The PFs founded by entities controlled by state enterprise managers and public officials, for example, clearly emphasize their orientation towards concentrated portfolios in particular industries, even particular enterprises. Such a strategy is being advertised also by private founders with a particular business interest in a particular production area. The PFs based on private founders associated with financial structures, on the other hand, aimed at investments maximizing their earnings, with a sufficiently large "for sale" portfolios for risk diversification. The private complex founders demonstrated plans for balanced portfolios combining active involvement in the acquired enterprises and presence in several important branches of the economy. The PFs founded by state financial institutions had the least clear orientation on their strategic goals. Most of them, however, intended a trade orientation.

4.2. Portfolio Management and Reconfiguration

The mechanism of voucher conversion in most countries suggests that some random elements of formation of the portfolios are possible. Therefore, it is an important part of the

portfolio management to restructure the initial acquisitions in order to reflect better the strategies of the organs of the privatization intermediaries.

As it was made clear earlier on, there are some restrictions on the reconfiguration of the "lead" portfolios of Polish NIFs. With regard to the minority packages, the prevailing strategies seem to be that of passivity and free riding on the activities of the "lead" NIFs, because of the non-profitability of any activism. Sales, however, are also common. It has been pointed out that most funds (six) favor strategies of consolidation of the minority packages in interested parties, because the dispersion of minority stakes has a negative effect on the stock exchange notations of companies. Consolidations are also useful to control the entry and exit of companies in the lead portfolios. The NIFs that have followed that strategy have expressed intentions to continue with that strategy through other methods.

On the whole, the outlines of the medium-term ownership strategies of individual NIFs in the companies they lead by the second half of 1996 reveal three types of behavior: a restructuring, a financial investor and a mixed one. The "restructuring" funds are characterized by an active involvement in the enterprises in a variety of forms in an attempt to increase the net assets of the portfolio companies. Such funds finance some of their lead companies by way of sales of minority stakes; loans are granted only to companies with established market position and qualified management; where deeper restructuring is needed, strategic investors are sought in most cases. Such funds intend to follow this strategy for a period up to 5 years. Another group of funds have chosen a purely financial strategy from the very beginning. As the report shows these are mostly funds with highly differentiated lead portfolios. In these cases direct involvement in companies is limited. The strategy is oriented to sales of lead as well as of minority packages. The proceeds are invested mostly in fixed interest assets, i.e. outside the mass privatization programme, and an overall liquidity of the portfolio is preferred. Most of the NIFs, however, reveal mixed strategies with varying combinations between restructuring and financial strategies.

With regard to the Bulgarian funds, it can be pointed out at this stage that the 6-months prohibition of sales of enterprise shares prevents any formal, explicit portfolio restructuring. The PFs are temporarily "locked up" in their portfolios and left with the choice of active behavior or passive free-riding. The analysis of the sizes of the "for sale" portfolios, however, shows that significant changes can be expected. In addition, some PFs, reflecting the interests of their founders, have already expressed their intention to transform themselves either in investment companies or in holding companies.

The research on the Czech IPFs is also still very modest. The general lack of liquid and well developed stock markets, however, clearly prevents the IPFs from active trading. Some off-stock exchange transactions, however, have occurred through informal swaps between funds in pursuits of more concentrated portfolios.

4.3. *Explicit Interest to the Corporate Governance*

It is mainly in the Czech Republic that some research has been carried out on the behavior of IPFs as enterprise owners. There still, however, no definite conclusions can be made. Most IPFs have sought maximum representation in the organs of their portfolio companies, in the Managing Boards where possible. Different strategies in recruitment of directors importance of incentives of investment companies barriers to active ownership: 20%, lack

of ability to provide financing plus technological competence; cross ownership and conflicts of interest.

Bulgarian MPS provides some evidence in that relation. In the immediate period after beginning of the trade privatized companies' securities almost 90% percent of the that deal consisted of so called 'block-trade' – the intensive intra-fund exchange at the previously agreed stock prices, which has strove to create large block or majority holdings. Another remarkable evidence is that almost all of PFs took the advantage provided by the regulation and registered as holding companies indicating this way a further interest in controlling their portfolio enterprises. The media reported as well their active presence on the boards, but there is not still systematic research on that.

5. Privatization Intermediaries - the new Institutional Investors in the East?

5.1. *The System of the Institutional Investors*

The above review of the MPS in CEE countries evidences some noteworthy features. Regardless, the strong variety among the countries, the PFs in any country are single type and provide a single type stock to the investors in the country. The Czech example makes a little difference, since the change in the legal form of the PFs registered for the second privatization wave changed the status of their investors, but not the services offered to them.

This is rather different from the situation in the market economies when the institutional investors represent a diversified system of different institutions offering a wide range of services.

