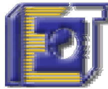
Partnership for Corporate Governance and Secondary Privatization in Transition

FINAL REPORT

PART B:

ANNEX TO TECHNICAL REPORT



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I. Corporate Governance and Ownership Structure in the Transition: The Current State of Knowledge and Where to Go from Here

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1. Introduction

Under the technological paradigm, including the neoclassical theory as propounded by Oliver Williamson (Williamson, 1990), it is generally believed that there is no pronounced relationship between the type of ownership and performance. Market structure and competition are thought to be much more important for an enterprise's performance than differences between the asset owners. As Yarrow argues, "the competitive and regulatory environment is more important than the question of ownership per se. In competitive markets there is a presumption in favor of private ownership. Where there is a natural monopoly, vigorous regulatory action is required" (Yarrow, 1986).

For that reason, the evaluation of advantages of private firms over state-owned enterprises has become a separate and critical issue. Defined more narrowly, it is a question whether there is a positive relation between privatization and enterprises' performance[1]. Most authors tend to answer this question in the affirmative, but (notwithstanding ample theoretical and empirical literature) there is no consensus on that issue yet. There are several arguments in favor of private companies:

– A social one: state-owned enterprises are a tool to remedy the faults of the market through a price policy taking account of social marginal costs (Shapiro, Willig, 1988). Such functions and costs have a negative impact on enterprise performance.

– A political one: political (bureaucratic) interference in the operations of an enterprise results in excess employment, non-optimal choice of products, non-optimal allocation and shortage of investments. These enterprises are more exposed to pressure from interest groups at the expense of profit maximization (Shleifer, Vishny, 1994).

– A competition-based one: privatization enhances competition, which makes enterprises operate more efficiently. Private companies are more subject to the discipline of commercial financial markets (Kikeri et al., 1992).

– An incentive-based one: the managers of state-owned enterprises may not have the appropriate incentives to work efficiently, or there is no adequate control over their activities (Vickers, Yarrow, 1988).

It is conventional wisdom that privatized companies are more efficient than state-owned ones. Even the process of preparation for privatization may in some cases (for example, in Poland in the late 1980s and early 1990s) encourage the management to improve productivity, as this boosts economic growth and investment. This idea has directly or indirectly dominated the reports of international organizations on transition economies (EBRD, 1997; World Bank,

[1] For details see: Perevalov et al., 1999.

1996). But a closer look at the literature suggests that privatization — any kind of privatization — in and of itself may not be sufficient to improve company performance; that the *type* of privatization may matter.

In the early stages of the transformation of the majority of post-Communist countries, various types of privatization schemes were applied in order to speed up the privatization of the state sector and ensure social support for the privatization process. In addition to classic commercial privatization methods "imported" from the West, these schemes — based on the free or nearly free transfer of assets to certain segments of the population — took the form of mass (voucher) privatization and management-employee buyouts (MEBOs). Let us denote those schemes, which usually involved the transformation of the ownership of a large number of companies according to some general formula, by the term "wholesale privatization." The common denominator was the definition by the state (to a greater or lesser degree) of the ownership structures of privatized enterprises, both by identifying future types of owners and, in some cases, by determining the proportions of shares to be held by various types of owners. Additionally, there was often a high degree of state involvement in the creation of various types of investment funds, which became shareholders in privatized companies. As a result, in countries where efforts were made to determine ownership structures from on high, enterprises often found themselves with identical ownership patterns immediately following privatization, regardless of their size, the markets in which they operated, or other specific characteristics. For this reason, this method of privatization is often viewed as "artificial," unable to provide firms with "real owners" and to bring about improvement in firms' performance. One of the main criticisms is that wholesale privatization creates diffuse ownership structures, which lead to poor corporate governance and the lack of deep restructuring.

The question has therefore arisen as to what extent can wholesale privatization accomplish the expected goals of privatization. Of course, the answer depends, among other things, on how one defines these goals. The assumption behind privatization in many parts of the world is that private ownership improves corporate performance. The empirical evidence for this assumption comes from two kinds of studies. The first compares the pre- and post-privatization financial and operating performance. A good example is found in D'Souza and Megginson (1999). They compare the pre- and post-privatization financial and operating performance of firms in 28 industrialized countries that were privatized through public share offerings during the period from 1990 to 1996. They document significant increases in profitability, output, operating efficiency, and dividend payments, and significant decreases in leverage ratios of firms after privatization. These findings suggest that privatization yields significant performance improvements.

The second strand focuses on comparing the performance of state firms with either private (Boardman, Vining, 1989) or privatized (Pohl et al., 1997b) firms operating under reasonably similar conditions. Additional evidence has been obtained recently by a number of studies of post-Communist transition economies which, because of the presence of large numbers of both state and privatized firms, have become a favorable testing ground for the general claim that privatization leads to improvements in economic efficiency. And if the aforementioned charges leveled against wholesale privatization are justified, then one might suspect that this form of privatization fails to pass this test.

Another approach to this question is possible, however. One might argue that we do not know what the characteristics of a "good" ownership structure or "good" corporate governance system are, and that it is the flexibility of the ownership structure, and not the structure itself, which is really crucial. In this view, it is important that the ownership structure be able to adjust to the firm's environment and characteristics. In other words, rather than considering ownership structure as exogenous and given, and looking at its impact on firm performance, we may view ownership structure as an endogenous outcome of the behavior of value-

maximizing economic agents operating in a specific environment and subject to various constraints. This perspective could be traced back to Coase. According to Coase, the allocation of property rights has no effect on economic efficiency, provided they are clearly defined and there are no transaction costs, because under such conditions people can trade their assets in order to achieve efficient reallocations. A possible consequence of this approach could be that, in order to assess the efficiency of a privatization strategy, we should be mainly concerned with the extent to which the reallocation of property rights can take place.

The proponents of wholesale privatization could claim that their strategy relied on the Coase theorem. They could argue that initial ownership structure does not matter, and that what really matters is the agents' ability to freely reallocate property rights. However, the coasian result strongly depends on the availability of contracting and re-contracting opportunities, backed by an established legal system and law enforcement. In particular, the process of evolution of ownership structure is closely related to the ease with which the original owners can maximize their gains by selling their shares (or claims) to other potential buyers. Conditions of resale play a crucial role in enabling new owners to gain ownership and control of firms by buying the claims of incumbent owners.[2]

Following up this argument empirically, we note that in countries where the transformation process began relatively early, a "secondary" ownership transformation process has also been unfolding. (The terms "primary" and "secondary privatization" which we use here are inspired by the analogy to primary and secondary capital markets). Soon after the primary privatization, which was often of a very administrative nature, many enterprises experienced changes in ownership which were influenced more by market forces, the behavior of rational agents and newer, more sophisticated regulations. The observation of these changes can provide us with important criteria for evaluating the degree of maturity of the systemic transformation in those countries.

One can expect these secondary changes in ownership to occur in all privatized enterprises since they represent an entirely normal feature of private firms in market economies. Of particular interest, however, is the question of how these evolutionary processes are unfolding in "schematically" privatized firms where the ownership structure was originally set — to a greater or lesser degree — by the government. Can we observe any general trends or patterns in these evolutionary processes, or are they varied in different countries? Are new owners emerging in the secondary ownership transformation process? Are firms moving towards a more concentrated ownership structure? What factors determine the types of secondary changes? How rapid is the pace of ownership evolution? Under what conditions is the evolution particularly rapid (e.g., in cases of the appearance of a strategic investor)? If the pace of evolution is particularly slow, can we identify factors inhibiting it? To what extent is state regulation or the government itself the source of such inhibiting factors, and to what extent are other actors — e.g., insiders — slowing the process down? Do secondary ownership transformations lead to changes in corporate governance (changes in management style or managerial staff) and the intensification of restructuring efforts? Do they affect the financial performance of the companies?

A number of related questions are also of interest. One of the most important issues is the problem of the mutual dependency of ownership concentration and structure on the one hand and economic performance on the other. Here, we are concerned primarily with the question of the endogeneity or exogeneity of ownership structure (i.e., is ownership structure a factor determining economic performance, or is it determined itself by performance and the factors which determine performance?). Another question is the search for an efficient owner-

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

ship structure and corporate governance model. Finally, a very stubborn question concerns the role of governmental and quasi-state institutions in secondary privatization and the influence of the state policy and residual state property on the process.

In research conducted by the CASE Foundation (presented in Section 3), an attempt was made to answer the above questions examining the cases of three Central European transition countries — the Czech Republic, Poland, and Slovenia. Researchers were able to identify the new owners emerging from the secondary privatization process in each country examined, as well as to observe the trends in the evolution of ownership structure and the degree of concentration. Moreover, they highlighted the factors behind this evolution which lie within the regulatory environment of the companies. These findings were based on large data sets assembled for each country and for each type of large privatization scheme. The data sets, in turn, allowed us to assess the economic and financial performance of companies undergoing secondary privatization. The time period covered by these data sets, however, is too short to draw unambiguous conclusions concerning the relationships between ownership evolution and performance.

2. Privatization and Enterprise Performance: Theory and Evidence

Before the aforementioned research was conducted, there was already a rich body of research in the broad area of privatization, enterprise restructuring, and corporate governance in Central and Eastern Europe (for surveys see Carlin et al., 1995; Carlin, 1999; Havrylyshyn, McGettigan, 1999; Nellis, 1999; Djankov, Murrell, 2002).[3] However, it is very difficult to compare or to generalize the outcomes of these studies since they used different methodologies and samples (often non-representative) in different time periods and countries with different environmental and regulatory conditions. However, one interesting and surprising result of research conducted during the *early phase of transition* was that privatization by itself seemed to have little influence on the adjustment and restructuring patterns of enterprises. Whether privatized, state-owned or commercialized, the key factors affecting the enterprise adjustment process seemed to be the degree of hardening of budget constraints and increase in competition on product markets, and not the form of ownership (Carlin et al., 1995). In the *later stages of reform* in the more advanced transition countries (especially since 1994), a gradual differentiation in the restructuring patterns of enterprises has been more and more visible. By 1997 there was evidence that privatization mattered: the differences between privatized and state enterprises, measured by any financial and economic performance indicators, were constantly increasing to the benefit of the former (Błaszczyk et al. 1999, Pohl et al. 1997a, b). Differences between state and privatized enterprises have emerged with respect to deep (strategic) vs. defensive restructuring (Grosfeld, Roland, 1996). Most research has shown that the strategic restructuring process, involving large investments and innovative technological changes, has been possible only in privatized enterprises (especially those with foreign strategic investors). There is also some evidence that non-privatized enterprises tend to consume the largest part of labor productivity increases in wages while the privatized en-

[3] Some studies on the countries examined in the research presented here include the following: for Poland, a series of papers published by the Gdańsk Institute for Market Economics (Dąbrowski, Federowicz, Levitas, 1991, 1993; Dąbrowski, Federowicz, Levitas, Szomburg, 1992; Dąbrowski, Federowicz, Szomburg, 1992; Dąbrowski, Federowicz, Kamiński, Szomburg, 1993; Szomburg et al., 1994; Dąbrowski, 1996); Pinto et al. (1993); Belka et al. ([1995]); Bouin (1997); Kamiński (1997); Błaszczyk et al. (1997); Jarosz (1994), (1995), (1996), (1997); for the Czech Republic, Mladek and Hashi (1993); Brom, Orenstein (1994); Coffee (1996); Katsoulacos, Takla (1995); Kotrba (1995); Marcincin, Wijnbergen (1997); Matesova (1995); Mejstrik (1997); Mertlik (1997) and Zemplinerova et al. (1995); and for Slovenia, Bohm, Korze (1994); Kanjuo-Mrcela (1997), and Simoneti, Triska (1995).

terprises use it for further investment (Grosfeld, Nivet, 1997).[4] However, there is some controversy about whether — and in what ways — the method of privatization used is a significant factor differentiating the performance of privatized companies.[5]

A more detailed discussion of the literature on the effects of primary privatization on enterprise performance follows below. However, we want to note here that little work has been done on the post-privatization developments in ownership (i.e. secondary privatization) and their impact on enterprise performance. The research summarized in Section 3 seeks to address this gap in the literature. What did we know about secondary privatization before embarking on that research? Literature on the beginning of secondary privatization in the Czech Republic, largely consisting of trading of shares by investment funds and often called the "Third Wave" (following the first and second "waves" of the voucher privatization program), was largely limited to anecdotal evidence (Mladek, 1996). In Poland, virtually the only research done in this area concerned the gradual increase in concentration of shareholding in companies privatized by management-employee buyouts (Jarosz, 1995,1996). In addition, at the time this project was designed, too little time had elapsed since the initial privatization of many enterprises to allow for a detailed evaluation of secondary transformations (and to some extent, this continues to be the case in many enterprises). In the countries under consideration, the transformation was already ten years old, and in most of the companies studied at least five years had elapsed since privatization. This period of time was considered sufficient for analyzing trends in the ownership changes which were underway. However, it is questionable whether it was also sufficient to analyze the relationship between those ownership trends and their impact on economic and financial performance. Moreover, it is clear that not all the "battles" over ownership in the companies we studied have been won and lost. Therefore, our report provides a picture of secondary privatization in an advanced, albeit not yet completed stage. This fact should provide a stimulus for the continuation of research in this area in the near future. Such research may indicate not only further developments in the evolution of ownership structures, but additionally shed more light on the relationship between the evolution of ownership structure and enterprise performance.

We now turn to a more detailed review of the literature on the relationships between the immediate post-privatization ownership structure and corporate performance, focusing on certain critical issues such as the role of ownership concentration, the type of dominant owner, and the regulatory and institutional environment, as well as methodological issues.

2.1. Ownership Concentration

Beginning with the early work by Berle and Means (1932) and continuing into the 1980s, the literature studying the impact of ownership structure on corporate governance[6] and

[4] For research showing positive effects of foreign investors see Smith et al. (1997), Błaszczyk et al. (1999) and the aforementioned papers published by the Gdańsk Institute of Market Economics.

[5] The difference between the conclusions of Pohl et al. (1997a, b) on the one hand and Błaszczyk et al. (1997) (as well as most other research done in Poland) on the other is that the Polish research finds that not privatization in and of itself but rather the methods of privatization have a strong influence on the quality of the restructuring process.

[6] There are various definitions of corporate governance. It can be defined narrowly, as the problem of the supply of external finance to firms (Shleifer, Vishny, 1997). It can also be defined as the set of mechanisms which translate signals form the product markets and input markets into firm behavior (Berglöf, von Thadden, 1999), or as the complex set of constraints that shape the ex-post bargaining over rents (Zingales, 1997). The control of the firm does not necessarily equate with equity ownership; it also depends upon control exerted by debt-holders. So, corporate governance may affect firm performance directly, via ownership and control, but also indirectly, through the financial structure of the firm. According to an even broader view of corporate governance, managers in firms characterized by the separation of ownership and control are constrained from taking actions that are not in the interest of shareholders by several disciplining mechanisms, such as the threat of take-

firm performance has focused on the advantages of ownership concentration. This question has important implications for privatization policy, as policy makers must decide whether it is better to distribute the shares of firms to large numbers of individuals (as in the voucher method) or to concentrated groups of owners or even single owners (e.g., through direct sales). The main concern was the cost of the separation of ownership and control, or agency costs (e.g., Jensen, Meckling, 1976; Fama, Jensen, 1983). The idea is that dispersed ownership in large firms increases the principal-agent problem due to asymmetric information and uncertainty. Because contracts between managers and shareholders are inevitably incomplete (future contingencies are impossible to describe fully), shareholders must monitor managers. There is a widespread consensus that a greater degree of control by an external shareholder enhances productivity performance: more monitoring presumably increases productivity (Shleifer, Vishny, 1986). When the equity is widely dispersed, however, shareholders do not have appropriate incentives to monitor managers who, in turn, can expropriate investors and maximize their own utility instead of maximizing shareholder value. Finally, concentrated ownership in the hands of outsiders is also often advocated on the ground that it facilitates the provision of capital.

In transition economies, conflicts between managers and outside (large and minority) shareholders are on the rise. Problems and costs of shareholders' control over the managers in the framework of principal-agent relations (Hart, 1995) are aggravated by the fact that managers — directly or through intermediaries — act as both insiders and outsiders, in all possible meanings of these terms. One of the key problems here is that of the share issuer's transparency to potential investors as well as incumbent outside shareholders. It should also be noted that in an illiquid emerging market the issue of a choice between the "voice" mechanism and the "exit" mechanism (Hirschman, 1970) is no longer a dichotomy. In fact, there are no alternatives here: if one cannot sell his or her shares, then the role of the "vote" mechanism has to be enhanced.

More recently, the focus of the literature has shifted, and several theories have been proposed to show the ambiguity of the effect of ownership concentration (Grosfeld, Tressel, 2001). One of the obvious costs of concentration is the ability of the holders of majority stakes to extract private benefits of control (Barclay, Holderness, 1989). La Porta et al. (1998a) show that, in most countries, large corporations have large owners who are active in corporate governance. Therefore, the main problem of corporate governance is not monitoring the managers; the real concern is the risk of the expropriation of minority shareholders. The same authors, in a comparative study of the effectiveness of legal systems in 49 countries from the perspective of investor rights protection, find that ownership concentration is a reaction (adaptation) to weak protection of investor rights under the national corporate governance models (La Porta et al., 1998b).

A similar view has been expressed by Becht and Röell (1999), reviewing of corporate governance in continental European countries where ownership structures differ significantly from those of Anglo-Saxon countries, well known for their dispersed ownership patterns. In most of the countries studied, companies tend to have large shareholders, and the main conflict of interest lies between them and minority shareholders.

Second, concentrated ownership may negatively affect firm performance through its impact on managerial initiative. If concentrated ownership provides incentives to control the management, it may also reduce the managers' initiative or incentive to acquire information (Aghion, Tirole, 1997). In this perspective, Burkart et al. (1997) view dispersed ownership as a commitment device ensuring that shareholders will not exercise excessive control. If the principal is concerned with providing the manager with the guarantee of non-intervention, he

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overs, bankruptcy procedures and the managerial labor market. Competition on the product market is often considered as another disciplinary device.

may choose to commit not to verify the action of management. Such inefficient monitoring technology may stimulate managerial activism (Cremer, 1995) creating, ex ante, powerful incentives for the management. When managerial initiative and competence are particularly valuable (which may occur when firms face high uncertainty), concentrated ownership may thus turn out to be harmful.

Third, concentrated ownership implies lower levels of stock liquidity which, in turn, weakens the informational role of the stock market (Holmström, Tirole, 1993). This may, again, be more valuable in an uncertain environment (Allen, 1993), or when it is essential to ensure that the management of under-performing firms changes hands. Finally, concentrated ownership is costly for large shareholders because it limits diversification and reduces the owners' tolerance towards risk (Demsetz, Lehn, 1985; Heinrich, 2000). Ownership dispersion allowing greater risk diversification may positively affect investment decisions. Overall, Allen and Gale (2000) conclude that in the second best world of incomplete contracts and asymmetric information, separation of ownership and control can be optimal for shareholders.

What do we observe in practice in the transition economies? Practically all of them demonstrate a trend towards *high ownership concentration* in the course of privatization (a point to which we will return in Section 3, particularly in the conclusions). In the Czech Republic, Hungary and Poland, 98% of medium-sized companies surveyed in the mid-1990's had a dominant shareholder (Frydman et al., 1997), with the average stake owned by the main shareholder varying from 50% to 80%. In the former USSR republics there is also a trend towards concentration. Data available on six countries show steady growth in the managerial shareholdings (Djankov, 1999).

Concentrated ownership is closely related to outsider ownership. In 1998, according to the data of a Russian survey conducted by the Higher School of Economics in Moscow, on the average, the largest shareholder's stake was about 28%, and the largest three shareholders owned 45% (up from 41% in 1995). Moreover, in 43% of the companies, three shareholders held over 50% (Dolgopyatova, 2000). According to the data of a survey of 437 Russian enterprises conducted in 2000, in 85% of the enterprises of the sample, none of the shareholders had even a blocking stake immediately following privatization. In 38% of enterprises dominated by outsiders, two or three shareholders had a more than 50% interest in 2000 (Bevan et al., 2001). However, the most obvious trend that Russian companies show is an increase in stakes held by other industrial companies. As a result, a majority stake in every tenth company is held by other industrial companies (Simachev, 2001).

One of the most peculiar features of Russian industry is the combination of ownership concentration with partial ownership dispersion (Dolgopyatova, 2000). Hence a certain dualism of corporate ownership characteristics cited by various authors (as compared to similar data on Western countries and other transition economies). The fact that Russia lags somewhat behind the Eastern European countries may be due to some provisions of anti-trust legislation (affecting acquisition of over 20% of shares) and corporate legislation (affecting acquisition of over 30% of shares).

As for the relationship between concentration and economic efficiency, an example of a formulation — and test — of the hypothesis of the effect of ownership concentration on performance is found in McConnell and Servaes (1990). They examine the impact of ownership structure on company performance in the largest European companies. Controlling for industry, capital structure and national effects, they find a positive relationship between ownership concentration on the one hand and the market-to-book value of equity and profitability of firms on the other.

In a similar study for a transition economy, Grosfeld and Tressel (2001) test the hypothesis of the ambiguous relationship between ownership concentration and performance. For a sample of Polish firms listed on the Warsaw Stock Exchange, they found that there is

indeed a U-shaped relationship. Firms with relatively dispersed ownership (no shareholder with more than 20% of voting shares) and firms in which one shareholder has more than 50% of voting shares were found to have higher productivity growth than firms with an intermediate level of ownership concentration. In Section 3, we will review some studies of Central European data which show no relationship between concentration and performance.

Other studies have found a less ambiguously positive relationship between concentration and performance. For example, data from surveys of Czech firms provide evidence that managers who were brought to privatized companies by outside owners operated much more efficiently than those appointed by government agencies (Claessens, Djankov, 1999a). Data on the operations of 706 Czech enterprises in 1991-1995 suggest that concentrated ownership boosts the market value of a company, thereby increasing its profitability. The authors of the paper in question also find that the company's main bank has a positive impact on the company's performance through indirect control over its investment fund (Claessens et al., 1997). In the Russian case, if we assume (based on the findings of Leontief Center, 1996) that the earlier companies were privatized, the higher the level of corporate ownership concentration (which is generally consistent with the Russian trend), this constitutes evidence that companies with concentrated ownership are more efficient.

Perhaps in the end the most appropriate view is the more nuanced one of Bolton and von Thadden (1998), who argue that it is not simply a question of whether ownership should be concentrated or not, but rather whether there are different levels of concentration most appropriate for different stages in the life of the firm. We hope that the research presented in Section 3 may shed some light on this question.

2.2. Type of Dominant Shareholder

Some authors do not find any consistent relationship between the post-privatization ownership structure and the intensity of change (Linz, Krueger, 1998; Earle, Estrin, 1997, based on surveys of Russian enterprises). Data on Ukrainian enterprises do not confirm the existence of a clear relationship between the ownership structure and change/restructuring either (Estrin, Rosevear, 1999). A paper on recent surveys of about 3000 companies in 20 transition economies analyzed the impact of privatization and ownership structure on enterprise restructuring but found no clear answers. This is attributed to the lack of information about enterprises before privatization (Carlin et al., 1999). Interim data from an analysis of over 7,500 Russian industrial enterprises (Brown, Earle, 1999) suggest that restructuring is in general very slow in companies of all forms of ownership, and slower in private companies than in state-owned ones. The authors find that privatization has an adverse effect on performance, but at the same time point out that it would be wrong to attribute it solely to privatization, as state-owned enterprises' performance is not much superior to that of other types of companies.

A number of authors have asked whether or not the *type* of owner who acquires a firm in privatization is of any significance. A number of related questions have been posed, and dealt with, in the literature: Are employees bad owners? Are foreign strategic investors the best owners? What about investment funds?

In their study of some 700 Czech firms, Weiss and Nikitin (1998) showed that ownership concentration by strategic investors other than investment funds has had a positive impact on performance, while this has not been the case with ownership concentration by bank-sponsored investment funds. Similar conclusions have been drawn by Claessens and Djankov (1999b) in their study of a cross section of over 700 Czech firms between 1992 and 1997.

In their above-mentioned study dealing with the effects of concentration, McConnell and Servaes (1990) also test the hypothesis that the identity of large owners — family, bank, institutional investor, government, and other companies — has important implications for

corporate strategy and performance. They find support for this hypothesis. In contrast, the study by Grosfeld and Tressel (2001) mentioned earlier examines these questions for a sample of Polish firms listed on the Warsaw Stock Exchange and finds that the type of controlling shareholder does not affect the correlation between concentration of ownership and productivity growth.

The beneficial role of foreign strategic owners in privatized firms has been highlighted in many studies. In an early survey of Czech, Hungarian, Russian and Bulgarian companies, Carlin et al. (1995) show the positive impact of foreign ownership on productivity growth, a finding which has been confirmed by many later studies (including, for example, Carlin, Landesmann, 1997). While Djankov (1999) found evidence that ownership by domestic outsiders is not significantly correlated with depth of restructuring, he also found that the positive impact of foreign ownership on restructuring only makes itself felt when the foreign-owned stake is relatively large (over 30%). Smith et al. (1997) examine the relationship between employee and foreign ownership and firm performance in a sample of Slovenian firms. In addition to the unsurprising finding of the strong positive effect of foreign ownership, they also find a positive (though much weaker) relationship between employee ownership and enterprise performance. A percentage point increase in foreign ownership is associated with about a 2.9% increase in value added, whereas a percentage point increase in employee ownership increases value added by about 1.4%.

