

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.

* Institute of Economics; Bulgarian Academy of Sciences

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.

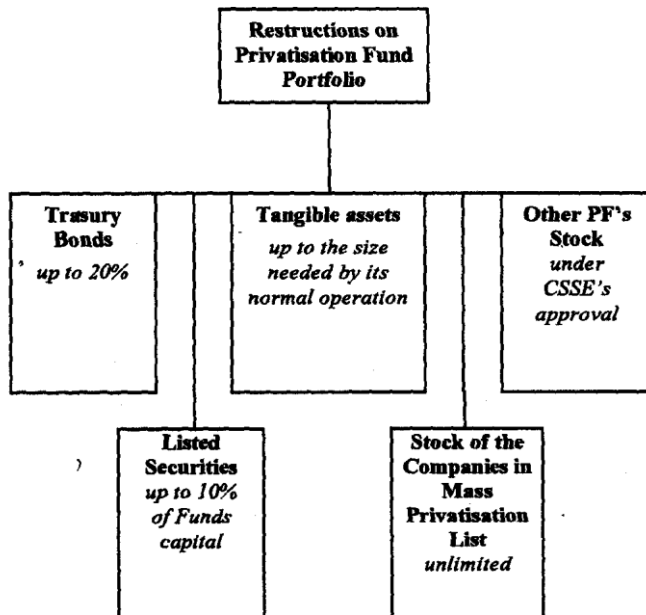
PFs' Portfolios

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 Company'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

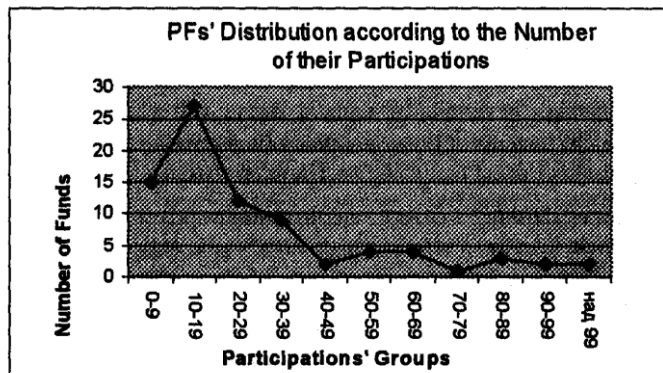
Size of the Package:	up to 10000 shares	10 000- 20 000	20 000- 30 000	30 000- 40 000	over 40 000 shares
Number of funds: Of which:	18	37	11	9	6
Extra Large (over 2.0 bln BGL)	0	0	2	5	5
Large (0.5-2.0 bln)	0	8	5	2	0
Medium (0.2-0.5 bln BGL)	3	13	3	2	0
Small (0.07-0.2 bln BGL)	15	16	1	0	1

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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