This is an essential distinction since that means that an investor in mutual fund has a choice between different time horizons for its investments, different extent of their riskness and thus makes his investment specific. None of this is typical for the CEE PFs. Regardless their promises, their actual portfolios are not fully according to their wishes, because of their random or the opposite centralized creation. This way the exact riskness of PFs portfolios is not clear, at least for a while, and that is true also for the prescribed time horizon for an average investment in their securities. Thus, their investors face problems with making their own specific strategy with those kinds of investments. Which means, that the most probable strategy might be the most general one – one-shot game targeted on the expected initial appreciation of the believed undervalued stock.

Polish case here might be an exception, since investors in Polish NIFs may expect more predictable portfolios and this way more predictable behavior. Also, the Polish investors have been given a chance to sale their certificates in advance if wished, so this may be seen as a preliminary selection for those who do not want to make those kind of investment which is offered to them by the MPS. Although, this distinction is not favorable for the Polish PFs identification as institutional investors as well, since this predictability is on the account of their moving away from the mutual fund model and approaching the holding company pattern. But this is another story.

Moreover, and more important, if one consider the institutional investors pyramid in a developed economy, its base consists of pension funds and life insurance companies, i.e. the mass case of investments are typically in largely predictable long-term investments. And the

various investments in the mutual funds and directly in securities are on the tiny top of the pyramid.

Again, the picture of the CEE PFs is adverse one. They keep in their portfolios high-risk stock originating from the companies, which have been never quoted, nor even valued by market standards. And this means that this institutions on average could not offer a good rate of return, even we leave apart the striking cases of abuse of their shareholders. Bulgarian case is strongly supportive with the dividends offered to the small PFs shareholders many times outweighed by the returns, gained by the individual investors; Romanian and Czech evidence is similar.

This way investing in a PF is rather different from investing in a mutual fund from the point of view of the investors expectations and opportunities to gain income.

Let's see now how the CEE PFs' portfolio regulation differs from the institutional investors' one.

5.2. Their Portfolio Structure

The portfolios of the Institutional investors are regulated by number of requirements targeted to ensure for diversification of the risk, for warranting the inflows etc. The life insurance companies and pension funds get more and more involved in offering a pure Investment-Oriented Policies. So called guaranteed investment contracts (GIC), often offer a guaranteed interest for a specified period of time. For that purpose their portfolio structures comprised a great deal of debt investments.

Table 1 proves that tendency showing also the important share of the mortgages, government securities, real estate etc.

Table 1

Distribution of assets of U.S. Life Insurance Companies:1988	
Asset	Percent
Government securities	12.3
Corporate securities	40.8
Of which: Bonds	36.2
Common Stock	3.8
Preferred Stock	0.8
Mortgages	19.6
Real estate	2.3
Policy loans	4.6
Cash	0.4
Short term investments	2.8
All others	17.2

Source: A.M. Best Company, *Best's Reports – Life/Health*, 1988, p. vii. Cited by: Fabozzi and Modigliani, (1992).

Though varying, there are general limits on the investments in the common stock, which are often tightened by the institutional investors' own policy; a leading principle for the British investment and unit trusts is to limit the stake they hold out of each company's stock to 2%, respectively to 3% of the stock traded on the market.

Situation with the CEE PFs is the opposite. They are not only permitted to invest in stock more largely, and even in a single company's stock, (up to 34% in Bulgaria), but they are encouraged to do so. The Polish program takes special measures to guarantee that high concentration of the portfolio's investments, though the procedure of the initial allocation. One may argue that this is favorable to the corporate governance; that might be true but at this point we are interested in the way the PFs differ from the standard institutional investors and not with goals of the mass privatization.

This tendency becomes much stronger after the beginning of the trade with the securities from the PFs portfolios. An active exchange has being established among the funds in order to concentrate further their holdings. Even during the period in which this trade has been prohibited or restricted, as in the first six months in Bulgaria after the auction rounds, there are invented a lot of avoiding mechanisms as preliminary contracts, contracts for management of securities etc., which allowed the process going on.

Thus, the very structure of the PFs does not resemble much that of the institutional investors and does not suggest a similar behavior.

5.3. Liquidity

Another important feature of the institutional investors concerns their liquidity and the liquidity of their assets. It is true that to some point they create liquidity of the stock markets . but it is not less true that they operate in the liquid markets. That means that they operate mostly in securities of the public companies, i.e. companies which are secure in terms that they are not supposed to be withdrawn from the market or restructured as private companies.

The risk of such an action decrease strongly the liquidity of the assets of the mass privatized companies, the risk of the government intervention due to substantial state share in many companies left apart, since the average portfolio investor on the secondary market does not admire the prices of the shares he invest in to depend on the transfer of block-holdings or decisions for conditional rise of the capital etc. This threat might be recognized to some extent by the policy makers and in Bulgaria all the mass privatized companies traded on the stock markets have been registered as public companies, even the smallest, which may be seen as another peculiar feature of the MPS.