However, most available data suggest that difference between companies owned by domestic insiders (employees and managers) and dominant outside investors is small (Carlin et al., 1995). Frydman et al. (1997) found that in the Czech Republic, Hungary and Poland private companies have made more progress in restructuring than state-owned firms; however, firms controlled by outsiders are more or less on the same level as those dominated by insiders. Brown and Earle (1999), analyzing the survey of over 7,500 Russian industrial companies referred to above, find that, on the whole, companies with large insider stakes and stakes acquired through voucher auctions show a much slower pace of restructuring than firms with stakes owned by holding companies and foreigners and "golden shares" held by the state. However, the influence of vouchers, holding companies and foreigners is highly uneven, and the impact of holding companies and foreigners does not increase with an increase in their stake. According to Kuznetsov and Muraviev (1999), their survey of the 103 best known Russian share issuers in 1995-1997 shows that the larger the stake of outsiders (both domestic and foreign), the higher the productivity growth. By contrast, insider and state ownership results in low productivity. Ownership by a state-owned holding company impedes productivity growth, though to a smaller degree than state ownership.

A couple studies of Russian data find evidence which reflects more favorably on insider ownership. In a detailed study by Bevan et al. (2001), the main finding as regards the ownership-performance relationship is that difference in restructuring (performance) between outsider- and insider-controlled companies is negligible, with the exception of profitability, which is considerably higher in companies with insider ownership. This might be explained by the fact that outsider dominance (especially if a company is part of a vertically integrated group) often results in the switching of financial flows to other entities and persistent (declared) losses. Similarly, Muraviev (2001), exploring the relationship between ownership structure and data on financial performance (return on equity, return on sales), finds a direct relationship between the insiders' stake in the company and its performance (no difference is found between management and employee ownership). In contrast, there is an inverse relationship between performance on the one hand and outsider-owned stakes (with the exception of foreign outsiders, for which the relationship is positive) and the stakes of regional and local governments on the other.

In addition to the type and concentration of ownership, the replacement of old management by new may be of crucial significance for the improvement of corporate governance and enterprise performance. Investigating the relation between profits and privatization, Claessens and Djankov (1999a) found that profitability and labor productivity are both positively related to the appointment of new managers, especially those appointed by private owners. Additionally, they find the equity holdings of general managers to have a small positive effect on corporate performance. A study of the transformation of Russian shops by Barberis (1996) confirms the positive impact of the appointment of new managers on the restructuring process. The main conclusion is that enterprise restructuring in transition countries requires new human capital, which can best occur through management changes.

This conclusion may have important implications for privatization policy: if a privatization method leads to the entrenchment of incumbent managers as holders of significant blocks of shares, many necessary changes may be stifled. And such entrenchment does indeed appear to be problematic in many transition countries. Research has shown that groups that have obtained relative control over privatized enterprises because of the particular design of privatization schemes may be more or less willing to allow new dominant owners to emerge. In their study of ownership change in privatized Estonian firms, Jones and Mygind (1999) argue that the initial dominant ownership group is associated with a great deal of inertia, i.e., that the dominant group retains its dominant position for quite a long time. A study of the role of managers and employees in the development of ownership in privatized Russian enterprises has also shown that managers have been hostile to outsiders and colluded with workers to keep the outsiders out of their companies (Filatotchev et al., 1999). The question of management entrenchment was of particular interest in the CASE research presented here.

An important feature of voucher privatization in the Czech Republic, Poland and Slovenia was the collective investment opportunities offered by numerous privatization investment funds. Due to the activity of these funds, enterprise shares were, to a large extent, not distributed amongst a large number of individual citizens, but rather concentrated in the portfolios of the funds. In the Czech Republic, for example, one third of the investment funds gained control of over two thirds of the total enterprise shares obtained by all funds. Mergers and acquisitions of funds resulted in further ownership concentration, and in an environment of lax regulation (as in the Czech Republic), this afforded ample opportunities for the creation of very non-transparent equity networks and thereby for the abuse of non-insider shareholders (Hashi, 1998).

In fact, while the Czech mass privatization was ostensibly designed to make outsider ownership the rule, in practice management was often able to use voucher privatization and the involvement of investment funds to retain a privileged position.[7] Moreover, Kocenda and Valachy (2001) offer further indirect evidence of significant insider involvement in Czech voucher privatization, noting that Czech privatization investment funds were often founded by manufacturing enterprises (it is reasonable to infer that many of these enterprises set up funds in order to acquire shares in themselves, as it were). An OECD report sums up this post-privatization situation when it states that the Czech voucher approach to privatization produced ownership structures that were not conducive to either efficient corporate governance or restructuring (OECD, 1998).

For these reasons, many conclude that Czech firms privatized through vouchers, in which investment funds held the controlling stakes, have not been sufficiently or consistently restructured. Weiss and Nikitin (1998) looked at financial performance in a set of Czech firms and concluded that the concentration of ownership has significant positive effects on performance except in the case of the funds, whose share in ownership has no positive effect on per-

[7] See evidence cited in Woodward (1996).

formance. Mertlik (1997), highlighting the dual role of partly state owned banks as owners (through bank-sponsored investment funds) and creditors of voucher-privatized firms, argued that a large number of these firms had not been subjected to the genuine rigor of market forces and not undergone serious restructuring.[8]

2.3. The Regulatory and Institutional Environment

One area in which there is growing agreement is that privatization in and of itself is not sufficient to bring significant change to companies; the environment (regulation, macroeconomic stability, etc.) is also of critical importance. Shleifer and Vishny (1997), for example, survey research on corporate governance, with special attention to the importance of legal protection of investors and of ownership concentration in corporate governance systems around the world. Estrin and Rosevear (1999) explore whether specific ownership forms have led to differences in enterprise performance in Ukraine. Using profit, sales, and employment as performance proxies, they find that private ownership per se is not associated with improved performance, suggesting that the insufficiently reformed Ukrainian environment is at fault. Similarly, Djankov and Murrell (2002) argue that the fact that it is more difficult to identify the effect of privatization on firm performance in CIS countries than in CEE countries may be attributed to the lack of some of the necessary complementary factors (e.g. in the regulatory environment) which make privatization work.[9]

Drawing attention to the role of the general economic environment in which privatization takes place, Nellis (1999) argues that the poor performance of mass (voucher) privatization was related to environmental factors in the following ways:

– Investment funds tended not to punish poor performance of firms, since pulling the plug would diminish the value of the assets of the funds' owners — banks — if the latter were forced to write off bad debts lent to those firms.

– Even though they did not own the firms to which they were lending, the partially state-owned, state-influenced, weakly managed and inexperienced banks tended to extend credit to high-risk, low-potential privatized firms and persistently roll over credits rather than push firms into bankruptcy.

– The bankruptcy framework itself was weak and the process lengthy, further diminishing financial market discipline.

– The lack of prudential regulation and enforcement mechanisms in the capital markets opened the door to a variety of highly dubious — and some overtly illegal — actions that enriched fund managers at the expense of minority shareholders, and harmed the health of the firm; for example, by allowing fund managers to load firms with debt, then lift the cash and vanish, leaving the firm saddled with debts it had not used for restructuring a practice that became known as tunnelling.

2.4. Methodological Issues

Any attempt to review the empirical literature on the effects of initial ownership and control structures on corporate restructuring and performance in transition countries would be incomplete if it did not take note of serious problems with the comparability of various studies. These studies employ different methodological approaches, different performance measures, different time periods, etc. Moreover, a number of methodological problems, notably

[8] Since then, the four largest Czech banks have been privatized, though the problem of enterprise debts has not been completely resolved.

[9] For an analysis of the complementarity between ownership and competitiveness of the firm's environment, see Grosfeld and Tressel (2001).

that of selection bias, often do not receive sufficient attention. This can lead to the formulation of conclusions on the basis of evidence that is often questionable.

One example is Claessens and Djankov (1999b), who concluded that the more concentrated the ownership, the higher the firm profitability and labor productivity, in spite of the fact that the coefficient on profitability was found to be insignificant. Another oft-quoted example is Frydman et al. (1999), who compare the performance of privatized and state firms in the transition economies of Central Europe. While they do control for various forms of selection bias, some of their conclusions become doubtful when one looks at the makeup of their sample. For example, they argue that privatization to outsider owners has significant positive performance effects, whereas enterprises privatized by MEBOs do not differ from state enterprises in performance (i.e., the latter form of privatization brings absolutely no benefits in terms of restructuring). However, in their sample of 185 firms from three countries (Poland, Hungary, and the Czech Republic), only 10 are majority-owned by non-managerial employees, and all 10 are from Hungary. There were none from Poland, where this form of privatization was applied to a much larger number of firms, and where employee-owned firms have been much more thoroughly researched.

3. Research Results for Three Countries

As mentioned above, the CASE Foundation carried out research on secondary privatization in three Central European transition countries.[10] With the knowledge presented in Section 2 as a starting point, three central goals were formulated for this research. The first was to analyze the secondary ownership transformations of enterprises privatized through wholesale privatization schemes in the three countries, focusing in particular on:

– The scope and pace of secondary ownership changes;

– Trends in secondary ownership transformations (e.g., identification of types of emerging new owners, changes in levels of concentration, etc.);

– Factors affecting the scope and pace of secondary ownership transformation as well as selection processes for agents involved in those processes;

– Barriers to secondary ownership changes, especially those resulting from institutional patterns and state regulations, and

– The effects of the regulation of primary privatization schemes on secondary privatization processes.

The second goal was to formulate and examine (using statistical methods) hypotheses concerning:

– Relationships between changes in economic performance and primary and secondary ownership transformation, and

– Relationships between changes in corporate governance and secondary ownership changes.

The third goal was to formulate recommendations for regulatory changes in the countries studied and more general recommendations concerning the utility of various alternative privatization schemes for other countries.

The research focused on three countries: the Czech Republic, Poland, and Slovenia. Large enterprise-level databases each country were used to examine ownership changes that had occurred since wholesale privatization was implemented. These were supplemented by

[10] This research was undertaken with support from the European Union's Phare ACE Program 1997, project P97-8201 R "Secondary Privatization: The Evolution of Ownership Structure of Privatized Companies", coordinated by Barbara Błaszczyk of the CASE Foundation in Warsaw. The content of the conclusions presented here is the sole responsibility of the authors and in no way represents the views of the Commission or its services.

the analysis of the relationship between performance and ownership changes in each type of wholesale privatization and in each country. Effort was made wherever possible to ensure the maximum possible methodological uniformity across countries, though for a variety of reasons (such as country specificities and data limitations) this was not always possible.

3.1. Slovenia[11]

Under Slovenia's mass privatization model, 20 percent of shares went to para-state funds (the pension fund and the restitution fund), 20 percent of shares to privately managed privatization funds in exchange for ownership certificates collected by them from citizens, and most of the remaining shares were distributed to insiders (managers and current and former employees). Of approximately 1,500 companies which were privatized under this program, only a few dozen acquired strategic owners, and very few were privatized using initial public offerings.

As a consequence, three typical groups of companies were formed:

– *public companies* quoted on the stock exchange;

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

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

In their analysis of ownership changes in Slovenian companies privatized under the mass privatization program, the authors first presented concentration indices for those companies at two points in time: the end of primary privatization and end of 1999. The indices are: shares held by the single largest shareholder, the five largest shareholders, and the ten largest shareholders (denoted as C1, C5, and C10 respectively) and the Herfindahl index.[12] Then, using a sample of 183 mass-privatized companies, they presented the weighted averages of shares of various types of owners (state funds, investment funds, managers and employees, domestic and foreign external investors) at the time of completion of primary privatization at the end of 1999. They concluded with a transformation matrix showing the transformation trajectory of firms grouped with respect to their dominant shareholders at the time of privatization, i.e. how the number of firms in each dominant ownership group has changed over time. They found that concentration had been occurring, especially in companies held by insiders: between the completion of privatization and the end of 1999 almost 40% of initial shareholders had exited the companies privatized through mass privatization. Small shareholders, the state and para-state funds had reduced their ownership stakes in these companies while managers and strategic investors have increased them. But both of the latter groups were accumulating their shares more intensively in companies not traded on the stock exchange. And these were transactions made on informal markets, with limited competition and transparency.

Another central problem that had emerged was the conflict between large shareholders — para-state funds and privatization funds, lacking both the ability and motivation for proper corporate governance — and small shareholders (largely insiders). In many medium-sized firms these two groups had entrenched their positions and were battling each other for control. There often seemed to be no way out of this battle, which was distracting the attention of company actors from restructuring-related issues. A further problem lay in the fact that the secondary privatization process had attracted too few foreign investors, who had been deliberately excluded during primary privatization.

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[11] See Böhm et al. (2001).

[12] The Herfindahl Index is calculated as the sum of the squared shares of each owner.

To examine the relationship between ownership and performance, the authors used a database containing financial and ownership information on 426 mass-privatized companies for the period 1995-1999. These companies were divided into groups depending on whether they were publicly traded, owned primarily by internal owners (management and employees), or owned primarily by external owners (for the most part, state and investment funds), and whether they had switched from one of these categories to another in the period under consideration. In their analysis the authors were particularly interested in identifying what they call the "owner effects" (the performance effects of staying in one ownership category) and "agent/seller effects" (the performance effects of moving from one ownership category to another). Performance indicators used in this analysis included the growth in the labor force, sales and assets, and productivity, and the ratios of operating profit, operating profit increased by depreciation, and net profits to sales revenues. Correcting for selection bias, the authors regressed measures of performance on various factors not related to the ownership structure which were thought to have an impact on performance as well as dummy variables for different ownership groups of companies.

The authors found the secondary privatization process in Slovenia to have been seriously flawed. It had had practically no positive effect either on economic efficiency or on financial performance in the 1995-99 period. On the basis of their analysis, they concluded that the major problems with the post-privatization ownership consolidation had been the quality and transparency of the process and not its slowness. Factors that prevented fast, transparent and effective secondary privatization stemmed from the corporate governance and finance regime established in mass privatization. The legal and regulatory framework adopted to guide secondary privatization postponed transferability of large volumes of shares and applied standard rules for ownership concentration and consolidation of control to privatized companies with tradable shares, even though only a fraction of them were quoted on the stock exchange. Though presented as protection of small shareholders, such restrictions and rules in fact hindered taking publicly traded companies and privatization funds private (that is, buying out small shareholders and removing their shares from public trading) in an orderly fashion. They were flagrantly abused in practice, while rules for voting on legal changes and reorganizations of corporations (which, under the circumstances, may be a better protection for small investors) had not been established.

3.2. Poland

The Polish privatization program included two "schematic" or "wholesale" methods: MEBO and the National Investment Funds Program. Why, in our research, did we treat MEBO privatization as a wholesale scheme, despite the fact that it was a bottom-up privatization procedure, initiated by the managers and employees themselves? We did so because the legal framework for this method was highly regulated by the government and fairly strict criteria concerning the structure of ownership had to be met (specifically, it was required that at least 50% of the employees of the state enterprise become shareholders in the new company). Also, the preferences given for insiders in this type of privatization influenced the lease/sale contracts to a great extent. For these reasons, the ownership effects of this privatization probably diverged considerably from the ownership structures that would have emerged without government regulation, supervision and preferences. On the other hand, it should be noted that this privatization path required much organizational and financial input from the buyers and differed considerably in this respect from give-away methods. More importantly, the ownership structures established by this procedure were simple and did not include the artificial constructions of mass privatization schemes (e.g., the National Investment Funds).

3.2.1. Companies Privatized by Management-Employee Buyouts[13]

The vast majority of employee buyouts in the Polish privatization process have been generated via the leasing variant of direct privatization, in which at least 50 percent of the employees of the state enterprise being liquidated had to form a new company to lease the assets of the old enterprise. By the end of 1998 lease-leveraged employee buyouts represented about one third of the completed privatizations carried out under the supervision of the privatization ministry, thus constituting the single most frequently used privatization method in Poland (in terms of the numbers of enterprises privatized). Most of the firms in this category are small- to medium-sized firms, usually with less than 500 employees.

In this study, 110 firms privatized by the lease-leveraged buyout method between 1990 and 1996 were analyzed. First, weighted averages of the shares of various groups of owners (strategic investors, other domestic and foreign external investors, and various groups of insiders) at the time of privatization and in 1997, 1998 and 1999 were presented and analyzed. These changes were summarized in a transformation matrix. Next, the evolution of C1 concentration was presented.

The ownership structure of Polish employee-leased companies, especially immediately after privatization, was characterized by large holdings of dispersed insider owners. Subsequently, the shares of non-managerial employees gradually declined, while those of outsiders grew. The concentration of shares in the hands of managers was expected from the very moment of privatization, although managerial holdings later stabilized and even decreased somewhat in favor of outsiders.

In general, however, change was found to be incremental. Radical changes in the ownership structure had been rare, and ownership structure seemed to be fairly inert. It would, nevertheless, be wrong to conclude that significant change was not possible when it was in the interests of the incumbents, as new strategic investors had appeared in about 10 percent of the sample by 1998. (It is, however, worth noting that there was a negative relationship between the size of top management's share and the appearance of strategic investors; it appears that once managers had decisive control over the ownership structure of a company, they were reluctant to relinquish it.) The most important factor influencing the direction and the dynamics of ownership change was the economic condition of the company, which, when it was poor, favored concentration and "outsiderization" of ownership (as well as changes in corporate governance).

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

There was some slight evidence that the extent of non-managerial employees' share in the ownership of the firm had a negative effect on economic performance in the early 1990s. In particular, there was a case — albeit a weak one — to be made for the claim that companies whose employees constitute the dominant owners followed a policy favoring consumption (wages, dividends and the like) over investment and development. However, the situation in the companies is likely to be differentiated, with the relationships between ownership structure and economic decision-making dependent on many factors that the authors were unable to analyze here.

[13] See Kozarzewski, Woodward (2001).

Finally, corporate governance in the employee-owned companies was examined, with special attention devoted to the role and composition of the supervisory board and the role of owners and top management in decision-making processes. Executive board membership was found to be dominated by persons who had managed the companies before privatization. Changes in top management had occurred most frequently in firms in which over 50 percent of the shares were in the hands of outsiders.

Contrary to what one might expect from the process of ownership "outsiderization", the position of insiders in supervisory boards was markedly strengthened in 1998-99. However, supervisory boards tended to be rather passive, not using all the powers they were entitled to by law and company by-laws. The small role of owners in the decision-making process was also striking. The owners most frequently acted as decision-makers where ownership was concentrated in the hands of a strategic outside investor. The general picture that emerged was thus one of consolidation of management's power and even managerial entrenchment.

3.2.2. The National Investment Funds and their Portfolio companies[14]

The initial ownership structure was identical in each of the 512 companies privatized in the National Investment Fund Program, so data analysis was not needed to describe it. Ownership changes in the 1995-2000 period were analyzed by looking at how many companies in the NIFs' portfolios were sold to what types of investors (i.e., domestic corporate, domestic individual, employee, foreign, other NIFs, public trading) in which years. A great deal of attention was paid to the issue of changes in the ownership of the funds themselves as well as the issues of corporate governance in the funds (management costs, strategies, etc.).

Finally, the economic performance of NIF portfolio companies was compared with other groups of companies in the Polish economy. NIF companies were also broken down with respect to the type of owner that acquired (or kept) them and then compared with each other using annual sales as the basis for comparison.

The authors demonstrated significant shifts in the ownership of the funds in the secondary privatization stage and a strong tendency to ownership concentration. The share of the State Treasury and small investors decreased significantly, while cross-holdings between the NIFs and the shares of institutional domestic and foreign investors increased.

The decreasing share of small investors (both individual and institutional) — i.e., those holding less than 5% of the shares of a given NIF — was noted. At the beginning of the program they had held 85% of the NIFs' shares; by the beginning of 2001, their share had dropped to 41% — less than half of its original level. By contrast, the share of large investors had been rising. The share of institutional investors had jumped to 46% by the end of 2000, mainly through the involvement of foreign investors. These trends were found to reflect the progress of ownership concentration. Over a period of 2.5 years (from June 1998 to December 2000), the C1 index (that is, the share of the single largest shareholder) had increased from 5.41% to almost 24%, and the C3 index (the share of the three largest shareholders) had increased from almost 7% to 42%.

As a rule, the NIF managers had not been particularly interested in restructuring their portfolio companies themselves, strongly preferring secondary privatization (i.e., sale to other investors). As of December 2000, over half of these companies (278) had found new investors, including companies quoted on the stock exchange (27) or over-the-counter market (12). In addition, at that time, 78 companies were under bankruptcy or liquidation procedures (of which nine had already been liquidated at the time of writing). Thus, in all, secondary privatization had affected 346 firms (out of a total of 512). The most numerous new owners were domestic strategic investors (large domestic companies), who had become shareholders in 134

[14] See Błaszczyk et al. (2001).

companies. Foreign investors were in second place with 57 firms. Individual private owners had taken control of 48 firms, and employees had acquired 14 NIF companies

A more detailed examination of the ownership structure of NIF portfolio companies showed that the concentration of ownership had increased in these companies — more slowly than in the funds, but still at a remarkable rate. By the year 2000, the largest shareholders were in near-absolute control in about one third of the companies. The economic and financial performance of the NIF companies had deteriorated in the early stage of the program because of its delayed implementation and the lack of restructuring activities during the waiting phase. In 1995, profitability had fallen rapidly and never recovered. Much better results were achieved in 1999 by other groups of privatized enterprises, and even by State Treasury companies.

Using the ratio of sales in 1999 to sales in 1995 as their measure, the authors looked at the financial situation of NIF companies that had undergone secondary ownership changes (i.e., had been sold to new owners) and found that the drop in sales had been sharpest (ranging from 30 to 60%) in companies sold to domestic individuals and employees. A significant decline was also experienced by companies which had not been sold by the NIFs (i.e., where the largest block of shares still belonged to the leading NIF) and by most companies which were publicly traded. Both types of companies continued to lack a strong outside investor who could bring them capital, know-how, etc. The best results were found in companies sold to domestic corporations and foreign investors relatively early.

The success of the NIF Program, which in effect "privatized" the process of privatization of the portfolio companies, was thus limited to cases where medium-sized and large companies were rapidly sold to domestic corporations and foreign investors, which helped those companies to at least maintain their market position. Where this had not occurred, it seemed rather to have been a failure.

3.3. The Czech Republic[15]

Using a relatively large representative sample of voucher-privatized Czech firms, the authors first showed the trends in these firms. The ownership data included the identity and the equity holdings of up to seven largest shareholders for each company since 1996. These owners were categorized into six types: other industrial groups or companies, investment funds, portfolio companies (companies engaged primarily in buying and selling of shares without any intention of interfering in management decisions), individuals, banks, and the state.

The primary changes in ownership structure in the 1996-1999 period were first calculated using three ownership concentration measures: C1, C5, and the Herfindahl index. The authors also calculated the mean ownership position for each of the categories of owners mentioned above. Additionally, the authors used density functions of ownership concentration indices to paint a broader picture of ownership structure and its changes during the period from 1996 to 1999.

To capture the relationships between the ownership changes described above and various aspects of enterprise performance such as profitability, strength and size of the firm, its financial position, and its scope of business activity, the authors carried out regressions employing the ownership variables described in the foregoing as well as various measures of profitability, financial strength, and sales. The performance variables were regressed on various ownership variables as well as industry and sector dummies.

The Czech voucher privatization took place in the years 1991-95. While it was only one of a number of possible methods of ownership transfer in the Czech privatization program,

[15] See Kočenda, Valachy (2001).

the voucher scheme led to the wide distribution of share ownership in the Czech Republic. Privatization Investment Funds (PIFs) had taken an active part in the implementation of the voucher scheme and become the most important owners of equity in the immediate post-privatization period. More than 400 PIFs had participated in the program. A significant number were founded by various types of financial institutions, mostly state owned at the time. Most of the rest had been set up by manufacturing companies. The 13 largest funds had obtained control over 56% of all voucher points invested in the PIFs by citizens. Foreign and domestic strategic investors had played a very limited role. This tendency toward overwhelming fund dominance decreased somewhat after the second wave of voucher scheme, when funds sold many of their shares to individuals and corporate entities.

In this early post-privatization period, heavy inter-fund trading rearranged the PIFs' portfolios. This was carried out under almost complete lack of government intervention by way of enforcement of legal provisions and regulations. The lax legal environment and the absence of any notification and disclosure requirements facilitated a wave of mergers and acquisitions, which contributed to further concentration of ownership. From 1996 onwards, ownership concentration in voucher-privatized companies continued to increase and reached levels which were extremely high in comparison with many developed countries. The most concentrated shares tended to be held by strategic investors (although the number of firms with foreign strategic investors was still relatively low in 1996-97), the lowest by banks and portfolio investment companies. PIFs had also begun divesting the firms in their portfolios.

The authors examined shareholding patterns by investigating which of six types of owners (i.e., manufacturing companies, banks, investment funds, individual owners, "portfolio companies"[16] and the state) constituted the single largest shareholder of these companies. They found that manufacturing companies were the most stable type of largest owner, followed by individual owners. Manufacturing companies also recorded by far the largest ownership gains in this period. The most unstable type of owner was the portfolio company.

In an econometric analysis of the impact of ownership concentration and the type of dominant owner on firms' performance, the authors concluded that ownership concentration did not explain changes in company performance. Some positive correlations were found between performance and the holding of the largest block of shares by portfolio companies and individuals (as opposed to other types of owners).

3.4. Endogenous Ownership Structure and Mass Privatization in the Czech Republic and Poland[17]

While the three country studies discussed above treated ownership concentration as exogenous and tried to analyze its impact on firm performance, the authors of this research took a different approach. They considered ownership structure as endogenous and tried to determine how it adjusts to firm characteristics and to factors characterizing firms' environment.

The authors first presented the theory and empirical evidence showing the ambiguous relationship between ownership structure and firm performance. Then, given this ambiguous relationship, they argued that an assessment of the effectiveness of wholesale privatization should not refer to concentrated ownership as a benchmark. What is more relevant, they argued, is the possibility for the firm to adjust its ownership structure to firm-specific characteristics and to its environment. Thus, flexibility of the ownership structure is a virtue. The authors documented the significant reallocation of property rights since the initial mass privati-

[16] This term refers to a category of institutional investors whose strategy is solely to realize profits through dividend payments or — more frequently — through capital gains and who normally have an intention of participating in corporate governance.

[17] See Grosfeld, Hashi (2001).

zation in Poland and in Czech Republic, showing that the ownership structure had evolved rapidly: it had become highly concentrated, and the identity of the largest shareholders had changed quickly. So, contrary to the concerns of the critics of mass privatization programs, the authors found the inertia of the initial ownership structure to be quite limited.

The authors also interpreted the significant evolution of ownership structures in firms privatized through mass privatization as an argument for treating ownership as endogenous. They cited several authors (Demsetz and Lehn, 1985; Himmelberg et al., 1999; and Demsetz and Villalonga, 2001) who have argued that even in more stable environments the usual regression of firm performance on ownership concentration would produce biased results. In firms privatized through wholesale schemes, this endogeneity problem is particularly important. So instead of treating ownership as exogenous, the authors considered various firm-specific characteristics and factors characterizing the firm's environment which might affect the evolution of ownership concentration and the change in the type of largest shareholder.

The authors re-examined the evolution of ownership structure in firms privatized through voucher schemes in the Czech Republic and Poland, focusing on the endogeneity of ownership structure and the effect of the companies' economic performance on ownership changes. They showed that not only has there been a strong tendency towards the concentration of ownership in fewer hands, but also a large-scale reallocation of ownership rights has taken place among various types of owners. Starting from a highly dispersed ownership structure, the large majority of voucher-privatized Czech companies had found a dominant shareholder by the year 2000. In nearly half of them, the dominant shareholder owned more than 50% of equity and had absolute control over the firm. In Poland, too, the majority of companies involved in the scheme found dominant owners, some 10% of them being foreign investors. Furthermore, manufacturing companies and individuals had emerged as major dominant shareholders in both countries.

The authors maintained that ownership structure had evolved in response to competitive pressures and constraints in the environment of the firms as well as firm-specific characteristics. They saw the rapid increase in concentration as the owners' response to firms' conditions and their long-term prospects. In particular, they found ownership concentration to depend on the degree of uncertainty in the firm's environment. The riskier the environment, they found, the greater the tendency of firms to have more dispersed ownership. The authors suggested that these results could be interpreted in the light of theories of the firm stressing the trade-off between managerial initiative and shareholder monitoring and control. The greater ownership dispersion they found in riskier environments leaves greater room for managerial decisions. An important implication of this finding, they argued, is that concentrated ownership may not always result in better corporate governance and control.

4. Conclusions and Policy Recommendations

As the overview of empirical research of the 1990s shows, complete consensus has not been reached on any of the issues under consideration. Sometimes empirical data run counter to generally accepted theoretical approaches. It seems there are only two points where the results of almost all empirical research agree:

– the finding that there is a positive relationship between foreign investors' stakes and performance, and

– the finding that the role of employees as shareholders is neutral or negative.

Empirical results are mixed or inconclusive with regard to:

– the "contribution" of privatization to improvement of company performance (taking into account the time of privatization and the size of the government-held stake in companies

with mixed ownership) and, in a broader perspective, the comparative efficiency of state-owned and private companies;

– the impact of ownership concentration levels on performance, and

– the nature of the relationship between the dominant owner type (managers, outside shareholders) and performance.

There are several reasons for this.

First, there is still a great deal of disagreement even in the theoretical discussion of the issues. For example, while in 1999 Joseph Stiglitz wrote about the need to pay greater attention to the role of insiders, who, in the context of the relationship between ownership and management in transition economies can have a positive impact by shortening agency chains (Stiglitz, 1999), in the same year the EBRD called for fighting against the interests of the "entrenched insiders" (EBRD, 1999). And Oliver Williamson, in a recently published overview of institutional theory pointing to the problems engendered by privatization in Russia, links what he views as the flaws in the county's privatization strategy to policy makers' adherence to the Grossman-Hart-Moore[18] theory of property rights (Williamson, 2000).

Second, the (corporate) ownership structure emerging in many post-Communist economies can still be assumed to be of a transitional nature; thus, it is too early to draw conclusions about its gravitation towards a particular classical model (ownership and corporate governance structure). In fact, various components of all traditional models can be observed in the transition economies at the moment: relatively dispersed ownership (but with an illiquid market and weak institutional investors, in contrast to the Anglo-Saxon countries where dispersed ownership is most typical), a clear and sustained trend towards ownership concentration (but without the adequate external financing and efficient monitoring mechanisms characteristic of the European economies with highly concentrated ownership structures), and elements of cross-ownership and emergence of complex corporate structures of various types (but without gravitation towards any particular type).

Clearly, this ill-defined character of the ownership and governance models evolving in the transition economies hampers decision-making in the law and policy areas. One example would be sufficient to illustrate this point. It is generally believed that a high need for company transparency (information disclosure) is reached if shareholder base is broad (i.e., concentration is low). If one assumes that the many stages of ownership redivision that are to follow will result in highly concentrated ownership, then the requirements of the law as to information disclosure (both current and new, more stringent ones) are groundless. Certainly they are not properly complied with now.

Third, the issue of relations between affiliated entities and beneficiary ownership is a difficult one. Given the actual ownership (control) structure and financial flows of many big Russian companies (see Radygin, Sidorov, 2000), practically all initial data used for empirical research — both in the issues of ownership (managerial as well as outsider) and financial performance — may be called into question. Managerial property is a special issue. It is clear that the managers' stake shown in all surveys is highly misleading. The actual power of managers in companies may be based on a relatively small stake (about 15% of shares is usually sufficient), even though there is an obvious trend towards maximization, part of which occurs through affiliated entities. In this situation testing classic hypotheses about the role of managers (e.g., the "convergence hypothesis" in Jensen, Meckling, 1976, and the "entrenchment hypothesis" in Morck, Vishny, 1988) is extremely difficult.

Fourth, there are serious difficulties associated with one of the classic econometric problems — that of causality (the "endogeneity problem"). The problem is that the choice of enterprises to be privatized cannot be considered accidental. Thus, privatization theory most

[18] For details, see Radygin, Entov, Malginov et al., 2001.

often proceeds from the assumption that it is inefficient enterprises facing crisis that have to (should) be privatized (Vickers, Yarrow, 1998). But investors prefer to acquire shares in efficient companies. This consideration must have played an important role in the course of post-Communist privatization (Carlin et al., 1995). However, if there are any real grounds for such assumptions, this is evidence of the unequal initial conditions of the operation of privatized and non-privatized companies. Indirect evidence of the problem of endogeneity can be found in the extent of insider ownership in many transition economies. Russian survey data from 2000 demonstrate that insiders acquired larger stakes in companies that had been characterized by higher performance (higher labor productivity and profitability) in the pre-privatization period (Muraviev, 2001). Thus, given the asymmetry of information, better performance of the companies where insiders have larger stakes could reflect "cherry-picking" by the insiders in the course of privatization rather than the superiority of insiders as a class of owners.

It is our hope that the research summarized in Section 3 can shed some light on these questions. The main findings of the studies presented there can, in spite of a number of differences between the experiences of the three countries studied, be summarized in the following generalizations about how the process of secondary privatization unfolded in those countries.

1. In the majority of enterprises privatized under mass privatization schemes in which insiders were not officially privileged, extensive secondary privatization processes have taken place (that is, new owners have taken control). The transfer of ownership to new owners in insider-owned companies like the Polish employee-leased companies and most privatized enterprises in Slovenia, however, remains limited to a minority of such companies.

2. There is increasing concentration of ownership in almost all enterprises under consideration.

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

4. This result may be an indication that ownership evolution is first and foremost an endogenous process determined by, rather than determining, the economic performance of the enterprise. The concentration of ownership by large shareholders is influenced by a variety of firm level factors as well as competitive pressures and constraints experienced by them. The absence of a direct relation between ownership concentration and performance may of course also be explained by the short period of time which had elapsed between the acquisition of the companies by their new owners and the time of the research.

5. The type of owner (i.e., "insider", "outsider", strategic or portfolio investor, domestic or foreign) seems to be very important. A detailed analysis of the identity of the new strategic investors emerging in the secondary privatization process is needed. Are they foreign or domestic? Do they come from the same branch as the purchased enterprise (thereby representing examples of horizontal integration), or do they have supplier or customer relationship with the acquired company (thus constituting examples of vertical integration)? Are they financial investors? What connections have they had with the acquired firm in the past? What are the strategies underlying their acquisitions? These are some of the questions that will be very important in further research.

6. The regulatory and institutional environment of the privatized enterprises is also crucial — as crucial for the success of secondary privatization as it was for that of initial privatization. Does this environment impede the entry of new owners, or does it facilitate their appearance in the privatized companies? This is a very broad topic, which was dealt with often

and from various angles in our work, and we believe that it, too, demands further, more systematic research in the future. When the legal, regulatory, institutional and general economic environment is highly unfavorable, we observe either blockages or pathologies in the secondary privatization process, as a result of which the end results of this process turn out to be very different from those expected by reformers. Some of these unexpected pathological results include the creation of monopolistic structures and the entrenchment of owners who are unwilling and/or unable to make the changes necessary to improve the economic viability of their companies. Poorly designed privatization institutions do not fulfill the roles assigned to them, but rather take on lives of their own and begin to create new problems.

7. A cardinal example can be found in investment funds, which constitute one of the central legacies, and one of the greatest problems, created by the privatization schemes we investigated in this project. Emerging as a result of various mixtures of spontaneity and state design in all three countries, they were originally intended by the designers of privatization policies to solve the corporate governance problem in one of two ways. First, they were to solve the principal-agent problem of an enormous group of shareholders, extending to practically the entire population, by concentrating managerial control in enterprises with widely dispersed ownership. Second, quite the opposite, they were expected to sell their shares in companies quickly, allowing for concentration of ownership in new hands and the elimination of the principal-agent problem altogether. Investment funds have not lived up to either of these expectations. They have had neither the capacity nor the motivation to engage in active corporate governance, but instead have become major players in the economies of at least two of the three countries we studied. Far from delivering improved corporate governance and company performance, they have often been used in schemes to drain companies of their assets (most notoriously in the case of the Czech Republic, whose experience led to the formulation of the new concept of *tunnelling*).

8. Another important institutional factor is the regulation of capital markets. There has been much commentary on the poor regulation of the Czech capital market and the high-quality regulation of the Warsaw Stock Exchange (see, for example, Glaeser et al., 2001), and it seems that the Slovenian exchange bears a number of disturbing resemblances to the one in Prague. These problems often reduce the transparency of the secondary privatization process, making it difficult for companies to raise new capital and for the rights of minority shareholders to be protected.

9. The inertia of ownership structures frequently observed in our samples is not accidental, but rather results from the entrenchment of incumbent owners (particularly the insiders) that emerged in the primary privatization process and frequently bar entry to all outsiders. Since the state can no longer exercise influence on this situation from the position of an owner, it can only act through the creation of new regulation, which could at least partially reduce some of the barriers to the entry of new owners. On the other hand, with respect to the stability of insider ownership noted above, it is likely that such ownership structures will remain both stable and economically efficient in the case of small and medium-sized enterprises which make up the majority of insider-owned companies in both Poland and Slovenia. As Chandler (1996) notes, the separation of ownership from control was an efficiency requirement for very large, multidivisional firms whose production processes were characterized by significant economies of scale and scope, but was not necessary in industries whose technologies allowed for combining relatively small firm size and efficiency.

Another issue worth commenting on at this point concerns the debate about whether the ownership and corporate control structures emerging in the post-Communist countries of Central and Eastern Europe would bear a greater resemblance to those in Anglo-Saxon countries (where capital markets dominate) or to those of continental Europe and Japan (characterized by concentrated ownership and the strong role of banks in corporate finance and control). It

seems that neither model is adequate to explain the directions of development in these countries. Capital markets (with the exception of Poland) lack the informational transparency provided by regulation in the Anglo-Saxon countries. The degree of concentration, and its increase, as well as the role of financial institutions, might suggest at first glance a similarity to the European or Japanese model. However, these financial institutions are portfolio investors — funds, not banks — with little or no interest in corporate governance, a fact which strongly distinguishes Central Europe from Western Europe. In short, unlike either the Anglo-Saxon or the German-Japanese system, the institutional environment created in Central European wholesale privatization and its aftermath has brought neither the informational transparency necessary for efficient markets nor the additional capital necessary for restructuring.

It is clear that the establishment of an efficient system of financial institutions, primarily commercial banks, is crucial for the development of a national model of corporate governance and finance. The weakness of such institutions in Russia, which became obvious in the 1998 financial crisis, deprived earlier discussions of the nature of the national model of corporate governance (Anglo-Saxon or German-Japanese) of all meaning. In an environment with limited or non-existent mechanisms for inducing managers to act in any interests other than their own, the potential role of banks as an alternative mechanism of corporate control (Stiglitz, 1994, pp. 77-78, 189-190) becomes largely irrelevant.

It is also worth calling attention to some of the nuances which, to varying degrees, differentiate the three countries studied. The Slovenian situation presented here bears much resemblance to that of Polish MEBO and NIF companies. Similarities are especially striking with regard to the behavior of investment funds, managers and employees as owners in the post-privatization phase, as well as with respect to the behavior of the state (both as an owner and as a regulator). In the case of the latter, the Slovenian and the Polish experience shows that it is difficult, if not impossible, for the state to refrain from exercising the power it reserved for itself by maintaining residual property in the privatized enterprises, as well as via its influence in the investment funds themselves. The role of state golden shares in the Czech Republic and that country's delays in the privatization of banks are also evidence of a similar tendency. Both states have also shown a tendency to make too many promises that they cannot keep, and to try desperately to keep those promises by utilizing privatization revenues (which, ironically, gives the state an incentive to keep as much residual property as possible, in order to have a reserve from which it can deliver on such promises).

Moreover, in both Poland and Slovenia, generally speaking, weaker performers went into the portfolios of investment funds via voucher privatization, companies with more or less average performance became employee owned, those with the best performance were often sold in IPOs. This seems to reflect both the aforementioned fiscal approach to privatization and the attractiveness of such companies for investors; however, it is clear that such a privatization strategy fails to bring new capital to the firms which need it most.

Another similarity between Poland and Slovenia lies in the fact that in both Polish and Slovenian employee-owned companies we observe problems arising from the fact that many people keep their shares after leaving their companies (due to retirement or other reasons), and from the fact that shares are often not available for new employees hired after privatization. The problems are due to perceptions that the most consumption-oriented attitudes are exhibited by former (and not current) employees, and that new employees (young, well-educated persons hired in the 1990s) are often the most valuable in the firm. A possible solution is the creation of trust funds which would hold employee shares on behalf of the employees, issuing shares to new employees and purchasing them from those that leave the company.

Some important differences among the countries need to be mentioned as well. These are:

1. Slovenian “employeeism”. The heavy emphasis on both codetermination (employee representation on supervisory boards) *and* employee ownership in Slovenia was not duplicated in any other transformation country. It seems that Slovenia has been unable to find an appropriate balance between the regulation for various forms of employee participation — those based on ownership and those based on employment. Slovenia represents an extreme in this area. The Czech Republic, on the other hand, has enacted the least “employeeist” legislation of the three countries studied here. Poland lies in between these two extremes, having mandated employee representation on supervisory boards in state-owned joint stock companies and — in companies privatized by commercial methods — the allocation of 15 per cent of the shares to employees free of charge. These trends seem to be connected with historical differences between the respective countries reflecting the extent of workers’ self-management ideology and practice under socialism. Workers’ self-management was strongest in Yugoslavia, from which Slovenia broke away in 1991, somewhat less strong in Poland (self-management legislation concerning state enterprises was enacted in Poland in 1981, but workers’ councils were not really allowed to operate freely in state enterprises until 1989), and non-existent in socialist Czechoslovakia.

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

3. There appears to be a difference between Polish and Slovenian employee-owned companies with respect to the ownership structure most attractive to potential strategic investors. As Böhm et al. (2001) write, strategic investors tend to be interested in acquiring companies in which the ownership structure is concentrated. It is probably safe to assume that such concentration means concentration in the hands of managers. In the sample of Polish employee-owned companies studied by Kozarzewski and Woodward (2001), the situation seems to be quite different. Here, there is a negative correlation between the entry of strategic investors and the concentration of shares in the hands of managers. In general, strategic investors seem to prefer companies where shares are dispersed among a large number of employees than those in which they are concentrated in the hands of a few managers (although it might not be strategic investors’ preferences that are crucial here, but rather those of managers — once they have achieved control, they may be reluctant to give it up).

Finally, we present a few suggestions for policy makers which emerged from this research. First, a few remarks concerning investment funds and their role in privatization. It is best if such funds are not set up by the state, and if they are, the compensation of their fund managers should be strictly tied to performance. Given the scarcity of capital and shallowness of capital markets in transition economies, as well as the desperate need for pension reform in most such economies, privatization funds should not be kept artificially separate from pension funds; in fact, it would probably even be a good idea to encourage mergers between the two. In general, as much freedom as possible should be allowed for the transformation of funds created for participation in privatization — into open-ended funds, closed-ended funds, mutual funds, venture funds, etc. Policy makers should realize that funds, if left to evolve freely, will take various forms in response to different kinds of market incentives and varying preferences of their participants. This process should be allowed to occur with a minimum of constraint. We will return to this point in a moment.

Second, the importance of capital market regulation is paramount. Disclosure requirements (e.g., requirements to disclose the size of blocks of shares held at certain thresholds), strict bans on insider trading, mandatory bid rules (i.e., the requirement that shareholders crossing certain thresholds should make offers to buy out other shareholders), and other forms of regulation are necessary to maintain transparency of the markets and transactions as well as protect minority shareholders' rights.

What about regulating the funds themselves (e.g., limiting the percentage of a given company that they can hold)? Having stressed the importance of capital market regulation but also the importance of allowing funds to evolve freely, we would add that certain regulations in force in more developed markets economies may be too restrictive in an environment where there is a need for rapid secondary privatization (which may involve, for example, taking companies private — that is, buying out the small shareholders in a publicly traded company and its de-listing). EU takeover regulations, for example, may be too restrictive for companies which are not publicly traded. It may also be useful to encourage off-market transactions in certain situations, though such transactions are generally strictly limited in strong regulatory regimes. In order to facilitate taking companies private, such transactions should serve to allow outside financial investors to exit in a fair and transparent fashion, and could include, for example, equity-to-debt conversions. Finally, given the fact that although most funds are typically portfolio investors, some have both the propensity and the competence to take active roles in the governance and restructuring of the firms whose assets they hold. Regulators should consider exceptions to the general practice of limiting the percentage of shares of a given company that a given fund may hold (Simoneti, 1995).

In the transition environment, it is important that regulation take into account the fact that there are different kinds of minority shareholders. While most such shareholders are individuals with small stakes who cannot defend themselves, some minority shareholders, with stakes of 10 to 40 per cent, are serious players battling for control over firms, sometimes to the detriment of those firms. Some observers consider the potential for abuses by large minority shareholders to have become a serious problem in Russia in recent years.[19] While these sorts of abuses are uncommon in Poland, some recent events show that even well-regulated Central European markets like the Polish one are not immune to such abuses.[20]

How, in such cases, is the regulator to protect the majority of shareholders from a minority shareholder's abuse of his rights? Is cumulative voting, which allows strong minority shareholders to appoint directors and is a standard measure used to protect minority shareholders' rights, perhaps inappropriate in transition environments? We believe this troublesome question requires further investigation.

Another point concerns employee ownership. Given that this has tended to become a fairly widespread feature of privatized companies in almost all transition economies, it might be a good idea to provide for employee trust fund mechanisms which would hold employee shares on behalf of the employees, issuing shares to new employees and purchasing them from those that leave the company. Such a mechanism might resemble, for example, the Employee Stock Ownership Plans in the United States. The Slovenian authors report that while a

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[19] Some possibilities for hostage-holding are discussed in Radygin et al. (2002), pp. 70-71.

[20] One such example is the case of Wólczanka, one of Poland's leading clothing manufacturers (Michałowicz, 2002, 2003). An investor who had consolidated a block of 16 per cent of Wólczanka's shares in 2000 had his representatives on the supervisory board elect a new vice president for capital investments. This vice president, in turn, was responsible for the creation of a Wólczanka subsidiary called WLC Inwest, which managed financial investments. WLC made a number of bad investments, leading to significant losses. The vice president claimed that these poor investment decisions were in fact made by the investor who had nominated him, who had conflicts of interest resulting from his shareholding position in companies whose shares were purchased by WLC. Investigations were later initiated by both the Securities Exchange Commission and the public prosecutor's office.

similar mechanism has been introduced in Slovenia, it has not been availed of in a significant number of companies, and point to the lack of promotion of the mechanism via tax incentives. However, tax incentives are not the only means of promoting this sort of arrangement (and it is debatable whether they are a desirable one).[21] Public education campaigns and training programs (e.g., for trade unionists) might well prove to be sufficient in raising public awareness concerning the advantages of such arrangements.

[21] Certain tax incentives might be advisable when employee stock options are used as a form of retirement insurance, but this would have to be part of a comprehensive pension reform.

II. Privatization in Russia and Poland

Piotr Kozarzewski, Georgiy Malginov, Alexander Radygin

1. Privatization in Russia 1992-2003: Legal Framework and Main Stages

1.1. Privatization Programs (Models) of 90's

First legislative acts on the privatization in Russia were adopted by the RSFSR Supreme Council in summer of 1991, however, their practical implementation began only in 1992. On December 29, 1991, the RF President signed the Decree "On Acceleration of the Privatization of State and Municipal Enterprises" in accordance with which there were approved the Fundamental Provisions of the Program for the Privatization of State and Municipal Enterprises in the RF for 1992. Those Fundamental Provisions had been drafted on the basis of the draft State Privatization Program for 1992. Implementation of those Fundamental Provisions started from January 1, 1992. The Fundamental Provisions became the first document regulating the privatization process and giving start to the programmed (i.e., not spontaneous) privatization in Russia. First Privatization Program (1992) became the fundamental document for the further large-scale privatization in 1992-1994 and also a compromise, on the one hand, between paid (for active part of the population) and gratuitous (vouchers to everyone and privileges for employees) privatization and, on the other hand, between the privatization model for everyone and division of property between the enterprises' employees.

As is well known, **mass privatization model** has become the core of the Russian privatization program, which unified the large-scale corporatization (side of supply) and distribution of the privatization vouchers among the Russian citizens (side of demand). Important elements of that model included closed subscription to shares among insiders, system of voucher auctions and intermediaries' system – voucher investment funds. The most important result – from the angle of perspective development of a new system of ownership rights – was formation of new institutes: corporate sector of economy (over 30,000 JSCs), corporate securities market, system of the institutional investors, approximately 40 mln formal shareholders in the result of the mass privatization.[22]

The privatization was the most intensive in 1993-1994. As is obvious from Table 1, a steady and stable reduction of the new objects' involvement becomes typical for 1995-2002. According to the RF Mingosimuschestvo [RF State Property Ministry], as of January 1, 2000, the sector of the privatized enterprises included about 130,000 enterprises (58.9% of the total number of enterprises in Russia by the beginning of the privatization). At the same time as a result of the privatization in 1992-1999 the State owned a significant number of the enter-

[22] About the first (voucher) stage of the Russian privatisation please see: Radygin, 1994; Boyko, Shleifer, Vishny, 1995; Radygin, 1995a-b; Vassilyev, 1995; IEPPP / IET, 1998b. About the second (monetary) stage please see: Bohm, ed., 1997, Radygin, 1996a; IET, 1992-1999. For comparisons of the different privatisation models in transition economies see, for example: Blaszczyk, Woodward, 1996; Earl, Frydman, Rapaczynski, 1993; OECD, 1995; Ernst, Alexeev, Marer, 1996; Railean, Samson, 1997; The World Bank, 1996; The World Bank – OECD, 1997; EBRD, 1997, 1998; Boehm, ed., 1997; IET, 1998 et al

prises' stocks (3,100 owned as the "golden share" and 7,000-8,000 unsold), the problem of sale of which became the key one for the privatization policy of 1995-2003. Unsold minority stocks (less than 25%) remain as the traditional problem for the privatization and for the state management.