Although, even such a severe solution hardly could solve the problem because the liquidity is also function of the performance of the traded company and this could not be resolved by the single act of the transfer of the property.

Later the relatively low dividends (or not at all) paid by the funds and the controversial performance of the companies, they hold stock in, does not promise substantial rates of returns to the potential portfolio investors, and eventually impede the liquidity of the PFs own shares on the markets. In fact there are no noticeable interest in these stock among the investors. Here, it is necessary to distinguish another kind of interests, that of acquiring control over the funds, which seems easy in many cases due to tremendously dispersed ownership of the PFs. Although, this is an interest of large investors which strives to make a 'big stroke' and which final goal is to withdraw a substantial part of the stock from the acting trade, contributing this to the restricted liquidity of the PFs assets.

5.4. Corporate Governance and the Institutional Investors

There are several problems associated with the corporate governance and the institutional investors. The actual problem for their refraining from the deeper involvement in restructuring of the enterprises from their portfolios often drives away the fact that they are operating in a well developed environment of the working corporate governance mechanisms. Regardless what type is the concrete financial system, in most cases the institutional investors of the developed economies are in the position to free-ride, and even if one insist that their passive behavior is due to the restriction imposed on them, that becomes feasible because some other institutions take the leading role.

Just the opposite is the situation with the PFs. They are operating in a system with not clear governance mechanisms, a mixture between still alive bureaucratic intervention of the government and the managers exercising almost unchallenged discretion over the privatized companies. Within such an environment very often the only conceivable active players in a specific company are the PFs, and particularly in the small companies.

This way there is a two-fold reasoning for an active involvement of the CEE PFs – from the one hand this is the strong temptation to rule over a ‘free’ company, where relatively small (and cheap) intervention – just to stop an apparent abuse of the company’s capital by the managers - could improve dramatically the performance and from the other hand impossibility to free-ride on someone’s effort.

Here, we do not touch the problem what forms take this governance and how effective it is, we just emphasize that by it’s very constitution the average Privatization Fund should intervene in the company’s affairs. And that difference the developed institutional investors enters all debates – is that behavior really beneficial for the investors? Why should he invest, even his vouchers, for a such a postponed, and uncertain enterprise, when he has a much more promising alternatives. Even in Polish case the individual may sale its certificates for cash, in accordance with the behavior of the regular small investor. We will return to this problem again in the last section, but what is important by now is that the CEE PFs could not resemble the market economy institutional investors as well.

5.5. The Complex Regulation

Within the developed market economies there is a complex system of regulation of the institutional investors, which scatter the rights and obligations among the government, central bank, self-regulated organizations of the agents on that market and the institutional investors themselves. It ensures high level of consumer protection, and especially that of the small shareholders and predictability of the behavior of the institutions.

This regulatory network makes the investments through this institutions enough specific, secure and differential, i.e. that they do not try to achieve various goals when they make portfolio investments.

In the CEE the regulation of the PFs is almost at its first steps. In most cases the development of such institutions precedes the establishment of the legal framework and this is even the first time of introduction of such an legal perception. The public company concept for instance.

The lack of investment information and the lack of strong protection of the small investors activism not only prevent the large entrance of the small investors, but also prevent their ability to imply disciplining pressure over the institutions in order to force them complying with the promised (and expected behavior).

This is another strong difference of the CEE PFs from their western counterparts.

6. Conclusions

The analysis of the specific institutions created under the mass privatization in CEE countries showed clearly that they have very little to do with the institutional investors of the developed economies. Their basic features differ strongly from the relevant features of their suspected counterparts. We suppose that they could be better seen as resembling the functions of the large industrial holdings. Considering the one of the main targets of the process itself – establishing the more effective corporate governance, this may be assessed as a positive move. Indeed, there are a number of signs, though still not systematic research, that the PFs show strong interest to involve in active monitoring over the enterprises they hold stock in.

Although, there is a room for some concerns on that development of the PFs. In fact they have been announced to the large public as institutional investors. In the period of attracting the vouchers from the population they emphasized the opportunities to offer an income flow to their clients. The legal form they had also induced such an expectations and behavior among the investors.

As a result the PFs obtained very dispersed ownership structure, with to different groups of shareholders. That of the small investors with property rights claims, but little influence in management of the funds, and that of the founders of the funds, also with relatively small holdings, but with the tremendous impact on the behavior of the funds. This way, in our opinion there is a large space for internal conflicts for the control over the PFs and the increasing wave of attempted take-overs in those CEE countries when the post-privatization trade started, is a supportive evidence of that statement.

This way the existence of the Privatization funds is stuffed with the controversies, which certainly do not support the expectations of the investors, but in our opinion will also impede their functions as holding companies, i.e. will deter the establishment of the active corporate governance as well.

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