The main document for **the monetary stage of the privatization** was the "Fundamental Provisions of the State Program for the Privatization of State and Municipal Enterprises in the RF after July 1, 1994" (approved by the RF Presidential Decree # 1535 of July 22, 1994). The Privatization Program, approved by the RF President in December 1993, remained in force in the part which is consistent with the Fundamental Provisions. The Privatization Law of 1991 also remained effective.

At the beginning of the "monetary" stage the problem of the profit maximization for the federal budget became dominating and, therefore, the "investments – budget" dilemma was settled in favor of the latter. On the whole with reference to the privatization we can speak about transformation of the uniform privatization policy into a spontaneous process of "throwing off" remaining stocks which proceeds to the regional level. It was typical for that period to use also quasi-privatization methods for attracting political allies among regional elite and major financial groups. The consolidation process and intensive further ownership redistribution among the first-rate financial alliances and companies – natural monopolies were going on.

The practice of holding **pledge auctions** in the end of 1995 is also well known. The chronic budgetary crisis and failure of the budgetary privatization task for 1995 became one of the most weighty incentives for implementing that scheme. 12 auctions that had been held on several major Russian enterprises made a profit for the budget in the amount of 5.1 bln rubles in the aggregate, including 1.5 bln rubles of the paid enterprises' indebtedness before the State. Two major Russian banks – "ONEXIM" and "Menatep" prevailed among the winners. It is obvious that almost all of the pledgees have been interested in acquiring those stocks into their ownership and to minimize relevant financial expenses.

From August 2, 1997, the **new Law** officially came into force – "On the Privatization of State Property and on the Basic Principles of Privatization of Municipal Property in the RF" (# 123-FZ, signed by the RF President on July 21, 1997). The following general innovations should be noted: the Law accentuates (in the title) not on the enterprises but on the property (state interest); the privatization program stipulates the list of the objects to be privatized within a year (depends on the current conjuncture) and the list of the strategic objects, privatization of which is forbidden (can be privatized only with the authority of law); the set of the privatization methods is expanded (through legalization of the previous derivatives' sales); possible privileges for the employees (5-10% discount from the selling price of shares), but such privileges can be abolished or become more flexible; cost of "property complexes" is determined jointly on the basis of the charter capital, balance evaluation and the market value; commercial tenders with investment conditions are introduced and the investment tenders are abolished; the term "lease with further purchase" is restored but "at the market value".

Nevertheless, the experience of the major transactions and the privatization practice of 1997-2002 do not give grounds for making conclusions about radical innovations. Privatization as an element of the economic reforms **becomes less and less urgent**. This applies both to its basic role (important for the first half of 90's) and for the budgetary orientation of the privatization sales (prevailing in the second half of 90's with the different extent of success). This process of collapse of the privatization role in the transitional economy development became apparent, in particular, in the growing activity of critics of the applied models in the end of 90s (not only the Russian model of the mass privatization but also Czech coupon scheme that had been standard from the point of view of the Western in former times became the object of the hard attacks).

From the angle of the further system reforms, it is obvious that the privatization has given up its place to the issues of corporate governance and reform of the privatized enterprises. From the standpoint of replenishment of the budgetary profits (since 1999 – financing of budgetary deficit) problems of rational use and increase of the efficient state property management appear in the foreground. Finally, the investment component of the privatization transactions is traditionally close to zero. Moreover, most of the transactions with investment conditions in 1999-2002 became an object for investigation for the purpose of restituting stocks into the state property for different reasons.

1.2. Recent Privatization Trends

As the name suggests, the entire period of the so-called 'cash' privatization (from 1994 until now) was primarily influenced by budget considerations and it was not uncommon for biggest and most important deals to get governmental approval only by the end of the year, incidentally also the time for reconciliation of budget revenues. All the more heartening that since 1999 the government at least no longer expects on receiving a fixed amount of revenue from privatization, which hopefully would translate itself into a sounder privatization policy. Since 2001 another positive trend regarding state property and its effect on the budget came with a shift of reliance from non-renewable to renewable sources of income. In other words instead of receiving big one-off sums for selling its property the government is now more keen on extracting stable revenue via retaining and better management of its assets (Table 1).

Although the **new privatization Law** came into force only in 2002 much of the privatization program for the year is based on changes introduced by this legislation. Thus the privatization program expects that thanks to a row of newly available methods of privatization the government would be able to get rid off its minority stakes and illiquid holdings and thereby drastically reduce the number of entities in state ownership, a goal that has been widely discussed since the mid-nineties. This should also apply to state unitary enterprises a number of which, especially with November 14, 2002 enactment of Law on State and Municipal Unitary Enterprises, is expected to be cut to 2.5 thousand. In addition, re-organization of such enterprises (mergers, liquidations, incorporation, partial sale, etc) would also affect their subsidiaries.

Table 1

Revenues from sale and use of state property in Russia between 1995-2003 (in current terms)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 (est.)
Actual number of privatized enterprises	6000	5000	3000	2583	595	320	170	2200 (planned)	1063 (planned)
Revenues from sale of state property (non-renewable source) in billion rubles									
Approved budget in rubles	4,991 all revenues	12,3 all revenues	6,525 all revenues	8,125[c]	15[e]	18	18	35	51
Actually received funds in rubles	7,319[a]	1,532	18,1[b]	15,442[d]	8,547	31,368	10,11	91,2[f]	-
Actual revenues from use of state property (renewable source) in billion rubles									
Dividends on federally-owned stakes in enterprises	92,8	118 (35 JSC)	270,5	.575 (200 JSC)	.848 (600 JSC)	3,675 (1050 JSC)	6,478	10,25 (708 JSC)	10,5
Payments on lease of state property	116,7	*N.D.*	305	466	2,191	3,427	4,896 on assets 3,917 from land	7,843 on assets 2,3 from land	7,3
Revenues (profits) from state-owned enterprises	-	5	26	.783 from Vet-sovpetro (VS)	5,675 from VS	11,687 from VS	13,622 from VS; .209 from131 state unitary enterprises	9.9 - VS .9 from 809 state unitary enterprises	12,3 - VS, 2,5 from state unitary enter-prises
Total	209,5	123	610,7	1,824	8,714	18,789	29,122	31.19	-
Cumulative revenue from use and sale of state property in billion rubles									
Actually received	7,529	1,655	18,702	17,266	17,262	50,157	39,233	122,39 vs. 70,6 planned	-

[a] approved budget was adjusted in December 1995, 70.8 % of actual revenue came from share-for-loans auctions;
[b] including US$1.875 billion from sale of stake in Svyazinvest holding;
[c] adjusted to 15 billion rubles in April 1998 (on governmental level);
[d] including 12.5 billion rubles from sale of 2.5% stake in Gazprom;
[e] from 1999 funds from privatization are not included in the budget revenue;
[f] includes 0.775 and 1.86 billion from the sale of state stakes in Lukoil and Slavneft respectively.

In general the law provided for 10 various methods for privatization, based on an enterprise's size, liquidity and/or results of initial sales:

1) transforming a closed, single-owner enterprise into a publicly listed company;

2) sale of state and/or municipal property through actions

3) sale of shares of publicly listed companies through special auctions

4) sale of state and/or municipal property via tenders

5) sale of state-owned open joint stock enterprises abroad

6) sale of shares of open JSC through brokers and exchanges

7) sale of state and/or municipal property via Dutch-style auctions open to general public (where final sale price or the cut-off point is exactly a half of the price offered at the onset of the auction)

8) sale of state and/or municipal property without disclosure of target prices (should it fail then the sale proceeds via Dutch-style public auctions)

9) incorporation of state and/or municipal property as charter capital contributions for open JSC

10) sale of shares of open join stock companies in accordance with results of trust management with a subsequent right to buy shares.

However ambitious the Property Ministry's plans appear at a first glance, most of actual privatization revenues come from large individual sales. Often, final decisions on whether to put a particular enterprise up for sale are made abruptly and arbitrarily, regardless of an approved privatization plan. At the same time sale of other enterprises can be put off a year after a year, and similarly, a deal on a verge of being closed can be cancelled at the last moment.

The 2001 Privatization Law undoubtedly introduced important new mechanisms for transferring state assets into private ownership. Thus the Law officially recognized that: a) land of a privatized enterprise constituted an integral part of a privatized property; and b) intellectual property could be counted as a contribution to a charter capital.

The next two to three years should demonstrate whether these newly devised methods of privatization provided by the Law are successful and conducive to the government's overall aim of financial stability, maintaining budget surpluses and ensuring that its revenue sources are diversified and do not run dry even in the event of tumbling oil prices and peak external debt servicing. The first such results can come as early as in the current 2003, the first year in which the legislation can be applied in its full spectrum.

In spite of the number of positive *technical* advances the Law fails to lay out a comprehensive *strategic* vision of how the privatization process should be pursued and what indeed it hopes to achieve.

Such long-term strategy, for instance, should first of all, in addition to overall budget goals, outline which enterprises in which industries would not be subject to privatization whatever the circumstance. Only upon determining a list of these off-privatization enterprises should the government decide which remaining entities go for sale in the short-, medium- and long-term based on an enterprise liquidity status.

The 2001 law also falls short of curing some of the biggest "headaches" of Russian privatization such as transactions transparency and lack of buyer equality in the conditions of systematic corruption – issues that obviously should come to the forefront of any technical aspects of the process. Sadly this lack of focus on bigger picture means that the Law is riddled with a number of loopholes a detailed account of which is provided below.

The 2001 Law also fails to set unambiguous criteria for dividing the large notion of "state" property into federal, regional and municipal subclasses. Last such criteria were set in 1991 by the Supreme Council of Russian Soviet Federative Republic and are obviously outdated. The lack of clarity is muddled further by a number of often conflicting bilateral agreements made between the federal center and various regions back in the nineties following the

break-up of the Soviet Union. Many hoped that the 1999 Conception for Management and Privatization of State Property and a row of new legislation that followed it would provide better guidance.

Finally, it is important that the government continues with a management reform of the property under its control. Such reform can be based on a simple inventory recount, which also has to include clear delineation of authority between various level of government over its particular holdings.

1.3. Conclusions

In Russia as in many transitional countries the privatization didn't result in any sizable investments in enterprises. This means a heavier press on the emerging model of corporate governance. However, in the legislation of many countries the necessary mechanisms have not been sufficiently developed yet (problem of additional issues, transparency, protection of different categories of shareholders etc.).

As for the existence of any direct links between privatization and the emerging corporate governance model, the following should be noted. At the level of *ideology* (that of the authors of privatization programs) and legal acts, the possibility for detecting any systematic activity aimed at creating a specific corporate governance model in future seems unlikely. This can be explained both by the compromise-oriented (partly due to political motivations) character of Russian privatization programs and by their traditional budget orientation. This situation would be typical of the whole period under study (1992-2003). The only obvious conclusion can be that the ideology of dispersed equity ownership which forms the core of the mass privatization program, similarly to many other transition countries, has transformed into its opposite, i.e., the processes of equity capital concentration presently constitute one of the predominant trends in post-privatization property distribution.

At the same time it is evident that it is those objective processes which are associated already with the post-privatization stage that have become by now quite relevant for the development of national corporate governance models (see the special section). The blocks of shares issued by quite numerous Russian enterprises and still owned by the state, in their turn, may indirectly be responsible for the peculiar features of the emerging corporate governance model in "mixed" companies.

2. Privatization and Corporate Governance Model in Poland

2.1. Privatization Tracks

The main privatization act is the Act of August 30, 1996 on Commercialization and Privatization of State-owned Enterprises which came into effect only in April, 1997. Before that, the Act of July 13, 1990 on Privatization of State-owned Enterprises had been in force. The law distinguish two basic privatization methods: indirect and direct.

The indirect (formerly called capital) method consists of two stages. At the first stage, a state-owned enterprise (SOE) is commercialized, i.e., it changes its legal form and is transformed into a company, where 100% of shares belong to the Treasury (so-called sole-shareholder company of the Treasury, Polish acronym: JSSP), and begins to operate under provisions of the Company Code, common to all entities (except state-owned enterprises and a limited number of companies which are governed by special legal acts). At the second stage, the sale of the shares takes place in a number of ways: public offering, sale to strategic investor (or combination of these two), inclusion to National Investment Fund program.

On April 30, 1993, the Act on National Investment Funds (NIF) was adopted introducing a kind of mass privatization program which, contrary to such programs in other post-Communist countries, had been designed not only to transfer a significant part of the state's sectors assets to Polish citizens, but also to create a mechanism for actively restructuring the companies participating in mass privatization. NIFs received blocks of shares of 512 companies which undergo mass privatization, and Polish citizens received a kind of vouchers which they could invest in the NIFs. It is worth noting, that mass character of NIF program was only a demand side (all Polish citizens), and not on supply side, as in other countries where mass privatization took place. The NIF program was supposed to accelerate the pace of privatization, at the same time providing for restructuring of companies, facilitated by the experience of the professional management companies employed by the NIFs. The second goal was never achieved.

The direct (formerly somewhat misleadingly called liquidation) method consists of liquidation of a SOE in a legal sense; then, the assets of the enterprise (in totality or divided into separated organized parts) are privatized in one of the three possible ways (in Poland often called "paths"):

– sale;

– entering as a contribution in kind into a company established by the Treasury and a private investor;

– leasing (employee buy-out).

The last path needs more attention because it was very popular and is Polish contribution into methodology of post-Communist privatization. A SOE can enter this path only on the request and with consent of insiders. A company (as a rule, LLC) with participation of employees is being set up which leases an equity of formally liquidated SOE. The company signs a leasing contract with the Treasury. The contract provisions stipulate, that upon repayment of all the capital installments and leasing fees the assets of the liquidated SOE will become the property of the company.

Another method of privatization was provided by Art. 19 of the Act of September 25, 1981 on State-owned Enterprises. It applies to SOEs in financial distress — the enterprise is liquidated and its assets are sold out. Some enterprises in agricultural sector are privatized according to the principles provided by the Act of October 19, 1991 on Management of Agriculture Property of the Treasury. There are also separate acts devoted to ownership transformation of certain enterprises and sectors of the economy. Recently, a number of acts have been adopted which link privatization with sectoral restructuring.

All methods and paths of privatization are equivalent (buyers pay market price or the price based on valuation), except the NIF program, where certificates of ownership have been distributed among the population for a small fee.

Polish privatization law is very diversified, if not to say eclectic. It reflects lack of consensus of Polish politicians on the scope and ways of ownership transformation, and more generally - on the principles of the post-Communist transformation as a whole. The privatization law represents a certain compromise between two main options: liberal conceptions patterned after solutions adopted in developed Capitalist countries, and participatory approach originating from the Polish labor self-management movement and tending towards a kind of "third road" of development through building of the so-called "social market economy". Impact of lobbies from branches and governmental administration can also be seen; some provisions of the law were also made in order to overcome the assumed resistance of insiders.

The privatization law regulates not only the privatization process itself, but also in some cases the initial corporate governance structure, including initial ownership distribution and composition of corporate governance bodies. The scope and character of the impact of the regulations depends on the privatization method applied (see also the next section). However,

the common feature are preferences for insiders, both in starting privatization, and in distribution of shares. Before the privatization act of 1996 was adopted, all privatization deals had been initiated or had needed to be approved by the governing bodies of SOEs. In 1997, such a requirement was lifted.

According to the 1990 Act, in indirect (capital) privatization employees had a right to acquire 10% of shares at reduced price; these preferences were increased by the 1996 Act by granting a right to insiders to acquire 15% of shares for free. Another 15% can be received for free by farmers and fishermen if they were suppliers of the former SOE (with restrictions regarding the volume of supplies). Besides, the new Act lifted the requirement that JSSPs, as a transitional entity, should be privatized within 2 years after commercialization. It introduced a legal background for impeding ownership transformation in this group of companies.

Privatization legislation imposes its own regulation on corporate governance bodies in JSSPs: the first supervisory board should consist of 5 members, including 2 representatives of employees; during the whole period when the Treasury is the sole shareholder in the company, employees have the right to elect 40% of the supervisory board members.

Until 1997, the leasing path of direct privatization preferred extremely insiderized patterns of ownership structure: the new company should have been founded by the majority of employees, no institutional outsiders were permitted (unless accepted by the Ministry of Ownership Transformation). The Act of 1996 imposes certain limits on the use of direct privatization paths and the role of insiders in ownership transformation. Limits have been set on the size of enterprises (in terms of employment level, assets and turnover); outsiders gained a right to take initiative in privatization without prior consent of insiders; in leasing path, at least 20% of shares in the new company must be in the hands of outsiders; possibilities of participation of legal persons have been increased.

2.2. Quantitative Effects of Privatization

In Poland, the so-called small privatization, affecting the retail, catering and service sectors, was conducted very rapidly: by the end of 1992, 97% of all units in these sectors had been privatized. At the same time, the overall pace of privatization of the enterprise sector was much slower than had been anticipated. The most rapid transformation took place during the first years of post-Communist transition, and since the mid-1990s we have witnessed a substantial slowdown of the privatization process, which occurred due to two main reasons: the stock of "easy to privatize" enterprises was rapidly depleted, and political pressure for privatization slowdown increased.

The speed of ownership transformation depended mainly on the branch, size of an enterprise, its organizational structure and profitability. The privatization of small and medium-sized enterprises (SMEs) in manufacturing, trade and construction was usually accomplished relatively quickly. The other pole was represented by the largest enterprises, especially from infrastructural sectors, mining industry and metallurgy. The problem was not only in the technically complicated nature of privatization of such enterprises and sectors, but also in obstacles of political nature: employees of these sectors were afraid that restructuring would almost inevitably lead to job cuts; on the other hand, the government slowed the pace of privatization in these sectors, mainly due to political reasons which we will discuss below. In 1993, a law on the ownership transformation of certain SOEs of special importance for the national economy was passed, which in fact excluded a large number of enterprises from the privatization process.

Besides, there was an interdependence between the pace of privatization and privatization method applied. On the one hand, "simpler" cases (SMEs which were profitable and needed no immediate investment or restructuring, or at least where there was already a buyer willing to do it) went through direct privatization, especially management-employee buyouts.

The direct privatization procedures were relatively uncomplicated. Large enterprises usually needed more complicated privatization procedures, that included negotiations with potential investors, harmonization of the interests of various stockholders and interest groups, resolving a number of technical issues etc. As a result, in about 1/3 of all enterprises where capital (indirect) privatization has been started, only the commercialization stage has been completed, and 100% of their shares still belong to the state. Besides, there are still nearly 2000 state-owned enterprises left (GUS, 2003) and more than 1200 companies where the state retains stakes of some size.[23] This means that the state retained control over nearly 3500 firms, which is about 40% of the total number of state-owned enterprises at the beginning of transition. Even if we subtract those enterprises which have to remain in state hands (some military, infrastructural and other entities), we still are left with the result that after 14 years of reforms, the government has failed to privatize at least every third SOE.

Although in the meantime the rapid growth of the *de novo* private sector took place and now state-controlled companies constitute merely 1.3 per cent of all firms registered, they still produce about 25% of the GDP.

Because of rapid growth of the Polish private sector, now nearly 74% of workforce is employed in private firms. However, most of the workforce is employed in the *de novo* private sector, the share of employees of privatized sector being modest: 6.5% of the total workforce (if we take into account employed in all the enterprises included in the process of privatization) or 3.8% (if we take into account only those enterprises where privatization has been completed)[24].

Due to difficulties in assessment of a number of quantitative effects of privatization (e.g., the value of state-owned property transferred to private hands or the share of the privatized sector in the GDP) we must also at least partly rely on experts' evaluations of the quantitative progress in privatization. Among others, such attempts are being made by the EBRD in its yearly Transition Reports. They lead to the obvious, if not banal, conclusion that while the results of privatization of small and medium-sized enterprises are among the best in the region, the "large" privatization in Poland lags behind (EBRD 2001).

There are also two indicators that at least partially describe the quantitative dimension of privatization effects in terms of meeting some specific privatization goals: budget revenues and attracting foreign investments to the enterprise sector. In terms of budget revenues, Poland is one if the leaders of post-Communist transformation, obtaining 11.6% of the GDP this way in 2000. However, in absolute figures ($6.2 billion), it was still well behind many developed market economies, such as France ($17.4 billion), Italy ($9.8 billion) or Sweden ($8.1 billion). Among post-Communist countries, Poland is the unquestionable leader in net foreign direct investments ($45 billion in 1990-2000), but per capita and GDP share indices are much more modest, placing Poland far behind the leading Central European countries.

[23] The Ministry of the Treasury data: http://www.mst.gov.pl.
[24] Own calculations based on GUS, 2003.

Table 2
Dynamics of privatization in Poland (number of enterprises included in privatization process)

Period	Total 3+7+10	Indirect privatization				Direct privatization			Liquidation (Art. 19 of the Act on SOEs)			
		Commercia lized	Shares offered for sale		% 4:3	Accepted by the MOT/MT	Excluded from the SOE regis-ter	% 7:6	No protest from MOT/MT	Excluded from the SOE regis-ter	Insolvency announced	% 11:10
			Total	Including indirect privatiz.								
1	2	3	4	5	6	7	8	9	10	11	12	13
Cumulative number of enterprises												
31 Dec. 1993	2498	527	98	98	18.6	892	707	79.3	1079	186	n/a	17.2
31 Dec. 1994	2985	723	134	134	18.5	1023	945	92.4	1239	303	387	24.4
31 Dec. 1995	3515	958	220	160	23.0	1174	1054	89.8	1383	396	441	28.6
31 Dec. 1996	3927	1076	787	184	73.1	1371	1243	90.7	1480	563	514	38.0
31 Dec. 1997	4358	1254	845	228	67.4	1564	1417	90.6	1540	678	552	44.0
31 Dec. 1998	4655	1372	886	244	64.6	1699	1572	92.6	1584	768	606	48.5
31 Dec. 1999	4957	1469	912	262	62.1	1847	1727	93.5	1641	820	618	50.0
31 Dec. 2000	5216	1506	938	283	62.3	2012	1873	93.1	1698	860	630	50.6
31 Dec. 2001	5350	1515	970	315	64.0	2084	1931	92.7	1751	870	656	49.7
31 Dec. 2002	5450	1527	992	336	65.0	2128	1994	93.7	1795	899	680	50.1
30 Nov. 2003	5522	1539	997	341	64.8	2156	2030	94.2	1827	939	689	51.4
Number of enterprises in subsequent years												
1990-1993	2498	527	98	98		892	707		1079	186	n/a	
1994	487	196	36	36		131	238		160	117	n/a	
1995	530	235	86	26		151	109		144	93	54	
1996	412	118	567	24		197	189		97	167	73	
1997	431	178	58	44		193	174		60	115	38	
1998	297	118	41	16		135	155		44	90	54	
1999	302	97	26	18		148	155		57	52	12	
2000	259	37	26	21		165	146		57	40	12	
2001	134	9	32	32		72	58		53	10	26	
2002	100	12	22	21		44	63		44	29	24	
2003	72	12	5	5		28	36		32	40	9	

Source: The Ministry of Treasury of Poland.

Table 3
Revenues from sale of state property in Poland in 1991-2001 (in mln zlotys in fixed prices)

Year	Indirect privatization	Direct privatization	Total
1991	140.5	30.4	170.9
1992	310.1	174.4	484.5
1993	493.4	287.0	780.4
1994	1271.9	322.9	1594.8
1995	2235.5	406.1	2641.6
1996	2776.4	973.4	3749.8
1997	6178.6	359.1	6537.7
1998	6619.9	428.0	7068.7
1999	12949.7	338.7	13347.5
2000	26740.4	438.6	27181.9
2001	6451.6	361.5	6490.1
2002	2579.1	280.6	2859.7

Source: The Ministry of Treasury of Poland.

2.3. Corporate Governance Model

The main act which describes the corporate governance model is the Company Code of September 15, 2001 (enacted on January 1, 2001). It replaces the Commercial Code of June 27, 1934.

In Poland, the continental model of corporate governance structure is developing. This model adopts the principle of strict separation between the management function and the ownership control function, as distinct from the Anglo-Saxon model in which these functions are to a large extent combined. The adoption of the continental model as the target, assuring a strict owner control over the company's executive bodies is particularly important, as in Poland, as well as in other post-communist countries, the influence of external control (in the form of commodity, financial, take-over and other markets) is in many cases still not sufficiently effective. In such conditions, efficient functioning of the internal supervision assumes fundamental importance. Moreover, the continental model assumes the significant role of a strategic investor, who, especially foreign investor, bring to a company not only capital, but also a new culture of management, of company's behavior towards its environment, new technology etc. which are badly needed in a post-Communist country.

On a company level, it means two-tier system with separate executive and supervisory boards. Supervisory boards are compulsory in all JSCs and large LLCs. As a rule, supervisory board members are elected by the general assembly of shareholders (group voting is possible). In most cases, supervisory board appoints the members of the executive board (in general, the supervisory board's position vis-à-vis executive board has been strengthened in the new Code). Formally, supervisory board has a wide range of powers, especially controlling ones, as a safeguard against opportunism of managers. It supervises all spheres of the company's functioning and has a right to study all documentation and to receive all necessary information not only from executive board members, but also from every employee in the company. Supervisory board's powers can be fine-tuned in order to reflect the needs of corporate governance in a specific company.

III. Ownership Changes and Ownership Structure Changes after Privatization

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1. Post-Privatization Changes in Ownership Structure in Russia: Empirical Data Of 1990-2000s

1.1. General Conditions and Empirical Evidence

In terms of quantity, Russia's corporate sector was most rapidly being formed during the privatization in the first half of the 1990s (Table 1). By early 2002, the cumulative share of private and mixed-ownership enterprises had amounted to over 92 % of Russia's total industrial output (Table 2).

The complex and controversial formative process of the post-privatization structure of ownership in Russia had as its general positive outcome the gradual stabilization (streamlining of the structure) of ownership structure: from an amorphous and dispersed structure to the appearance of the apparent (formal, based on the title to the property) or hidden (informal, based on the real authority within a corporation) hubs of corporate control.

In general, the present process of the ownership redistribution in Russia is characterized by two parallel basic trends: the strengthening of managers (in their capacity as shareholders or as persons who exercise real control over enterprises) and the growing "invasion" of outsiders. All this redistribution is taking place against the background of the further concentration of ownership.

From the standpoint of changes in the initial post-privatization ownership structure[25] the following key trends should be singled out (Table 3):

– the decrease of the employees' share, the rate of which slowed down in 1995-1998;[26]

– stabilization or growth of the administration (management)' share;[27]

– significant increase of the share of outside majority investors (which in 1996-1998 nevertheless was growing slower than in 1994-1995);

– stabilization or decrease of the share of external minority investors (individuals);

– consistent decrease of the government's share.

[25] The detailed description for the period by mid-90s see IET-IRIS-Maryland University report on the research project of 1994-1995 "Secondary markets for corporate control".

[26] The increase of the employee's share in 1995-1996 indicated in the poll (3) (Table 3) was probably a result of the policy consciously pursued by the management in order to disperse the additionally issued shares among the employees and to prevent the establishment of outside control.

[27] The tendency towards the formal decrease of the managers' share pointed out in poll (1) (Table 3) most probably is also connected with the dispersion of equity in 1995-1996. We can also presume that part of the shares obtained by the managers under the closed subscription or at the secondary market was "transferred" to other companies in order to avoid social tension (or in part was really sold to outside shareholders). However, in general that does not mean that managers lost control.

Table 1
Enterprises in RF: overall data

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total number of registered enterprises and organizations (USREO), thousand units[a]	1245	1946	2250	2505	2727	2901	3106	3346.5	3593.8	3845.3
In industry, thousand units (% of total)	212 (17)	289 (14.8)	310 (13.7)	324 (12.9)	339 (12.4)	352 (12.1)	372 (12)	384 (11.5)	401.5 (11.2)	421.1 (11.0)
Economic societies and partnerships, thousand units[b]	No data	748	895	1329	1480	1623	1819	2049.5	2272.9	2504.1
- including joint-stock companies, thousand units[c]	No data	43.13	51.148	No data	No data	No data	No data	429.6	438	445.6
Unitary enterprises, thousand units	No data	No data	No data	No data	No data	No data	No data	79.9	78.6	77.8
Privatized (changed form of ownership) enterprises (facilities), per annum[d]	42924	21905	10152	4997	2743	2129	1536	2274	2287	2557
Number of privatized industrial enterprises, per annum	12052	5895	2087	864	365	229	140	160	123	137
Joint-stock companies created during privatization, per annum	13547	9814	2816	1123	496	360	258	199	125	125
Joint-stock companies whose block of shares is consolidated in State or municipal ownership, per annum	439	1496	698	190	84	142	101	72	59	38
Joint-stock companies with "golden share", per annum	204	792	429	132	58	28	42	8	2	1

[a] Data as of January 1 of the next year (after the year indicated here). The USREO is the Unified State Register of Enterprises and Organizations of all forms of ownership.

[b] Before 1996 – "Joint-stock companies and partnerships".

[c] For the years 1994-1995 only open joint-stock companies are indicated, from the year 2000 onward – joint-stock companies of all types.

[d] According to different estimates, in 1991 in Russia there were about 242 000 state enterprises, including 30 000 medium-size and large ones. During 1992-2002, a total of about 140 300 enterprises (facilities) were privatized (or changed their form of ownership), including about 32 500 newly created joint-stock companies. For the years 2000-2002, unified data are presented (enterprises, immovable property, etc.)

Source: The RF Goskomstat.

In general we can draw the conclusion that the aggregate share of internal shareholders was going down (due to the decrease of the employees' interest), while the share of external and pseudo-external shareholders in companies' equity was growing.

Table 2
Distribution of industrial enterprises in RF according to their forms of ownership[a], in % of number of enterprises and in % of total production volume

	1993	1994	1995	1996	1997	1998	1999	2000	2001
State and municipal ownership	19.4 (44.9)	8.9 (21.5)	7.7 (11)	4.4 (10,4)	4.4 (10,2)	5.1 (11.4)	5.2 (9.4)	5.1 (9.3)	5.4 (9.3)
Private ownership	61.3 (9.3)	72,1 (15)	72.3 (18.9)	87.1 (25.2)	88.1 (25.8)	88.1 (27.0)	88.4 (29.6)	88.7 (41.1)	85.6 (43.2)
Mixed Russian ownership	17.3 (43.7)	16.5 (60.9)	16.9 (66.9)	6,0 (60,8)	5.5 (58.8)	5.6 (52.4)	5.1 (51.0)	4.7 (33.1)	6.6 (29.9)

[a] State ownership – property belonging by right of ownership to the RF (federal ownership) and to subjects of the RF (ownership of subjects of the RF). Municipal ownership – property belonging by right of ownership to urban and rural settlements and other municipal formations. Private ownership – any property of citizens and juridical persons, excepting certain types of property that they cannot own as determined by law. The rest (up to 100 %) – ownership with foreign participation, by public organizations, etc.

Source: The RF Goskomstat.

The stock ownership structure of the largest Russian companies was, of course, different from the typical one (Table 4). It's characterized by the following features:

– large participation of the financial and industrial groups and holdings including the public ones;

– considerably smaller (as compared with the typical) share of the employees of all kinds;

– relatively large share of non-residents of different types.

Of course, any quantitative estimate would be rather artificial if the fact that among the formally external shareholders of the companies there is a considerable number of those, which are directly or indirectly owned by the managers of this particular company or are friendly towards them, is taken into account. It is indirectly confirmed by the fact that among the holders of large or controlling stakes a considerable proportion consists of commercial enterprises and holdings. In practice such commercial enterprises or holdings are often nothing but companies set up by the management as trade intermediaries and created for the mobilization of the company's profits, which are being used, among others, for the buying out of the company's shares during the privatization and on the secondary market. Similar mechanisms are well known in other countries.

As to efficiency of activity of the managers as subjects of corporate control in a post - privatization period, the evaluation may be only dual:

– On the one hand, this policy is certainly successful and is effective in the sphere of preservation (consolidation) of control;

– On the other hand, this activity remains a subject for discussion if we are trying to evaluate the efficiency of "managerial model" of control (not only for strategic development, but also for elementary survival of enterprises).

According to some studies, the concentration of managerial control ensures significant increase of enterprise efficiency. But, according to some data (Frydman, Gray, Hessel, Rapaczynski, 1997), the dominating control of the managers shares some "weakness", appropriate to the employees ownership. Nevertheless, corporations controlled by managers were characterized by much higher efficiency, than enterprises owned by employees.

Table 3

Stock ownership structure in Russian joint-stock companies in 1994-1999 (data obtained in different surveys, %)

	(1)			(2)			(3)			(4)		
	After priv.	1994	1996	1994	1995	1996	1994	1995	1996	1995	1997	1999
1. Insiders. total	66	66	58	62	56	56	65	55	58	58.5	51.6	51.3
- employees	47	44	43	53	43	40	56	39	40	48.5	39.5	36.3
- managers	19	22	12	9	13	16	9	16	18	10	12.1	15
- collective trust	-	-	3	-	-		-	-	-	-	-	-
2. Outsiders. total	10	16	33	21	33	34	22	33	33.6	31.7	41.3	45.3
2.1. Juridical persons			23	11	21	25	-	23	24.52	20.7	23.6	22.8
- banks	-	-	2	-	1.5	-	-	1	1.6	1.6	1.2	1.7
- investment funds	3	5	5	-	6	-	-	6	5	7.2	4	5.2
- suppliers. buyers. other firms	-	-	3	-	3	-	-	5	3	8.1	12.9	11.8
- holdings and FIGs	-	-	3	-	1	-	-	1	2.6	3.5	4.9	3.4
- others	-	-	10	-	9.5	-	-	10	12.32	0.3	0.6	0.7
2.2. Individuals	3	6	8	10	11	9	-	9	6	9.6	13.2	15.6
2.3. Foreign investors	-	-	2	-	1	-	-	1	1.6	1.7	5.1	7.6
3. State	20	12	9	17	11	10	13	13	9	9.5	6.5	2.7
Total[a]	100	100	100	100	100	100	100	100	100	100	100	100

(1) - The survey of 1994 covered 88 privatized enterprises of Moscow, St.Petersburg, Urals and Nizhny Novgorod. The survey of the fourth quarter of 1995-first quarter of 1996 covered 312 privatized enterprises (across 12 branches of industry) of Moscow, St.Petersburg, Urals and Nizhny Novgorod. Collective trust was not mentioned in other surveys for other years as well. The data of the University of Nottingham. Source: Afanasyev, Kuznetsov, Fominykh, 1997, c. 87. (2) - The summary evaluation of the author on the basis of the results of 1994-1996 surveys conducted by the RF State Property Committee (400 enterprises), FKTsB and the securities market monitoring group of FKTsB (250 and 889 enterprises), IET (174 enterprises) which together covered all regions of Russia. In the lines "legal persons" and "individuals" the real data on large and small outside shareholders are shown. It should be remembered that in 1994 and 1995 "small shareholders" meant less than 5% of the equity; in 1996 – up to 1% of shares. The figures in the table were calculated as unweighted arithmetic average, but the absence of weights should not, presumably, play any significant role since the size of the enterprises in the sample is almost comparable (no small and largest companies were included). For more details see: Radygin, Gutnik, Mal'ginov, 1995; Radygin, 1996b). (3) - Surveys of the Blasi group of 1994 (143 enterprises), 1995 (172 enterprises), 1996. Sources: FKTsB, 1996b; Blasi, Kroumova, Kruse, 1997, p. 193. Data for 1995 differ across quarters, here the fourth quarter data are shown: see FKTsB, 1996b. (4) - Surveys of the Russian Economic Barometer in 1995 covered 138 industrial enterprises (conducted upon request of IET), in 1997 – 139 (out of which 46 were present in both surveys), 1999 – the respondents' forecast. Source: Aukutsionek, Kapeliushnikov, Zhukov, 1998.

[a] Strictly speaking, many of the figures are not consistent from the standpoint of analysis of the annual changes of ownership structure since even the annual data are based on different (in survey (1)) data arrays or data arrays with little repeated coverage (surveys (2) and (4)). As regards survey (3) there is no exact information about the used annual samples. Nevertheless, considerable coincidence of the results for one and the same period in different surveys allows us to draw a conclusion about a high degree of reliability of these figures summarized in the table from the standpoint of the general trends in the changes of ownership of stocks at large and medium privatized enterprises in Russia. It also important that all the above-mentioned surveys focused mainly on "typical" Russian industrial enterprises (medium and large), what also allows us to extrapolate (with some reservations) these trends to the whole Russian industry. Also see: Ownership structure and problems of corporate control in Russian economy. IET, 1999.

Table 4
Stock ownership structure of 100 largest Russian companies, %, 1997[a]

Types of shareholders	%
All employees of the company	22
including employees	20
Administration	2
Share of managers of all levels among all employees	5
including general manager	0.5
Shares sold to the employees during last 12 months	6
Issuer (issuer's representatives)	21.8
All outside shareholders	57.6
including the state or state holding	20.6
including the state	6.5
state holding	14.1
Average shares of all large outside shareholders (including the one out of all Outsiders) (from large to small)	
Russian commercial enterprises, total	16.7(10.5)
Russian investment funds, total	11.7(10.5)
Foreign companies, total	11.7(11.1)
Out of which (individual types):	
Russian enterprises-suppliers of the company	10.0(22.8)
Russian fin.-ind. groups or non-state holdings	10.0(33.0)
Russian commercial banks	6.7(17.0)
Foreign banks	6.7(9.3)
Russian enterprises-buyers of the company's output	3.3(16.4)
Foreign investment/pension funds	3.3(14.0)
Russian pension funds	1.7(1.0)
Additional data	
Percentage of companies with a large outside shareholder (more than 5%)	88
Average number of large outside shareholders	2.5
Average share of the large outside shareholder's ownership	15.3
The mean value of the average share of the large outside shareholder	12.6

[a] The average data on sample groups of shareholders where taken which do not add up to 100% of the companies capital.

Source: Khoroshev, 1998.

The employees - insiders in all countries with transitional economy, as a rule, do not represent an independent side as special subject of corporate control. Their shares are controlled by managers,[28] or are “sprayed" and form an amorphous structure of stockholdings. The activity of small-sized shareholders-insiders is traditionally low, and their interests are focused mainly on various payments. For example, the practice of general shareholders’ meetings in Moldova shows that the typical conflict between the shareholders - employees and managers is on employment and various money payments.

According to the survey of 312 Russian joint-stock companies in 1996, only 7,5 % of the managers indicated importance of participation of the employees - shareholders in the board and supervisory council, 19 % - in discussion of strategic and current problems on general meeting of the shareholders and 21 % - on desirability of granting managers with the right of a voting for general meeting of the shareholders (Afanasyev, Kuznetsov, Fominykh, 1997, p. 96).

[28] A direct analogy to an evaluation of the American ESOP schemes as a method of self-protection of managers from hostile takeovers (Williamson, 1985) arises in this case.

As regards foreign investors (both in typical and largest companies) the major problem here is to identify the real origin of investment. In many cases it's in reality the repatriation of capital, which was taken out of Russia.

The state shareholdings in the equity of the majority of enterprises (with the exception of the strategic branches of economy and largest companies) are not, in fact, playing any key role. If the management and a part of large outside shareholders can be included into the "active" groups of stockholders the most "passive" group actually include the government and the rank-and-file employees of enterprises.

By the end of 90s a lot of empirical studies on ownership structure in various countries with the economy in transition were conducted. Practically all of them are rather conditional for the purposes of inter-country comparisons (by virtue of problems of sample, various sizes of the enterprises, close-oriented behavior of the respondents, impossibility to reveal affiliate entities and real pole of corporate control, etc). Nevertheless they allow to evaluate most general and characteristic tendencies with the relatively high level of reliability. [29]

Practically in all countries with transitional economy the tendency to a *high level of ownership concentration* is observed during and/or after privatization

In Czech Republic, Hungary and Poland in a middle 90s 98 % of the inspected medium-sized companies had a dominating shareholder (Frydman, Gray, Hessel, Rapaczynski, 1997). The average share of the main shareholder varied within 50-85 % (except for the state and Czech investment funds). It is connected first of all to the fact that owners cannot afford to rely on other institutions and arrangements designed to monitor and discipline managerial performance (although the separation of ownership and management is common in the region).

In the countries of the former USSR (so called NIS) the tendency towards concentration is also marked. The available data on 6 countries (table 5) allow to speak first of all about stable growth of a share of managers. In Russia post-privatization redistribution of ownership leads to the concentration of dispersed stocks in privatized enterprises since 1993 as the most common process (including loans for shares schemes of 1995, the "oligarch" wars of 1997, transition from the wildest forms of redistribution to the legal procedural technologies of corporate control and redistribution of equity in 1996-1999).

Table 5

Changes in the ownership structure, % of total (Means)

	Georgia		Kazakhstan		Kyrgyzstan		Moldova		Russia		Ukraine	
	1995	1997	1995	1997	1995	1997	1995	1997	1995	1997	1995	1997
Managers	41.5	53.6	23.1	29.4	28.1	34.4	7.2	18.3	25.4	36.3	14.6	46.2
Employees	9.4	10.4	10.7	8.2	38.3	36.4	21.6	19.7	26.0	23.3	23.6	15.3
State	41.0	23.3	34.8	16.1	12.4	5.6	38.6	23.8	23.5	14.7	42.6	15.4
Local outsiders[a]	4.9	8.0	23.6	30.2	16.8	18.9	24.7	22.6	23.4	21.5	18.9	17.7
Foreign outsiders	1.0	2.2	4.4	6.8	2.2	2.3	0.3	2.1	1.6	3.8	0.3	0.9
Individuals	2.0	2.2	3.4	9.3	2.2	2.4	7.6	13.5	0.1	0.4	0.2	4.5

[a] Including investment funds.

Source: Djankov, 1999.

[29] See: Afanasyev M., Kuznetsov P., Fominykh A. (1997); IMEMO at al., 1999; Klepach A., Kuznetsov P., Kryuchkova P. (1996); Leontieff tsentr (1996); Radygin A., Gutnik V., Mal'ginov G. (1995); Энтов Р.М., 1999; Aukutsionek S., R.Kapeliushnikov, V.Zhukov (1998); Blasi J., M.Kroumova, D.Kruse (1997); Carlin W., S.Fries, M.Schaffer, P.Seabright (1999); Classens S., S.Djankov, G.Pohl (1997); Djankov S. (1999); Earl J., S.Estrin, L.Leshchenko (1995); Frydman R, Ch.W.Gray, M.Hessel, A.Rapaczynski (1997); Pohl G., R.E.Anderson, S.Classens, S.Djankov (1997); Radygin A., Entov R. (1999) et al.

The financial crisis of 1997-1998 gave a considerable boost not just to the redistribution, but also to consolidation of equity in Russia.[30] The disappearance of price indicators as market capitalization fell prompted a further large-scale spontaneous flight from small illiquid blocks of shares and a switch to the pattern of one-off direct sales. The lack of interests on the part of the state and a low price of residual blocks of shares created favourable conditions for managers and major shareholders to consolidate control. The dramatic fall of prices in the secondary market enabled a number of industries to complete the consolidation of corporate control at the minimum cost. While at the stage of a fast growing market in 1996-1997 many shareholders had to limit themselves to portfolio investments or to a blocking interest at best, in the conditions of the crisis further concentration of equity becomes only logical. The factors that facilitated it included both the mass flight of foreign investors and the desire of some holders (particularly financial institutes) to improve their financial position by shedding shares. A number of industries, facing a favourable price situation in commodity markets, especially after the rouble devaluation, displayed the trend towards strengthening the managers' hand and ousting foreign investors. Finally, it should be mentioned the crisis of financial-industrial groups (FIGs), primarily those based on banks. Involuntary sales of company stock, attempts to get rid of illiquid and money-losing assets, voluntary repayment of one's own debt with shares of industrial companies, problems of repaying loans secured by shares, seizures of debtors' blocks of shares or sale of individual interests through official bankruptcy procedures became typical features in the post-crisis period.

The fact that a new large-scale redistribution of property started in the corporate sector in 1998-1999 is proved by the data of registrars: firstly, the registrars saw no decrease in the overall amount of transactions they re-registered in the fall of 1998 and 1999; secondly, the number of registrars who provided services to over 500 000 holders of named securities dropped virtually to zero in 1999 against 20 in 1998. It can be added that a total of about 19 000 securities issues were registered in the Russian Federation in 1999 against 20 000 in 1998, but there were twice as many closed subscriptions during that period, whereas the number of open subscriptions dropped sevenfold compared to 1998.

Data available for the year 2000 (table 6) also testify to a considerable change in the structure of Russian companies' equity. It was 1998 that proved to be a turning point. At the beginning of 2000, the average government stake in the Russian corporations was 13%, outsiders' stake – 56%, with insiders' stake equalling 32%. A dramatic decrease in the share of insiders (employees) and a growing power of outside shareholders are attributable first, to the post-crisis process of ownership concentration, which was partly facilitated by an abrupt plunge in the price of shares, and second, to a decrease in the officially registered share of managers from an average of 12-16 percent in 1996 to 7-8 percent now.[31] The latter has occurred either through a direct transfer of shares to outside investors (in the form of sales or debt repayment) or through a widening practice of informal control by managers (transfer of existing shares to or registration of newly purchased shares with affiliated companies). Finally, the actually constant government's share (9–10 % on average in 1996) is a clear indication of privatization stagnation in the second half of 1990s. A certain growth of the government-held stake may have resulted from bankrupting private businesses due to tax arrears and transferring them to the state, the practice widely used in the regions.

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[30] Redistribution of property - in particularly, through the market of corporate control – is, undoubtedly, a normal and efficient mechanism of corporate governance and supervision over managers via civilised legal procedures, if it results in the company's greater efficiency. In Russia – and most transition economies – this result is far from evident.

[31] See: A. Radygin, R. Entov. *Institutional Problems of Corporate Sector Development: Ownership, Control, Securities Market*, Moscow, IEPP, 1999, p 65-66.

Table 6.
Average stakes in 2000 (%)[a]

	Whole sample	Machinery	Light industry	Food processing industry	Building materials industry
JSC employees	20.4	24.0	29.4	16.9	17.6
- of which collective trust	5.6	5.2	10.5	7.9	5.8
Management	7.2	7.4	7.8	11.6	6.7
- of which the general manager	3.7	3.7	4.3	6.5	2.7
Stake held by the JSC itself (shown on the balance sheet)	4.0	4.5	6.1	1.0	4.2
Suppliers and customers	6.5	1.3	2.4	17.5	6.0
Other enterprises	16.2	17.6	17.5	14.2	18.3
Holding companies and FIGs	6.2	3.2	0.0	7.5	16.3
Commercial banks	2.2	2.7	0.0	2.3	2.8
Investment funds	4.4	5.1	6.2	0.9	3.1
Pension funds	0.1	0.0	0.0	0.0	0.3
Insurance companies	0.1	0.1	0.0	0.0	0.0
Outsiders (individuals)	15.2	15.1	20.8	14.6	19.2
Foreign shareholders	4.7	4.8	0.0	0.0	1.2
Government	12.8	14.3	9.9	13.4	4.3
- of which federal government	9.6	11.1	9.1	0.8	4.9
Total	100	100	100	100	100

[a] The IET panel of business surveys of managers of industrial companies accounting for 22% of employment in Russian industry conducted by the Institute for the Economy in Transition was used as a basis for the sample. It includes companies of the main Russian manufacturing industries and sub-industries. Out of 1400 companies of all forms of ownership represented in the panel, 872 joint-stock companies (JSC) were identified. 201 JSCs responded, but the data obtained made it possible to carry out both qualitative and econometric analysis of the ownership structure in the surveyed Russian companies

The main trends of the 1990s have been confirmed by the results of several other surveys of Russian enterprises (Table 7).

The most complete although not quite exhaustive information concerning the changes in ownership structure in the Russian industry after the 1998 crisis has been yielded by the results of the all-encompassing structural survey of Russia's medium-size and large enterprises conducted by the RF Goskomstat in 1999-2000. The limitation of this survey was that the amount of the charter capital was applied for calculating average weighted indices, whereas in the Russian situation the amount of the charter capital has little connection to the size of a company. The data on the average weighted stakes of the main groups of shareholders are shown in Table 8 and confirm the general trends. At the same time, the one result differing from others is the conclusion concerning the discontinued growth of the stake of credit-and-financial institutions (a consequence of the 1998 crisis).

As regards ownership concentration, 62% of the JSCs (IET poll of 2000) did not have one single shareholder owning more than 25% of the shares. In 32% of the JSCs only one shareholder owning a blocking stake was reported. Companies with two shareholders owning such stakes accounted for only 6% of the sample. Still, keeping in mind the government stake, it can be suggested that at more than one third of the JSCs surveyed a shareholder owning a stake bigger than 25% has emerged. Only 13% of the JSCs have a shareholder that owns more than 50% of the shares and only 4% – a shareholder with a bigger than 75 % stake.

Table 7

Changes of stakes owned by different categories of shareholders, as shown by surveys of Russian enterprises (in percent points)

	BEA[a]	HSE[b]	Earl and Brown[c]
Labour collective	- 14.5	- 9.7	- 2.8
Including:			
CEOs	5.0	1.2	3.1
Rank-and-file workers	- 19.5	- 10.9	- 5.9
The State	- 6.5	- 1.3	- 9.6
Including:			
Federal level	- 4.4	- 0.5	- 6.3
Regional and local level	- 2.1	- 0.8	- 3.3
External shareholders	16	11	15.4
Including:			
Russian non-financial commercial companies	14.7	1.9	8.7
Russian banks, investment companies and funds	2.4	2.5	
Foreign shareholders	2.6	1.9	1.9
Other	9.7	4,7	1.8

[a] The 2000 survey of the Bureau for Economic Analysis: 437 enterprises, 6 sectors of manufacturing industry in 12 regions, from the moment of privatization till the end of the year 1999.

[b] The survey conducted by the SU-HSE under an order of the RF Ministry of Economy in 1999: 318 joint-stock companies in 39 regions.

[c] The survey conducted by D. Earl and D. Brown in 1999-2000. The sample was formed on the basis of the sample of RLMS, 430-480 respondents (Privatization and restructuring in Russia: evidence from panel data on industrial enterprises/ Report at NES's annual conference, 2001).

Table 8

Distribution of charter capital of joint-stock companies (JSC) in industry between shareholders, in %

	Total, industrial JSCs as of end of year	
	1999	2000
Employees of enterprise	11.4	9.5
State and local authorities	14.3	11.8
Including: federal	9.3	8.1
Federation's subjects	4.6	3.5
local self-government	0.4	0.2
Commercial non-financial organizations	42.6	46.0
Credit-and-financial institutions	7.6	7.6
Physical persons (not employees)_	9.6	11.5
Other shareholders	14.5	13.6
Total	100	100

Source: The RF Goskomstat's structural survey.

As shown by the sample of the SU-HSE, an average stake of the biggest shareholder grew between 1995 and 1998 from 22% to almost 29 %, and the cumulative share of three biggest shareholders - from 40.4% to 45.6%, respectively. By the end of 1998, the biggest shareholder owned a stake of less than 10 % of the capital only in 15 % of cases, and owned a block less than a blocking stake – in one half of cases.

According to the data of the BEA as of early 2000 (Table 9), from the moment of privatization till the year 2000 the average amount of the stakes owned by all external shareholders and the companies' chief executive officers (CEOs) was growing, while an average stake owned by employees and the State was decreasing. The average stake of non-financial companies (if they appeared after the privatization campaign) amounts to more than 42 %. It was

this group (if we exclude foreign shareholders who traditionally are not very noticeable in samples) that demonstrated the highest growth in the post-privatization years.

The share of the enterprises where one shareholder owns a blocking stake grew from 13% to 26 %, the share of enterprises with a controlling block of stock owned by one shareholder grew from 5.5 to 10.3%. Even more noticeable was the share of enterprises where the property was concentrated in the ownership of several shareholders: if at the moment of privatization the controlling block was owned by a total of 2 or 3 shareholders at 3,3 % of enterprises, by the year 2000 this became true already for 13.6 % of enterprises. Thus, the elements of a concentrated ownership structure (at least one blocking stake owned by one shareholder) at the moment of privatization was noted at 1/6 of enterprises, by 2000 – at 1/3.

According to the RF Goskomstat's data, the number of those JSCs where the controlling block belonged to one group of owners, during the year 2000 alone grew by 22.5 %, whereas the number of enterprises with a blocking external owner went down by 6 %.

Table 9

Changes of average stakes, by categories of owners, in %

	Average stake, as of 01.01.2000	Changes after the moment of privatization
Employees	36.1	- 37
CEOs	21.5	41
Federal authorities	23.1	- 30
Regional and municipal agencies	24.7	-10
Non-financial Russian enterprises	40.7	22
Financial companies	32.2	40
Foreign owners	41.2	175

Source: The BEA.

The latest data of the year 2002 have provided some evidence that these trends are still present. As the results of the 2002 survey conducted by CEFIR/NES (using the databases of the IET's poll laboratory) have shown, property concentration in the Russian industry is high enough.[32] The enterprises' CEOs control an average of 19% of shares. At those enterprises where CEOs own a share of property, their stake is 27%. The biggest external owner controls on the average 24% of stock (for those enterprises where such an owner disposes of more than 1% of stock, this stake amounted to 40%). At the same time, the share of small-scale shareholders is still high – on the average they control 24% of stock. Since most of the enterprises in our sample are not represented on the stock market, the presence of small-scale shareholders can be explained by the consequences of privatization.

In this connection, the higher property concentration is in the hands of CEOs or a big external owner, the higher becomes the corporate governance level. However the positive effect is present only until property concentration in the hands of one person does not exceed 50% of stock. Further property concentration above this threshold results in worsened corporate governance. Besides, only one-third of the respondents were familiar with the Code of Corporate Behavior, and only 4 % knew it in detail.

Of interest also are the results of the survey conducted in Russia under an order of the International Financial Corporation in the autumn of 2002. [33] This survey involved 307 JSCs with the number of shareholders above 50, in 4 regions (St. Petersburg, Samara and Samara Oblast, Ekaterinburg and Sverdlovsk Oblast, Rostov and Rostov Oblast). In 40% of the companies, the biggest shareholder owns 5% to 24.99 % of stock. In 19 % of companies, there is

[32] Guriev S. et al. Corporate governance in Russian industry, mimeo, M., CEFIR, 2003.

[33] Corporate Governance Practices in Russian Regions. Draft Report. IRG, under an order of the IFC, 2003

one controlling shareholder (over 50 % of shares), in 23 % - one blocking shareholder (25-49.99% of shares).

The three biggest shareholders are as follows: in 85 % of companies – the members of the board of directors/the agencies they represent (in 31 % this is the biggest shareholder), in 79 % - Russian organizations (the biggest one in 33 %), in 34 % - CEOs (the biggest one in 15 %), in 22 % - Russian physical persons, in 18 % - federal government agencies (the biggest one in 12 %), in 9 % - foreign organizations, in 5 % - regional government agencies.

Concentrated property has a positive effect on a company's performance. Mean productivity (per one employee) in companies with one controlling shareholder (more than 50 % of shares) is higher than that in companies with a different (more dispersed) ownership structure by at least 60 % (although sectoral peculiarities were not taken into consideration). A similar conclusion has been made regarding companies with one blocking shareholder (performance lower than that in highly concentrated ones, but higher than in the others).

Finally, among recent studies, the survey of directors of enterprises conducted in 2002 by T. Dolgopiatova and B.Kuznetsov (within the framework of a larger-scale study (headed by Ye.G. Yasin) concerning the structural changes taking place at Russian enterprises).[34] We are going to describe here only the most important trends among those that were revealed:

1. During the past three years (mid-1999 – mid-2002) certain changes in the composition of main (influential) owners took place at 39 % enterprises. Every fifth JSC underwent *cardinal* changes. The 2001 survey (encompassing the years 1998-2001, 358 enterprises) yielded similar data – cardinal changes occurred at 18 % of enterprises. Other studies (SU-HSE, REB) also demonstrated annual changes in ownership occurring at 5-7% of enterprises.

The generalized data on the charter capital structure of JSCs are shown in Table 10. On the whole, all external private owners are represented at 191 JSCs and own on the average a total of about 67% of the charter capital. This concentration is higher than the stake of insiders and has been achieved due to the participation of commercial organizations and physical persons.

Table 10

Distribution of charter capital of sampled JSCs as of end of year 2001 (in % of resulting values)

	For all 243 JSCs	For JSCs with one such shareholder[a]
Federal authorities	3.3	35.9/22
Authorities of Federation's subjects	3.5	52.9/16
Local self-government agencies	1.9	36.6/13
Non-financial commercial organizations	26.9	50.8/129
Crediting-and-financial organizations	0.8	15.6/12
Non-commercial organizations	4.2	33.1/31
Physical persons	59.4	66.2/218
- including employees of enterprise	38.7	49.3/190
Total for sampled JSCs	100	100
Including foreign physical and juridical persons	4.6	42.9/26

[a] In the denominator there is the number of JSCs with a contribution of this shareholder in the charter capital.

[34] Dolgopiatova T., Kuznetsov B. The adaptation factors of industrial enterprises. Report at the SU-HSE IV International Conference "Modernization of Russia's economy: social context", April 2-4, 2003. The survey involved 473 enterprises in 11 regions, although the numbers of those enterprises that did answer certain specific questions are noticeably smaller.

2. There was not only an increase in the concentration level of joint-stock ownership, but also the gap between mean and median values was reduced. This gap demonstrated a dispersion of shares among smaller shareholders in face of a high capital concentration in the hands of dominant shareholders. The narrowed gap was an evidence of a decrease in the dispersed part of the joint stock capital (Table 11).

Table 11
Shareholdings concentration indices

	1998 (end of year)		2001 (end of year)	
	Mean	Median	Mean	Median
Share of biggest shareholder, %	36.7/204[a]	30.0	42.2/224[a]	39.5
Share of 3 biggest shareholders, 3 %	48.9/163[a]	47.5	57.6/181[a]	56.0

[a] Number of respondents.

3. The board of directors, being the main mechanism of effecting the shareholders' control over the operation of a JSC, consists on the average of 7 members, and a decrease in their number has been noted. The average number of the board members correlated with the size of a JSC: from 6 members at small companies to 8 at super-large ones. The most significant is the following trend visible during the years 1998-2001: in face of a preserved dominance of CEOs and the labor collective within the board, *the representation of insiders was gradually decreasing.* This was counterbalanced by a growing representation of other groups of shareholders. The leaders in absolute values were shareholding physical persons, in relative values – the representation of government agencies was growing most rapidly (which may be associated with the fact that since 1999 a certain tightening of control had occurred), as well as that of other groups, including the so-called independent directors (Table 12).

Table 12
Aggregate composition of boards of directors (in % to total number of board members)

	1998 (273 JSCs)	2001 (289 JSCs)
Employees of enterprise	59.9	55.8
- including CEOs	38.2	35.1
Big shareholders – physical persons	16.5	18.2
Government agencies	5.2	6.4
Commercial organizations, including crediting-and-financial institutions	12.3	12.9
Non-commercial organizations	1.6	1.5
Others, including independent directors	4.5	5.2

If private external owners are dominant in the ownership structure, within the structure of a board of directors the same is true for insiders (Table 13). The coefficient of a shareholder's representation in a board of directors can be calculated as his weight per 1% of shares: for the 2002 enterprises the coefficient of employees' representation is 1.49, that of external private owners is 0.73, that of government agencies is 0.56.

In terms of creating *actual* poles of control in corporations, narrow *groups of partners* – or real owners – continue to consolidate the levers of power and business management (not necessarily on the basis of share ownership). Explicit or disguised *processes of ownership (control) concentration in Russian corporations are a key mid-term trend*, which should be taken into account in an effort to devise government regulation measures.

In connection with the problem under review it would be also interesting to know the results of the comparison between the legal systems of 49 countries from the standpoint of the investors' rights protection conducted in Harvard (La Porta, Lopez-de-Silanes, Shleifer,

Vishny, 1997, pp. 32-35, 40-43). The authors came to the conclusion that the concentration of ownership was at the same time reaction (or adaptation) to the weak legal protection of investors within the framework of the national model of corporate governance. High accounting standards, legal mechanisms of investors' protection and the level of the legislation enforcement have a very negative correlation with the concentration of ownership. At the same time the high level of concentration signifies the weak operation of the capital market. The conducted analysis linked this to the fact that the weak legal protection of investors denies to the companies the opportunity to mobilize the necessary capital.

Table 13

Types of dominant shareholders within ownership structure and within board of directors (in % to number of enterprises)

Type of dominant shareholder	Charter capital	Board of directors
Employees	35.8	59.2
Government agencies	8.6	5.3
External private owners	55.6	28.9
Total sample (for which data is available)	243.0	202.0

This conclusion is also valid for the Russian situation. Bearing this in mind we may presume that the problem of attracting investment to the privatized enterprises will not be resolved even when the struggle for control in the new corporations is over. The concentration of ownership typical for the process of struggle for control may be regarded as the method of the new owner's adaptation, but it doesn't offer any guarantees to the new potential investors under the conditions of weak legal regulation.

With reference to Russia, nevertheless, the situation has *a dual character*. The process of ownership concentration is closely connected to activity of managers (or large shareholders becoming insiders). Accordingly, the process of ownership concentration becomes by no means the tool for adaptation to the weakness of external mechanisms of corporate governance. On the contrary, just the ownership concentration becomes the tool of violation of the rights of other shareholders (investors).

1.2. Conclusions

1. The (corporate) ownership structure currently emerging in Russia (as well as in other transitional economies) still appears intermediary, which makes it premature to draw any conclusions on its gravitation towards a certain classical model.

At the moment, one can note a formal existence of single components of all the traditional models in the country: a relatively dispersed ownership (but a non-liquid market and weak institutional investors); a clear and steady trend to concentration of ownership and control (but no adequate financing and efficient monitoring in place); elements of cross-ownership and the emergence of complex corporate structures of different types (though not gravitating to a certain one). Such an amorphous model also creates visible challenges to decision- making processes in such areas as legal and economic policies.

It should be noted that the existing uncertainty (instability) in the sphere of property rights leads to at least medium-run conservation of non-stable and intermediary type of corporate governance' model in Russia. In this context there is no current alternative for development of the legal mechanisms of corporate governance and for enforcement in the medium-run period.

2. From the standpoint of changes in the initial post-privatization ownership structure[35] the following key trends should be singled:

- the decrease of the employees's share, the rate of which slowed down in 1995-2002;
- stabilization or growth of the administration (management)' share;
- significant increase of the share of outside investors;
- stabilization or decrease of the share of external minority investors (individuals);
- consistent decrease or stabilization of the government's share.

In general we can draw the conclusion that the aggregate share of internal shareholders was going down (due to the decrease of the employees' interest), while the share of external and pseudo-external shareholders in companies' equity was grown.

3. The principle importance of the problem of affiliation relationship should be noted. As far as a real organization of ownership (control) structure and financial flows of many large national companies are concerned, practically all the original data for empiric research in such areas as ownership (with respect to both managers and outsiders) and enterprises' financial operations can be viewed as dubious.

In this respect, the problem of managers' ownership should be singled out: obviously, the share of directors cited in any polls is far from real. Their actual power in the company can be based on a relatively small stock package (according to some estimates, it is a 15% stake that often suffices), though there is a clear rend to maximization of the formal control – through their share in the joint-stock capital, including affiliated structures. In such a situation, it is extremely hard to test various hypotheses about the role played by managers in the form they were stipulated in classical papers ("the hypothesis of convergence" and "the hypothesis of entrenchment").[36]

More generally, from the standpoint of the applied analysis of the corporate control issues the situation in the transitional economy is ambiguous. On the one hand, according to the tradition of the "manager's revolution' concept known since 1930s (Berle, Means, 1932) there are reasons to put formal owners outside the framework of the real authority relationships involving control and management in Russian joint stock companies. This is especially typical for the first post-privatization years before law "On joint-stock companies" was enacted. On the other hand, there are also reasons to claim that there is such a link as "ownership – corporate control – corporate governance". The latter makes sense in cases when it's possible to identify different types of the "hard core" shareholders exercising control either directly, or by means of the affiliated entities ("coalitions" in terms of the organizations theory). In this connection the key problem is to identify the hubs of real control in a corporation under the formally dispersed ownership structure.

4. Conflicts between managers and outside shareholders (both large and small) within the framework of the "principal-agent" relationship become very sharp. Problems related to the monitoring of managers by shareholders and consequences thereof are aggravated by the fact that managers, either directly, or through proxy, are acting both as insiders and outsiders of the corporation however these terms are interpreted. The problem of an issuer's transparency becomes a crucial one not only for potential investors but also for de-facto outside shareholders of the corporation.

5. It's also important to take notice of one more principal trend. The second half of 1990s – beginning of 2000s is characterized by a very specific process of merging between

[35] The detailed description for the period by mid-90s see IET-IRIS-Maryland University report on the research project of 1994-1995 "Secondary markets for corporate control".

[36] Jensen M. Meckling W. Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure.- Journal of Financial Economics, 1976, vol.3, p. 305-360; Morck E., Shleifer A., Vishny R. Management Ownership and Market Valuation: an Empirical Analysis.- Journal of Financial Economics, 19888, vol. 51, p. 293-315

the functions of managers and outsiders in the Russian corporations. The managers gradually become stockholders in corporations, while the outsiders consolidating their control start function as managers. This is a conflict-ridden process and so far it has not been playing a decisive role, but in perspective it is very important as regards its potential for smoothing over so far very bitter corporate conflicts and further stabilization of the propertry rights in corporations.

6. Problems of representation of the external shareholders in different bodies of joint-stock companies gather in importance. In particular, in Russian joint-stock companies there is a significant stratum of shareholders, who, while participating in the capital, neither are present in any corporate governance body, nor participate in the current management. To the greatest degree it concerns shareholders - employees and external shareholders - individuals, while commercial banks and industrial enterprises (suppliers and buyers) are least affected. The latter is not surprising, because both indicated groups have more possibilities to ensure their shareholder rights by using financial and trade mechanisms of pressure.

7. The weakness of banks within the corporate governance model in Russia became especially apparent during the financial crisis of 1998 so the theoretical discussion about the principal character of the national model of the corporate governance (the American model versus the German one) became useless. Correspondingly, the potential role of banks as an alternative mechanism of the corporate control under the conditions when other mechanisms, which might have forced managers to act not only in their own interests, are of limited use (discussed in Stiglitz, 1994, pp. 77-78, 189-190) and also turn out to be of little relevance.

2. Ownership Structure of and Its Post-privatization Changes in Polish Enterprises

2.1. Initial Conditions for Secondary Privatization

The heterogeneous character of Polish privatization (many different methods and "paths," consensual character of most privatization cases — see Chapter II) led to heterogeneity of emerging types of ownership structure and patterns of further property redistribution (often called "secondary privatization").

Indirect (capital) privatization included mostly large SOEs, in relatively good economic and financial condition, and in sectors whose privatization was politically uncontroversial. In the "mainstream" indirect privatization, strategic investors were preferred; minority blocks of shares were distributed among employees and other small shareholders. However, one should remember, that a significant number of enterprises (475 at the end of 2001) failed to privatize after commercialization and the Treasury remains their sole shareholder (comparing with 309 companies where indirect privatization has been completed).

In the NIF program, most companies are medium-sized (100-500 employees); the main blocks of shares were distributed among 15 investment funds (one, the so-called leading fund, received 33 per cent of shares, others received 1.93 per cent each); the Treasury was the second largest shareholder, keeping 25 per cent of shares, and employees received the remaining 15 per cent.

Direct privatization as a whole included mostly small and medium-sized enterprises, even before maximum size of SOEs was imposed in 1997. There is also a significant differentiation within the direct method of privatization:

– direct sale mostly covered rather small firms which could be easily sold to a new owner. At the same time, a modification of this "path," called "the fast track," covered enterprises in economic distress, and the buyer had to pay off the firm's debts. In both cases, as a

rule, an enterprise was sold to one person, so concentrated patterns of ownership were preferred;

– on the contribution in kind "path," the were no clear preferences for a specific type of enterprise; however, the importance of this path is very small (only 9.7 per cent of all direct privatization cases);

– for leasing (the so-called employee buy-outs) a specific category of SOEs suited more: rather small (in order to be affordable for employees), and in rather good economic and financial condition (in order to produce enough profit to pay leasing fees and do not need immediate investments). Legal requirements predestined highly insiderised and to a large extent dispersed ownership structure.

Another group of factors which constitute the initial conditions for secondary privatization is a kind of "legacy" after a state-owned enterprise: its organizational structure, structures of power and influence, mentality of main insider actors. Further changes in ownership structure (pace and character) to a large extend depend on whether those "legacy" factors are surmounted during or after privatization.

2.2. Evolution of Ownership Structure

In Poland, there were a lot of studies and surveys devoted to ownership structure of privatized enterprises. The contribution of at least three research teams, which studied national samples of enterprises, should be mentioned:

– a team of the Gdańsk Institute for Market Economics (IBnGR) which studies the problems of corporate governance in publicly listed firms. In the first half of the nineties, they also studied impact of privatization on enterprises, including ownership issues;

– a number of studies performed by the CASE Foundation in co-operation with research centers in Great Britain, Czech Republic and other countries. Two of them should be mentioned in the first place: the project devoted to secondary privatization in Poland, Slovenia, and Czech Republic (special attention was paid to employee buyouts and NIF program), and the project on corporate governance restructuring in Poland and Hungary (largest privatized enterprises);

– studies performed through the whole nineties by the research team of the Institute of Political Studies, Polish Academy of Sciences on direct privatization, foreign investments in privatization and, recently, a comparative study of direct privatization, foreign investments and the JSSP sector.

None of the teams have performed a survey which covered the whole sector of privatized enterprises in Poland. In each research project, field of study, as well as key for choosing companies to be surveyed were different. As a rule, those studies were made once and never repeated; they reported a situation for a certain moment, or at least period of time if it had been possible to build time series of data; some data are overlapping. Therefore data gathered by the research teams are fragmented and not fully comparable.

At the same time, because of initial diversification and specific regulations concerning property redistribution after privatization, several patterns of ownership structure evolution, as well as the whole corporate governance system, are evolving. Therefore, analyzing ownership structure of Polish privatized enterprises, we should not use mean values for the whole population, because it will conceal very important differences between various groups of companies.

The results of most recent surveys are presented below in groups according to privatization methods and types of companies under review.

2.2.1. Indirect (Capital) Privatization

A. The National Investment Funds Program

After the program started, a significant evolution of ownership structure has taken place in enterprises included in the NIF program. There was a strong tendency towards concentration of ownership in fewer hands (C1=48.3 in 2000) and at the same time a large-scale reallocation of ownership rights. In the five-year period (1995-200), 245 companies (48 per cent) have been transferred to strategic investors, with 52 of them sold to foreign investors (10 per cent of the whole population). 80 companies (15 per cent) went bankrupt or have entered bankruptcy or liquidation processes. 36 companies (7 per cent) are quoted on the WSE (Błaszczyk et al. 2001).

The majority of companies have come out of NIF control and have found dominant owners. Other companies and individuals have emerged as major dominant shareholders. On average, most strategic investors gained an absolute control (more than 50 per cent) of the firms' equity (see Table 14).

Table 14
The evolution of ownership structure in NIF companies

Largest shareholder group (more than 15 per cent of equity	Number of firms in 2000	Equity holdings in per cent, mean
Domestic investors	193	58.6
of which:		
employees	13	55.4
individuals	48	55.0
other firms	116	60.6
financial institutions	10	32.8
other NIF	6	35.4
Foreign investors[a]	52	73.7
Others:		
firms listed on the WSE[b]	36	
liquidation	12	
bankruptcy	68	

[a] For the firms with foreign investor the 15 per cent threshold is not imposed.
[b] 25 of these companies is included in the group with "domestic investors" as the main shareholder.
Source: Grosfeld and Hashi, 2001.

It is not clear, what are the determinants of ownership concentration. Firm specific factors do not always appear significant. An attempt to find a correlation between ownership and performance has been made. It was assumed, that ownership structure is endogenous. The results, however, are not unambiguous. If further analysis does not confirm that ownership and performance are both determined by unobserved fixed effects, the authors of the study promised to look for the impact of ownership on performance.

Changes in ownership stricture of the National Investment Funds have also been studied. Share of the Treasury and of small investors (institutional and individual) was steadily decreasing (from 25 per cent and 85 per cent respectively at the beginning of the program to 13 per cent and 41 per cent at the beginning of 2001). At the same time, the share of institutional and large investors has been rising. By January, 2001 institutional investors had 46 per cent of the shares of NIFs, and foreign investors 26 per cent. At that time, Polish large investors' involvement was more modest (13.5 per cent). All observed trends reflected progressing ownership concentration. Over a period from June 1998 to December 2000, the C1 index increased from 5 per cent to 24 per cent and C3 index increased from 7 per cent to 42 per cent. Now, all NIFs achieved a concentration level and ownership structure ensuring full and stable control of the funds.

However, an impact of NIFs on their portfolio companies has been assessed as unsatisfactory. During the whole period, economic and financial performance of the NIF companies

has been deteriorating, and in 1999 this group of Polish enterprises had the worst profitability among other groups of companies. It is clear, that the capital and/or strategies of other investors were more effective in generating improvements in companies than were the NIFs.

B. Largest privatized enterprises

In the framework of the Phare ACE project "Corporate Governance, Relational Investors, Strategic Restructuring and Performance in Hungary and Poland" (coordinated by Tomasz Mickiewicz, SSEES UCL), a survey of 84 Polish privatized industrial companies (the share of the state is less than 50 per cent), sampled from a list of the 500 largest firms (in the terms of sales), has been performed. The collected data cover the period from 1998 till the end of 2000. All enterprises have been privatized through the indirect method.

Ownership structure of this group of companies is highly concentrated (and the concentration level is still growing) and insiders' participation is very limited, unlike in privatized SMEs and contrary to pro-insider provisions of Polish privatization law.

In almost all companies under review, deep changes in corporate governance structures have been introduced, and the "legacy" of state-owned past has already been overcome. Thus, the processes of post-communist corporate governance transformation seem to be completed. However, changes in corporate control mechanisms appear to be conditional on the characteristics of the controlling shareholders group.

There are four such groups:

– foreign investors;
– domestic institutional shareholders;
– domestic private individuals not working in the companies;
– insiders.

Companies with highest levels of ownership concentration, especially dominated by foreign investors, have more coherent corporate governance structures. In the companies with lowest levels of ownership concentration, the shareholders' majority is often rather formal and does not ensure a real control over the company.

At the same time, no evidence was found that the level of ownership concentration directly affects companies' performance. The concentration indicator proves to be of secondary importance, conversely the type of dominating owner shows a much stronger correlation with performance of the firms. However, there is no sufficient proof that the type of dominating owner is the sole or the most important factor which affects the performance of the companies. In many cases, ownership structure could have an endogenous character, because a type of buyer of state property to a great extent was determined by companies' characteristics. At the same time, there is evidence that some types of ownership structures can have an exogenous character, first of all ownership concentrated in the hands of foreign investors (Kozarzewski 2002).

C. Enterprises privatized with participation of foreign investor

In the framework of the project "Privatization in Poland 1990-2002: Progress, Conflicts, Dysfunction" financed by the State Committee for Scientific Research (coordinated by Maria Jarosz, Institute of Political Studies, Polish Academy of Sciences), a comparative study of three groups of enterprises have been carried out: companies sold to a foreign investor, sole-shareholder companies of the Treasury (JSSPs), and employee buy-outs (Jarosz 2003). In the course of the survey at the enterprises, data for 1998-2000 and the moment of privatization has been gathered, as well as opinions of top managers on functioning of their firms.

In the privatized companies with foreign participation, the highest possible level of ownership concentration has apparently been reached. There is a dominating investor (more than 50 per cent of shares) in 80 per cent of such firms, and in the rest of firms there is at least one strategic investor (20 per cent of shares or more). The ownership structure has stabilized: during 1998-2000, no significant changes were seen. Interesting feature of corporate govern-

ance policy in foreign dominated companies is introducing incentives for insiders, first of all managers, in the form of small blocks of shares and/or seats on the supervisory board. Corporate governance structures in most of these companies are transparent with clear division of powers among executive board, supervisory board, and shareholders' meeting, with broad participation of insiders, especially elites of the former SOE. At the same time, foreign investor keeps tight and efficient control over the firm.

Table 15
Ownership structure and ownership concentration of largest industrial companies (per cent, simple averages)

	1998	1999	2000
Shareholder type			
top managers of the company	3.4	2.7	4.4
other employees of the company	9.3	8.0	7.0
former employees and managers	2.7	3.4	2.5
other external private individuals	19.2	18.8	17.7
the Treasury	8.8	8.3	7.9
domestic industrial companies	9.2	8.8	10.5
investment funds	11.7	11.7	8.1
banks	2.9	2.4	3.0
foreign investors / companies	19.8	22.3	26.1
other	6.4	7.2	7.9
Ownership concentration			
one largest shareholder	54.2	55.7	59.1
five largest shareholders	78.2	78.7	80.7

Source: Kozarzewski, 2002.

D. *Sole-shareholder companies of the Treasury (JSSPs)*

Studied in the framework of the same project, JSSPs proved to be the most dysfunctional group of companies included in the privatization process. Lack of progress in privatization of these firms leads to lack of formation of efficient corporate governance structures and relations. The existing structures are characterized by high level of managers' and trade unions' influence and very weak role of the Treasury as the sole owner of the company. Besides, in many JSSP the spheres of influence of main actors has not stabilized which gives ground for perpetual conflicts. There is nothing to be said about ownership structure dynamics in JSSPs under review: during the whole period, it remained unchanged.

E. *Listed companies*

A study of 210 listed non-financial companies (190 listed on the WSE and 20 on a free market) has been performed at the Gdańsk Institute for Market Economics in the framework of the project "Ownership and Control of Polish Corporations" (financed by the State Committee for Scientific Research and the CIPE, coordinated by Piotr Tamowicz) (Tamowicz and Dzierżanowski 2001a). The data reflects the situation of the companies in November, 2000. Ownership structure was measured by voices at shareholders' meeting. Both concentration indexes and overall ownership structure have been analyzed. Ownership concentration of the companies under review proved to be high and similar to that of in many other countries of continental Europe. Other companies and physical persons were the largest shareholder groups (they possessed 39.4 per cent and 30.8 per cent of all largest blocks of shares). Foreign investors had the largest share in companies' equity, the Treasury and state-owned companies being the second largest group of owners (see Table 16).

Table 16
Share of owner groups in publicly listed companies' capitalization (per cent)

Shareholder category	Non-financial companies	TP SA (telecom)	Banks	Insurance companies	NIFs	Total
Foreign strategic investors	14.6	25.0	59.7	25.3		28.8
Foreign financial investors	5.3		4.1		29.4	3.8
Total of foreign investors	19.9	25.0	63.8	25.3	29.4	32.6
Domestic banks	1.2	–	–	1.5	12.1	0.7
Domestic insurance companies	0.1	–	0.0	–	5.4	0.1
Domestic investment funds	0.1	–	1.4	–	0.9	0.4
NIFs	0.5	–	–	–		0.2
Pension funds	0.1	–	–	0.2	0.3	0.1
Public companies	1.8	–	0.2	3.6	–	0.9
Subsidiaries	0.4	–	0.9	–	–	0.4
Other domestic companies and cooperatives	4.1	–	–	1.8	0.8	1.8
Physical persons	10.2	10.0	0.0	62.0		7.9
The Treasury	11.5	35.1	3.9	–	15.5	16.4
State-owned companies	0.1	–	2.1	–	–	0.6
Companies owned by local self-governments	0.6	–	0.0	–	–	0.3
Total of domestic owners	30.9	45.1	8.6	69.1	34.9	29.8
Total concentrated ownership (5 per cent of shares in a company or above)	50.8	70.1	72.4	94.5	64.3	62.4
Dispersed domestic	37.9	19.9	25.9	5.5	35.7	29.4
Dispersed foreign	11.3	10.0	1.8	–	–	8.2
Total dispersed ownership (shareholders that possess less than 5 per cent of shares in a company)	49.2	29.9	27.6	5.5	35.7	37.6

Source: Tamowicz and Dzierżanowski, 2001a.

A study on difference between ownership and control has also been performed. It was measured as difference between number of shares and number of voices possessed by various types of shareholders.[37] In the case of the largest blocks of shares, the overall difference was not high (median for control was 39.5 per cent and median for ownership was 37.2 per cent). However, in some companies such a difference was very high (in one case, a person which possessed only 47.5 per cent of shares had 81.0 per cent of voices). Two main methods of increasing control over the number of shares were used: privileged shares had been issued before the company went public (36 per cent of companies under review), and control via dependent companies or pyramids.

F. Large private companies

The same team performed a study of 560 large private companies (sales above 70 million zlotys) in non-financial sector, without classifying on privatized and *de novo* private firms. The Dun & Bradstreet database for 1999 was used. The research showed that the ownership concentration level in this group of companies was extremely high. On average, the

[37] Problems of control vs. ownership have been also studied in other projects, i.e. devoted to 500 largest enterprises and direct privatisation. However, the method was different: ownership structure was compared with structure of seats on the supervisory board and the real influence of various groups of owners in the decision-making process.

largest shareholder possessed 68 per cent (78 per cent after excluding the Treasury and investment funds as largest shareholders). The highest concentration is linked with foreign investments (average C1 = 97 per cent).

2.2.2. Direct Privatization

A. Employee buy-outs

A number of surveys have been conducted by the team from the Institute of Political Studies, Polish Academy of Sciences (coordinated by Maria Jarosz in the framework of the projects ordered by the Ministry of Ownership Transformation, the Ministry of Treasury, and the State Committee for Scientific Research) (Jarosz, 1996). Data from these surveys have also been used in the above-mentioned project on secondary privatization performed by the CASE team. Not only ownership structure and its evolution have been studied, but also causes of these changes, interdependencies between ownership and performance, and structures of power and control.

The surveys show that four main ownership groups have emerged which can be described along two axes: concentrated versus dispersed ownership, and insider versus outsider ownership:

– outsiders with small holdings;
– strategic outside investors;
– insider shareholders with large holdings (members of managing and supervisory bodies);
– insiders with small holdings (generally, non-managerial employees).

Table 17
Ownership structure of employee-leased companies (per cent, simple averages)

Shareholder category	Immediately after privatization	1997	1998	1999
Shareholders:				
Strategic investors (domestic and foreign)	3.3	7.1	9.4	11.0
Other domestic outside investors:				
private firms	–	0.6	2.1	2.7
commercialized firms	–	0.4	0.2	0.0
private banks	–	–	–	–
state-owned banks	–	–	–	–
private businessmen	2.5	2.3	2.0	4.5
others	2.2	6.4	8.5	12.2
Other foreign investors	–	0.2	0.7	0.6
Supervisory board members employed in the company[a]	11.5	12.0	8.1	6.4
Executive board members	16.0	18.8	18.9	19.3
Other managers	13.5	11.9	14.5	11.0
Non-managerial employees	51.0	40.3	36.2	32.3
TOTAL	100.0	100.0	100.0	100.0
Shareholder groups:				
Strategic outside investor	1.4	9.1	15.2	17.1
Other outsider investors	6.2	12.3	16.3	22.0
Managers	33.7	37.6	36.7	29.4
Non-managerial employees	58.7	41.0	31.8	31.5
TOTAL	100.0	100.0	100.0	100.0

[a] Note: Supervisory board members in 1999 are only those who were also employees; prior to 1999, all supervisory board members were included.

Source: Kozarzewski and Woodward, 2001.

There were two main trends of ownership transformation in employee-owned companies: towards concentration of shares and toward their "outsiderization" (see Table 17). These

processes had different intensity in different groups of companies, and three patterns of ownership structure have emerged:

– management-employee pattern (large blocks of shares in the hands of managers, the rest is dispersed among non-managerial employees);

– dispersed insider ownership;

– ownership concentrated in hands of outside investor.

By the end of nineties, the secondary privatization processes have been completed in most employee-leased companies, and now only minor changes can be seen.

A number of factors which influence the direction and dynamics of ownership changes, among others sector affiliation, company size, initial ownership structure, personal composition of managing bodies, etc., but the most important is the economic condition, which, when poor, favors concentration and "outsiderization" of ownership (as a trade-off between power of insiders and the firm's existence) (Kozarzewski 1999; Kozarzewski and Woodward 2001). However, there are path-specific factors that influence processes of initial property distribution and redistribution (see Table 18).

Table 18

Chief factors behind perpetuation and change of the initial ownership structure of employee-leased companies

Factors	Perpetuation	Change
Mentality and behavior		
"Legacy" of state-owned enterprise	- organizational structure - structures of power and influence - old mentality of insiders	
Changes in the position of various insider groups	- fear of outsiders	- property factor: ownership = power - reconfiguration of functions and tasks - insiders have to adapt to new conditions - perception of outsiders as representing an opportunity for new investments, management techniques, etc.
Legal environment		
Privatization law	- employee leasing is insider-dominated - corporate partners and foreigners barred from participation in privatization - lower leasing fees (since 1997) - faster transfer of title to assets to employee-leased company (since 1997)	- outsiders should hold at least 20 percent of shares (since 1997) - faster transfer of title to assets to employee-leased company (since 1997)
Company Code	- companies' charters can contain restrictions on circulation of shares	- new organizational structure - system of property rights - mechanisms of raising capital, share issues and share trading

Source: Kozarzewski and Woodward, 2001.

There is strong evidence that, although the ownership structure had been to a great extent predetermined by the privatization "path," as a result of secondary privatization processes in many companies ownership structure changed its character from exogenous to endogenous.

Comparing to the enterprises that have been privatized through indirect methods, corporate governance structures in employee-leased companies seem to be to a great extent dysfunctional. Wrong division of powers and functions can be seen in many companies, the shape of dysfunction depending mainly on specific ownership structure pattern.

B. Other "paths" of direct privatization

In the framework of the project "Direct Privatization. Investors. Managers. Employees" (ordered by the Ministry of Treasury, coordinated by Maria Jarosz), all "paths" of direct privatization have been studied. Generally, the sale "path" of privatization favored initial concentrated ownership patterns with predominance of outsiders or managers. The contribution

in-kind path led to outsider domination, and the "fast track" modification of sale "path" did not show any clear ownership pattern. However, factors which influenced the secondary privatization processes in those three groups of companies were similar to those of employee buy-out firms (sector affiliation, company size, initial ownership structure, and economic condition) (Jarosz 2000).

2.2.3. Studies on assets distribution and redistribution

Attempts have been made to look at ownership structure changes in the course of privatization as a reallocation of the state property. In 2001, CASE participated in the project "Restructuring and Growth in Transition Regions and Countries" (coordinated by Andrew Warner from the Center for International Development at Harvard University) devoted to the assessment of shifting economic resources to new sectors and industries during transition. Surveys of enterprises in 13 post-Communist countries, including 151 in Poland, have been carried out (Warner 2002). The survey included SOEs, privatized enterprises and *de novo* private companies. Managers were asked to assess what percent of the company's fixed assets at the time of privatization (or establishment) and at the time of the poll had been previously owned by a state-owned firm or the government. According to managers' opinions, in Poland at the time of privatization, the share of former state property in the fixed assets of privatized enterprise amounted to 91 per cent, and in 2001 it fell to 61 per cent due to new assets acquisitions from private sector. For *de novo* private firms, those figures were 34.3 per cent and 23.1 per cent. Those figures seem to be highly inaccurate because they are based on managers' ideas of market value of the state property in the absence of market on which this value could be verified.[38]

In the framework of the USAID project "Sustaining Growth through Reform Consolidation" (coordinated by Barbara Błaszczyk, CASE Foundation) two regional case studies of state-owned assets reallocation to private sector have been performed (in regions of Lower Silesia and Katowice). The research shows, that in the case of SOEs in good economic condition, privatization is the most common method of reallocation of state property. In the case in badly performing SOEs, the most common ways are bankruptcy and liquidation procedures. Slow pace of reallocation is caused by incorrect policy of the state in the field of restructuring of the state-owned enterprises and sectors which are still mostly state-owned.

2.3. Conclusions

The heterogeneous character of Polish privatization and coexistence of a number of interests groups involved into privatization process led to heterogeneity of emerging types of ownership structure and patterns of further property redistribution. There are at least three patterns of secondary privatization in Poland:

The first pattern is represented by the largest companies which went through capital privatization and have concentrated ownership structures, often dominated by foreign investors. By the way, in the sector of former SOEs, they are unquestionable leaders in post-privatization restructuring and creation of highly efficient corporate governance structures and behavior. The ownership structure of this group of companies is highly concentrated (and the concentration level is still growing) and insiders' participation is very limited, unlike in privatized SMEs and in spite of pro-insider provisions of Polish privatization law. Within that pattern, four main groups of dominant owners exist:

– foreign investors;
– domestic institutional shareholders;

[38] The drawbacks of such an oversimplified approach can be clearly seen in the case of Belarus, where, according to respondents, at the moment of privatisation assets of the state origin constituted a mere 57.3 per cent of the companies' fixed assets. This value seems to be absurdly low.

– domestic private individuals not working in the companies;
– insiders.

The second pattern is found in companies privatized by management-employee buy-outs (MEBO). Most of them used the leasing path of direct privatization, although a significant number of such companies emerged as a result of direct sale and even indirect privatization. In these companies, four main ownership groups have emerged which can be described along two axes: concentrated versus dispersed ownership, and insider versus outsider ownership:

– insider shareholders with large holdings (members of managing and supervisory bodies);
– insiders with small holdings (generally, non-managerial employees);
– outsiders with small holdings;
– strategic outside investors.

There were two main trends of ownership transformation in employee-owned companies: towards concentration of shares and toward their "outsiderization". These processes had varying intensity in different groups of companies, and three patterns of ownership structure have emerged:

– management-employee pattern (large blocks of shares in the hands of managers, the rest dispersed among non-managerial employees);
– dispersed insider ownership;
– ownership concentrated in hands of an outside investor.

The third pattern is represented by the JSSPs, companies wholly owned by the state. In fact, these are SOEs that have initiated indirect (capital) privatization but not gotten beyond the stage of commercialization. Initially, JSSPs were intended to be a transition entity between the SOE and a private company (with this stage lasting no longer than one year). However, in practice, for every third enterprise which entered capital privatization, ownership transformation stopped at this stage indefinitely.

As we show in Chapter IV, patterns of secondary privatization strongly affect corporate governance functioning in Polish enterprises.

The role of banks in privatisation of Polish companies seems to be very modest, especially in the field of acquiring state property by the banks. Banks see the companies mostly as actual and potential debtors rather than a source of property. Nevertheless, banks have important channels of monitoring the situation in most enterprises, so there is a potential for the growth of the banks' influence on companies' management.

Another peculiarity of ownership structure of Polish privatized enterprises is the very weak role of outsider dispersed investors which is determined by weak and shallow capital market, especially its organized part. This also prevents certain kinds of financial investors (such as investment and pension funds and insurance companies) from expanding their role as portfolio owners (see Chapter IV).

Unlike the situation in Russia, where the currently emerging ownership structure still appears intermediary, in Poland ownership structure patterns seem to have stabilized. All major changes occur mainly within existing shareholder categories. Nevertheless, the Polish enterprise sector has substantial capacities for ownership structure changes in future, due to a large number of cases of suspended privatization (JSSPs) and still large SOE sector.

IV. Corporate Governance

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1. Corporate Governance Mechanisms and Outcomes in Russia

1.1. Introduction

The theory of corporate governance describes a number of mechanisms ensuring realization of the shareholders rights and forming the system of relations between the shareholders, managers, employees, creditors and other participants of firm operations concerning the order by assets disposition and distribution of the incomes.[39] The various aspects of operation of these mechanisms are studied by the economic theory, jurisprudence, sociology, psychology and other sciences. Researchers mark the tendency to shaping the interdisciplinary approach in the theory of corporate governance (see Prentice, Holland, 1993).

The mechanisms of corporate governance are traditionally differentiated as internal and external: internal procedural mechanisms of governance within corporation and the influence of an external environment (external mechanisms of governance) respectively. External mechanisms usually include :

– Corporate legislation (codes, special company laws, conjugate laws, departmental acts, rules and instructions) and, what is more important, its executive infrastructure (enforcement);

– Control via financial markets, i.e. mass "dumping" of securities of ineffective corporation on liquid financial markets (accordingly managers meet an intractable problem of search for new resources in conditions of falling interest of financial investors to corporate securities);

– Threat of corporation's bankruptcy as a result of invalid policy of managers (in the most rigid variant - transition of control to creditors);

– The market of corporate control (threat of a hostile take-over and replacement of the managers).

Below we review the key mechanisms and obstacles for the development of a national model of corporate governance in Russia. The present study mostly focuses on open joint-stock companies set up in the industrial sector on the basis of medium and large public enterprises in the course of their corporatization and privatization.

1.2. Internal Mechanisms (Corporate Governance Structures Within an Enterprise: Legal Aspect)

Following the classification of J.Tirole (Tirole, 1999), it is possible to indicate at least three internal mechanisms regulating the coordination of decisions within the corporation

[39] See, for example: Corporate governance: the shareholders, directors and employees of joint-stock company. M., 1996; Entov, 1999; Andreff, 1995,1996; Charkham, 1994; Clark, 1986; Monks, Minow, 1995; OECD, 1999; Prentice, Holland, 1993; Wouters, 1973.

with interests of the shareholders: 1) preservations of a manager's post for the manager (and, clearly, its business reputation in the appropriate market in case of successful activity of corporation); 2) maintenance of stimulus for effective (from the point of view of the shareholders) management with the help of specially elaborated systems of payment; 3) direct monitoring realized mainly by large shareholders and their representatives.

In some countries a role each of these mechanisms may essentially differ. At the same time - with all differences in existing structures of corporate governance - in each developed country checks and balances were generated in order to ensure interests of the investors and to provide sufficient independence and initiative of the managers. In countries with transitional economy rather weak development of "external" mechanisms of corporate governance objectively stipulates the special significance of the "internal" mechanisms.

According to the Russian law "On joint stock companies", a joint stock company is managed by the following bodies: the General Shareholders' Meeting; the Board of Directors (the Supervisory Board); and Executive bodies: the General Director (the single-member executive body), the Management (collective executive body).

The supreme management body of a joint stock company is the **General Shareholders' Meeting.** The following *issues shall be considered at the Annual Shareholder Meeting*: election of the Board of Directors; election of the Inspection Commission (Inspector) of the company; approval of the company's External Auditor; approval of the annual report, annual bookkeeping accounting including profits and losses reports (profits and losses accounts) of the company, as well as distribution of profits, including payment (announcement) of the company's dividends, and losses resulting from the financial year; issues which fall within the competence of the General Shareholders' Meeting may also be considered.

The following issues fall within the jurisdiction of the General Shareholders' Meeting: incorporation of amendments and additions to the company's Charter or approval of a new version of the company's Charter; reorganization of the company; liquidation of the company, appointment of the liquidation commission and approval of the intermediary and final liquidation balance sheets; determination of the number of members of the company's Board of Directors, election of the members thereof and early termination of their powers before time; determination of the quantity, nominal price, category (type) of the declared shares and rights granted by these shares; increase/decrease in the Charter Capital of the company and some others.

The General Shareholders' Meeting shall have legal power if shareholders possessing in aggregate over half of the votes of the company's distributed voting shares have participated in the meeting. The decision of the General Shareholders' Meeting on the issue set to vote shall be taken by a majority of votes of the shareholders – owners of the company's voting shares participating in the meeting.

The company shall notify its shareholders of the General Shareholders' Meeting no later than 20 days prior to the date of holding the meeting, if the agenda of the meeting includes the item on the reorganization of the company - not less than 30 days prior to the date of holding the meeting. If the agenda of the Extraordinary General Shareholders' Meeting includes the item on electing the members of the company's Board of Directors (are to be elected by cumulative vote), the shareholders shall be notified of the Meeting not less than 50 days prior to the date of holding the meeting. A shareholder (shareholders) owning at least 2% of the voting shares have the right to make proposals with respect to the agenda of an Annual General Shareholders' Meeting, and to nominate candidates to the Board of Directors of the company, collective executive body, Inspection Commission (Inspector) and Counting Commission of the company (the number of such candidates should not exceed the number of members of the respective body). The shareholders (shareholders) may also nominate a candidate to the single-member executive body.

The company's **Board of Directors (Supervisory Board)** shall carry out overall management of the activity of the company within its jurisdiction. Only a physical person may become a member of the company's Board of Directors. A member of the Board of Directors shall not necessarily be the company's shareholder. The company with less than fifty shareholders owning voting shares may provide in its Charter that the functions of the company's Board of Directors shall be executed by the General Shareholders' Meeting.

The exclusive jurisdiction of the company's Board of Directors includes the following issues: determination of priority areas for the company's activity; calling the Annual and Extraordinary General Shareholders' Meetings; approval of the agenda of the General Shareholders' Meeting; increase of the company's Charter capital by distribution of the shares within the limits of the quantities and categories (types) of declared shares; 6) distribution by the company of bonds and other emissive securities, recommendations on the amount of the dividends on shares and some others. Issues relegated to the jurisdiction of the company's Board of Directors may not be transferred to the company's executive body.

Members of the company's Board of Directors shall be elected by the Annual General Shareholders' Meeting for a period untill the next Annual General Shareholders' Meeting. Members of the company's Board of Directors with over a thousand shareholders owning common shares shall be elected by cumulative vote. By the decision of the General Shareholders' Meeting the powers of any member of the Board of Directors may be early terminated, insofar, if members of the Board of Directors were elected by cumulative vote, the decision on the termination of powers may be taken only with respect to all members of the Board of Directors. For an open joint stock company with over a thousand shareholders owning common stock and other voting shares of the company, the Board of Directors should be composed of at least seven members, while for the company with over ten thousand shareholders - at least nine.

The law prohibits to combine the positions of the Chairman of the Board of Directors and General Director (a single-member executive body). The Law also provides that the members of the company's collective executive body may not account more than one quarter of the company's Board of Directors.

An independent director is a member of the company's Board of Directors who is not and was not during a year preceding the adoption of resolution (on the approval of an interested-party transaction):

– a person carrying out the functions of the single-member executive body, including the functions of its manager, a member of the collective executive body, a person holding a position in the bodies of the managing company;

– a person whose spouse, parents, children, brothers and sisters, adoptive parents and adopted children are holding positions in above-mentioned company's management bodies, of the managing company, or being the Manager of the company;

– the company's affiliate, excluding the member of the Board of Directors.

Decisions at the company's Board of Directors shall be adopted by a majority of votes of the members of the company's Board of Directors participating in the meeting, unless provided otherwise by the Federal Law 'On Joint Stock Companies' or by the company's Charter. Remuneration and compensation of expenses related to the execution of duties by the members of the Board of Directors shall be paid by the decision of the General Shareholders' Meeting. The amounts of such payments are established by the decision of the General Shareholders' Meeting.

The jurisdiction of the **company's executive body** includes all issues relating to the management of the company's current activity, and implementation of decisions adopted by the company's General Shareholders' Meeting and the Board of Directors, except for the is-

sues relegated to the exclusive jurisdiction of the company's General Shareholders' Meeting or the Board of Directors.

The General Director (Director) shall be elected, and shall also early terminate his/her duties, by the decision of the General Shareholders' Meeting or the Board of Directors, depending to whose jurisdiction the resolution of the specific issue is relegated. The powers of the General Director, by the decision of the General Shareholders' Meeting, may be transferred under a contract to a commercial organization or an individual entrepreneur (Managing Company).

The company's collective executive body shall be formed and shall early terminate its powers by the decision of the General Shareholders' Meeting, unless the company's Charter delegates the right to resolve such issues to the company's Board of Directors. The Charter of the company which provides for both a single-member and collective executive bodies should specify the powers of the company's collective executive body. In this instance, the person executing the functions of the company's single-member executive body (Director, General Director) shall also execute the functions of the Chairman of the company's collective executive body (Management Board, Directorship).

Members of the management bodies are liable to the company for losses inflicted to the company by their culpable actions (omissions), unless federal laws establish other grounds and scope of liability. Insofar, members of the collective executive body and the Board of Directors who voted against the decision which caused losses to the company or who did not participate in the voting procedure shall not be held liable. In determining the grounds and scope of liability one should take into account normal course of business and other circumstances material for business.

The company or a shareholder (shareholders) owning in aggregate at least 1 percent of the company's distributed common shares may file a suit to court against the member of the management bodies and claim compensation of losses inflicted to the company. The representatives of the State or a municipal organization in the Board of Directors of an open joint stock company incur the same liability as other members of the Board of Directors of an open joint stock company.

To supervise financial and business activity of the company, the General Shareholders' Meeting elects **the Inspection Commission (Inspector)** of the company. The inspection of the company's financial and business activity is conducted upon the results of the company's activity for the past year, and at any time at the initiative of the Inspection Commission, by the decision of the General Shareholders' Meeting, of the Board of Directors, or at the request of a shareholder (shareholders) of the company, holding in aggregate not less than 10% of the company's voting shares.

The members of the company's Inspection Commission (Inspector) may not be at the same time the members of the company's Board of Directors, or occupy other positions in the company's management bodies. The shares in possession by the members of the company's Board of Directors or persons occupying positions in the company's management bodies may not participate in election of the members of the company's Inspection Commission.

The **External Auditor** audits the financial and business activity of the Company on the grounds of the contract concluded therewith. The company's External Auditor shall be approved by the General Shareholders' Meeting. The amount of compensation for its services shall be determined by the company's Board of Directors.

In cases, when the company distributes its shares and emissive securities convertible into shares by a public subscription, **the company's shareholders** (see also table below) shall have the preemptive right to acquire the above shares in the amount proportionate to the number of shares of this category (type) belonging thereto. Shareholders of voting shares shall

have the right to demand that all or part of their shares be redeemed by the company in the following circumstances:

– in the event of the company's reorganization or conclusion of a major transaction by decision of the General Shareholders' Meeting, provided they voted against such decisions or did not participate in the vote on such issues;

– in the event of introduction of amendments and additions to the company's Charter or approval of a new edition of the Charter which restrict their rights, provided they voted against the adoption of the corresponding decision or did not participate in the vote.

Table 1

Stockholders' rights depending on their share in the paid-up capital

The threshold of participation	Stockholder's powers
1 share	1. the voting right at the general meeting 2. eligibility for dividends on the given category of stock 3. eligibility for receipt of a part of property (an adequate value) in the course of liquidation of the JSC 4. the right to demand the stock redemption under certain circumstances 5. the right to appeal to the court concerning decisions passed by the general meeting 6. the right to have an access to documents related to the JSC's operations, as per the law except those associated with accounting and protocols of meetings of the JSC's collegial executive body 7. the right to receive an extract from the JSC's register 8. the right to receive an extract from the list of individuals who are eligible for participation in the general meeting of JSC's stockholders
1%	1. the right to get oneself familiarized with the list of individuals who are eligible for participation in the general meeting of JSC's stockholders 2. 2)the right to file a lawsuit against a member of the Board of Directors, individual executive board, member of a collegial executive body of the company and a managing organization or manager on recovery of losses caused by in the event stipulated in the law
2%	1. the right to include his questions to the agenda of the annual general stockholder meeting. 2. the right to propose candidates to the board of directors, revision commission, and accounting commission of JSC
10%	1. the right to request an early general stockholder meeting 2. 2) the right to demand at any time to inspect the JSC's economic and financial operations
25%+1 share	1. 1) the right to bloc decisions passed by the general stockholder meeting with regard to introducing amendments to, or approval of a new version of the company's Charter, placement of stock (closed subscription, placement of ordinary stock through open subscription, if over 25% of earlier placed ordinary stock are to be placed, placement through open subscription of issued papers that can be converted into ordinary stock and account for over 25% of earlier placed ordinary stock), reorganization and liquidation of JSC, appointment of the liquidation commission, approval of liquidation balances, computation of the quantity nominal value, category (type) of stated stock and rights provided by them, the company's acquisition of placed stock in the vent provided by the law, and approval of decisions on concluding large deals. 2. 2) the right to familiarize himself with accounting papers and minutes of the JSC collegial executive body's meetings.
30%+1 share	The right to hold a repeatedly convened general stockholder meeting (instead of the one failed due to the lack of quorum)
50%+1 share	1. the right to hold a general stockholder meeting 2. 2) the right to make a decision at a general stockholder meeting (except the issues that require qualified majority
75%+1 share	Full control over JSC

Shareholders-owners of preference shares shall participate in the General Shareholders' Meeting and have the right to vote on issues concerning the company's reorganization or liq-

uidation, in the event of adopting a decision to introduce amendments and additions to the company's Charter which limit the rights of preference shareholders of such type, including instances of the determination of or increase in the size of a dividend and/or the determination of or increase in the liquidation value payable on preference shares of the higher priority, as well as the granting to preference shareholders of this type of a higher priority during the payment of dividends and/or the liquidation value of shares.

The company is obliged to provide its shareholders with the following **information on the Company**: the agreement on the establishment of the company; the company's Charter, amendments and additions to the Charter and registered in accordance with the established procedure, decision on the creation of the company, certificate of state registration of the company; documents certifying the rights of the company for the assets shown on its balance sheet; internal documents of the company; provisions on a branch or a representative office of the company; annual reports of the company; accounting documents; voting ballots, as well as power of attorneys (copies of power of attorneys) to participate in the company's General Shareholders' Meeting; independent appraiser' reports; lists of the company's shareholders entitled to participate in General Shareholders' Meeting, having the right to collect dividends as well as by other lists drawn up by the company for the exercise by its shareholders of their rights; issue prospects, issuer's quarterly reports and other documents containing information to be published or disclosed by other means in accordance with the Federal Law 'On Joint Stock Companies' or in accordance with other federal laws; lists of the company's affiliated persons; other documents stipulated by the Federal Law 'On Joint Stock Companies' in force, the company's Charter, the company's internal documents and decisions of the General Shareholders' Meeting, the company's Board of Directors, its management bodies, as well as other documents provided by legislative acts of the Russian Federation. Only those shareholders (shareholder) holding in aggregate no less than 25% of the company's voting shares have the access to the company's accounting documents and the minutes the meeting of the company's collective executive body.

The latest amendments to the Federal Law "On Joint Stock Companies", in effect since January 1, 2002, includes a number of important new imperative provisions representing effective safeguards for minority shareholders' rights and statutory interests:

– The Law provides for extra guarantees for shareholder rights during joint stock company restructuring by way of split-off or split-up;

– Changes to a holding company's corporate structure by means of issues of shares or other securities convertible into shares are now much more difficult to effect.

– The Law offers a new precaution against unfair buy-outs of shareholders' assets upon the emergence of fractional shares during stock consolidation, which were previously subject to obligatory repurchase.

– The Law expands the competence of a general shareholders' meeting.

– The Law also updates some procedures involved in the convocation and conduct of general meetings, thus further securing stockholders' rights to share in the governance of their companies.

– The Law sets a period of limitation for appealing decisions made by general shareholders' meetings.

– It is now easier to dismiss the company's executive authorities.

– The Law establishes new rules for the approval of interested-party transactions, which reduce the risk of the company being governed in the interest of a limited group of parties.

– The list of documents which the company is obliged to keep and copies of which it is required to submit at shareholder requests is much longer than earlier.

1.3. External Mechanisms of Corporate Governance

1.3.1. The Corporate Securities Market

The importance of the corporate securities market for the formation of any specific model of corporate governance is quite obvious and requires no further comments. Under the conditions of an illiquid developing market, the problem of a choice between the mechanism of "vote" and the mechanism of "withdrawal" loses the character of dichotomy[40] and becomes, in fact, predetermined: if it is impossible to sell one's shares, one would face the necessity to increase the role of the "vote" mechanism. When the major object of trade is the securities issued by 10-15 issuers, the mechanism of "withdrawal" (selling of shares) as an element of a model of corporate governance would not work in an absolute majority of cases. The liquidity of the market of securities of one specific issuer, as a rule, is rather short-term; moreover, it is one-sided: small share-holders can only carry out "withdrawals," and only during the periods of consolidation of the controlling block of shares, or at the time of an aggravation of corporate conflicts between major share-holders and managers. In a number of situations, this problem could not emerge in principle (when absolute control is established and/or the enterprise is simply of no interest to anybody).

Consequently, the formation of a model of corporate governance would actually become predetermined: if the mechanisms of "withdrawal" do not work (it is impossible to sell one's shares), the development would, objectively, take the course of strengthening the role of the mechanism of "vote." If any problems emerge even in this respect (the managers can still preserve the ideology of "principals"), then there will be no other recourse but to address the government executive and judicial systems.

At the same time, there is also a certain feedback. According to a number of estimates, violations of the norms of corporate governance in Russian corporations became one of the dominant factors resulting in the departure of investors and the collapse of the securities market in 1998.[41]

The years 1999 and 2000 did provide certain reasons for optimism regarding the prospects for the development of the Russian securities market (Table 2). The favorable estimates, first of all, were related to the industrial recovery resulting from the devaluation of the rouble and the growth of oil prices and the price of gas which led to an increase in tax receipts on the part of the budget and a rise in the exporters' income. According to the estimates made by the majority of agencies and influential financial publications, in the first post-crisis year, that is, in 1999, the Russian equity market became one of the three most rapidly growing markets in the world. In just one year, the capitalization of the blue-chip-stock market had increased by 182%. In 2001 and 2002, the Russian equity market was, in general, characterized by a positive dynamics.[42]

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[40] Hirschman A.O. Exit, Voice, and Loyalty: Response to Decline in Firms, Organisations and States." Cambridge: Harvard University Press, 1970, pp.15-54.

[41] The contribution of this factor in the decline of capitalisation of the market is estimated in the range between 30% (Federal Security Commission of Russia) and 100% (Brunswick Warburg), though it is clear that such estimates are very arbitrary.

[42] For more details, see: Rossiiskaia ekonomika v 2002 godu. Tendentsii i perspektivy. (The Russian economy in the year 2002. The tendencies and prospects). M., IEPP, 2003, pp. 116-125; Sostoianie finansovykh rynkov Rossii v 2002 godu i perspektivy ikh razvitiia v 2003 godu. (The state of Russia's financial markets in the year 2002 and the prospects for their development in the year 2003). BEA, informatsionno-analiticheskii bulleten' No 37, aprel' 2002 g. (BEA, The information and analytical bulletin No 37, April 2002.

Among the most important negative (restraining) factors are the absence of significant structural changes in the economy (the reform of natural monopolies[43] and housing-and-communal facilities), the slow progress of the reform of government service, the remaining nontransparency of businesses and the absence of any visible interest to the reform of corporate governance, the substantial role of political and administrative factors in the process of regulation of economic disputes, etc. An important influence on the state of Russia's financial market is undoubtedly exerted by the prospects of realization of the banking reform in general and the possibility of bank crediting for medium-sized and small companies. The forecasts made by the world finance markets also give no grounds for any excessive optimism despite the active growth of Russia's credit ratings and the rise in the interest in Russian securities in the year 2002, as demonstrated by foreign institutional investors oriented towards longer-term investments and fundamental indicators of the companies.

It is also necessary to take into consideration that quite a distinctive feature of the processes of restructuring and consolidation experienced by largest industrial groups in 2002-2003 has become the newly emerged clarity of their intermediate goals - in particular, that of entering the Russian and the international equity markets. Apparently, the consolidation of property and managerial control represents an important, though not the only one, precondition for the realization of such programs. An equally important precondition is the formation of the image of "transparency" for potential investors. In this respect, it is also possible to foresee a growth of potential demand for innovations in the sphere of corporate governance dealing with disclosure of information and financial accountability of the companies.

Table 2

Major indicators of the development of Russia's equity market, 2000-2002

	1995	1997	1999	2000	2001	2002
RTS index, points (annual change in %)	100 as of 1.09.95	572 –history. maximum 6.10.97	98	143.29 (-19.95)	260.05 (98.5)	359.07 (34.1)
Capitalization, $ million	5-8	60-65	about 20	40	82	110
Trade turnover, $ billion (share in total volume, %)	0.2 (Sept.-Dec.)	16.7-17	5.7	20.8 (100)	28.04 (100)	41.07 (100)
Incl. RTS	-	-	-	5.8 (28)	4,44 (16)	4.57 (11)
MICE	-	-	-	15 (72)	23.6 (84)	36.5 (89)
Number of issuers whose shares participate in transactions, units (including quotation lists)	70-80 (-)	260-300 (100-120)	350-400 (50-60)	300-350 (30-35)	370-400 (30-35)	370-400 (30-35)
Number of broker and dealer companies, units	3176	5045	1628	924	618	619
Number of credit institutions, units	2295	1764	1375	1320	1320	1331
Trade systems wherein over 90% of trade volume is concentrated, units (all in Moscow)	2	3	3	3	3	3

Source: RTS, MICE, FSC, BAE, Bank of Russia, Ia. M. Mirkin's and Iu. A. Danilov's data.

In 2002, the role played by the Internet on the market of private internal investors was growing in importance. In the financial section of the MICE, 77% of the turnover went through the so-called "Internet-portal": the turnover of transactions carried out via the Internet

[43] Nevertheless, for example, it is the prospects for restructuring of the electrical power industry that were responsible for the process of intensive purchasing of shares of the Russian joint-stock company "UES of Russia" and a number of joint-stock energy producers.

was 711 billion roubles. Approximately 75% of these transactions was conducted by physical persons. By the end of 2002, the trading system of the MICE had been joined by 191 broker systems, which permitted the investors to be served via remote terminals or other Internet technologies.

At the same time, we presume that that *the medium-term prospects of the market's development should not be overestimated*. First of all, the Russian equity market is still incapable to adequately perform the functions of moving the investment resources. The most probable variant of the market's development is a rather moderate activity on the part of external and internal investors. One should also point out a number of disproportions and specific features that have become typical of the Russian market in the several past years.

Firstly, despite the fact that, for example, the RTS index had approached the maximum values by the time of the 1998 crisis, while in the year 2002 its growth was 35%, the market's capitalization still had not exceeded 160 billion dollars by mid-2003.[44] The share of oil and gas companies in the general volume of capitalization of the RTS amounts to approximately 60%, which clearly demonstrates the presence of structural distortions in the Russian economy and its orientation towards export of raw material resources.

Secondly, the market remains highly concentrated. In 2002, the securities issued by five issuers accounted for 72.18% (76.91% in 2001) of the total turnover of the RTS.[45] Ten companies provide 90% of the turnover, and approximately 45% of it falls on just two companies - LUKoil and the RJ-SC "UES of Russia". The maximum amount of transactions involving the shares circulating in the RTS falls on UES (11,400), while LUKoil ranks second (6,200).

Thirdly, all the important trade remains concentrated in Moscow, where it is conducted on two trading floors - the RTS and the MICE. In the recent years, there has also emerged a definite tendency towards the MICE's dominance on the market (Table 1).

Fourthly, highly important is the problem of the objective limitation of the scope of possible sources of financing open to corporations (see above). Another factor restraining external joint-stock financing is the fact that a lot of companies are still underestimated by the market (whatever the reasons are).

Fifthly, in recent years, the tendency of the Russian market to be debt-based has become especially apparent. Under the conditions of an intensive process of post-privatization redistribution of property, corporate bonds are becoming, in fact, the only safe method to attract external financing.

Sixthly, the still isolated cases of IPOs are too few to allow us to share the euphoria of rather numerous analysts (and especially their interpretation of the year 2003 as the "IPO year" which followed the year 2002, the "year of rouble-denominated corporate bonds"). It is typical that by now, all the relatively successfully realized placements have been related to

[44] According to the RTS data as of the end of December, 2002, the hierarchy of the five Russian companies leading in the sphere of capitalization has undergone certain changes by comparison with the year 2001. The J-SC "YuKOS" ranks first (21 038 million USD) followed by J-SC "Gazprom" (18 039 million USD) and the J-SC "LUKoil" (13 099 million USD). The last-year leader, the J-SC "Surgutneftegaz" occupies only the fourth place (11 409 million USD), while the J-SC "Sibneft" is the last on the list. As for the companies outside of the oil & gas and the power industries, the J-SC "Sberbank" is most highly capitalized (3 629 billion USD), while among the "Blue Chips" the one with the smallest aggregate value of shares is the J-SC "Rostelecom" (870 million USD). The aggregate share of capitalization of the "Blue Chips" in the total volume of capitalization of the RTS is approximately 78%.

[45] The share of ordinary stock of the RJ-SC "EUS of Russia" in the total RTS turnover has slightly decreased as compared to the year 2001, sliding down to 26.3% (from 32.86% in the year 2001), and that of "LUKoil" has increased to 19.31% (from 16.65%); the share of "Surgutneftegaz" has risen to 10.65% (from 9.02%), while "YUKOS" which was virtually catapulted into the "Big Five" last year, has maintained its positions by demonstrating a rise to 10.41% (from 13.2%), whereas the results of the J-SC "Tatneft" are 5.51% (against 5.06% in the previous year).

those companies which were private from the very beginning and owned well-known brands; the bidders were not strategic investors, but financial institutions.

Seventhly, the Russian market is a "market of large blocks of shares". At the same time, the relatively high degree of concentration of joint-stock capital (and the existing tendency for a rise in the degree of concentration) makes it possible to envisage the formation in Russia of a model of a highly liquid and broad-based market only as a long-term prospect.[46]

From the very beginning, Russia's securities market has been developing as a market of corporate control. The existing situation is characterized by a decrease in the volume of transactions forming portfolio investments, and by an increase in the scope of redemption of shares which is aimed at re-distribution of property.[47] Nevertheless, mergers and takeovers have practically no impact on the organized equity market, and the market price of shares at the secondary market is of no significant importance. The major "blue chips" with a relatively liquid market have the least chances to become an object of takeover, even if their market value is substantially undercut in comparison with the potential one.

In a *short term perspective*, the securities market is likely to be characterized by the following basic tendencies:

– by a further reduction in the number of professional participants of the securities market, their enlargement (through mergers), and sharper competition among them;

– by the continuing process of consolidation and reorganization in the midst of financial groups and corporations which will preserve the acuteness of corporate conflicts and the gravity of violations of the shareholders' rights;

– by a low probability of any substantial increase of interest in the Russian market on the part of foreign investors (both because of the absence of clarity in respect to restructuring of the banking system and because of the general state of the world financial markets);

– by the search for new instruments and by the development of those which have already occupied a certain segment of the market (corporate bonds irrespective of their time of maturity, warehouse receipts, mortgage documents, etc.); this process can develop both in response to demand on the part of investors and issuers and "from above", for example, on a regional basis;

– by the development of new forms of collective investment (closed mutual funds in the sphere of real estate, etc.);

– by the competition between government agencies and market participants for the funds accumulated by the pension system.

At the same time, it should be clearly understood that in a medium-term perspective this market will not become a serious source of investment recourses for the enterprises due to a number of objective and subjective reasons. Therefore, when elaborating a socio-economic strategy, the practical importance of this segment should not be overestimated.[48]

1.3.2. Bankruptcies

The role of bankruptcy as a means to exert pressure on corporate managers under the conditions of a market economy is well known in all its aspects (both positive and negative)

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[46] See: Uirh.in la.M. Synok tsennykh bumag Rossii. (The securities market of Russia). M., AL'PINA, 2002, p. 319.

[47] Rudyk N.B. , Semenkova E.V. Rynok korporativnogo kontrolia: sliianiia, zhestkie pogloshcheniia i vykupy dolgovym finansirovaniem. (The corporate control market: mergers, aggressive takeovers and buyouts by means of debt financing). M., Finansy i statistika, 2000, p. 9.

[48] Despite the fact that this point of view is shared by an absolute majority of Russian experts, a more optimistic opinion is represented in the following work: Danilov lu.A. Rol' fondovogo rynka na makro- i miikrourovne (ili o mifakh fondovogo rynka). (The role of the stock market or- the macro- and the microlevels (or a few words about the myths of the stock market). A report at the seminar of the SU-HRE "The institutional problems of the Russian economy", April 25, 2003.

and has been thoroughly described in numerous studies. The risk of bankruptcy facing each corporation whose managers are pursuing an erroneous market policy (in the worst-case scenario it can mean the transfer of control to the creditors) is routinely considered as the most important external instrument of corporate governance. It is apparent that the expected result of this mechanism being applied (irrespective of all the pluses and minuses of all the specific country-oriented models - pro-creditor and pro-debtor) should be financial recovery and a rise in efficiency of the corporation which has become the object of the procedures in question.

At the same time, the specific objective limitations hampering the effective and widespread application of this mechanism in Russia and some other transition countries are also common knowledge. These limitations are as follows:

– an unfavorable financial position of a large number of newly established corporations;

– the traditionally soft budgetary restrictions;

– the preservation of a large number of corporations with government participation;

– the necessity to establish an adequate and qualified executive and judicial infrastructure;

– socio-economic barriers hampering the conduct of real bankruptcy procedures in respect to unprofitable corporations, especially in the case of largest or city-forming enterprises;

– numerous technical difficulties hampering an objective estimation of the financial position of potential bankrupts;

– corruption and other criminal aspects of the problem including those dealing with the processes of property redistribution.

In the 1990s, the institute of bankruptcy was used in Russia either as a method of redistribution (seizure, detention, privatization) of property, or as a highly selective method of political and economic pressure exerted on the enterprise by the state. There exists a paradoxical situation: the enterprises with a sufficient safety margin become the object of bankruptcy procedures (because the competitors have good chances to seize control over them), while hopeless enterprises elude this procedure (because nobody wants to seize them enterprises, since the chances to recover the debts in the course of the bankruptcy procedure are rather slim).

The first Law "On insolvency (bankruptcy) of enterprises" was enacted in Russia in November 1992 – approximately at the same time as in other transition countries. Though during the years 1995-1997 the number of petitions for a bankruptcy filed at arbitrage courts was growing at a rather rapid rate, the bankruptcy procedure has not become a commonly applied one, as compared to other transition countries (see Table 3). The principle on which the Law was founded was that of nonpayment. The practice of implementing the Law has demonstrated that the creditors' rights were considerably limited by the difficulties associated with the need for a realistic estimation of the cost of property and the actual carrying-out of the latter by an arbitrage court, and, accordingly, the court's decisions concerning the bankruptcy of a debtor were delayed.

The second Law "On insolvency (bankruptcy)", No 6-FZ of 8 January, 1998, was enacted from 1 March, 1998. The founding principle of this law was that of insolvency: an enterprise's failure to fulfill its obligations at the time of repayment, in that case the enterprise is recognized as insolvent on a cash basis. This has resulted in a considerable lowering of the barriers for initiating bankruptcy procedures.

Obviously, no other Russian law has become the focus of so heated arguments and discussions as the second law concerning insolvency. In principle, this law is to a markedly greater degree was oriented at enforcing payment discipline and equal opportunities for creditors to initiate the bankruptcy procedure. However, for several economic and legal reasons this law when implemented in practice became, instead of an instrument for debt repayment, the means of struggling for achieving control over large and relatively well-functioning enterprises. The way this law was being implemented in the years 1998-2002 has demonstrated its

vulnerability to abuse from many directions, as well as the complexity and disputability of the court decisions.

Table 3
Bankruptcies in some transition countries, 1991-1998

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Russia (progressive total):									
Petitions filed	-	-	-	100	240	1108	3740	5687[a]	12 781[a]
Recognized as bankrupt	-	-	-	50	no data	469	1226	2269[b]	4747[b]
Czech Republic:									
Cases considered	-	-	350	1098	1816	2393	2990	n/a	n/a
Cases completed[c]			5	61	290	482	725		
	-	-	(0)	(1)	(2)	(2)	(6)	n/a	n/a
Hungary:									
Cases considered	-	-	14060	8229	5900	6461	7477	n/a	n/a
Cases completed[c]			1302	1650	1241	2276	3007		
	-	-	(740)	(510)	(90)	(21)	(9)	n/a	n/a
Poland:									
Cases considered	151	1327	4349	5936	4825	3531	3118	n/a	n/a
Cases completed[c]	29	305	910	1048	1030	1030	984		
	(1)	(8)	(98)	(179)	(235)	(287)	(173)	n/a	n/a

[a] Petitions filed at arbitrage courts.

[b] Importantly, in the first few months after the enactment of the new law only (March-June 1998) 800 petitions were filed. By early November 1998 the number of petitions grew tenfold, up to 8000, which can explain the dramatic growth demonstrated by the results of the year 1998.

[c] Reorganizations included.

Sources: data provided by FUDN; Commentary to the RF Law “On insolvency (bankruptcy)”. M., 1998; EBRD Transition Report 1997. Enterprise Performance and growth. London, 1997; EBRD Transition Report 1998. Financial Sector in Transition. London, 1998; EBRD Transition Report 1999. Ten Years of Transition. London, 1999.

In a situation of rampant corruption and an ongoing redistribution of property, the decision-making scheme and the spectrum of possible decisions have become a convenient instrument of manipulating and exerting pressure in the interests of various participants in the process (however this, certainly, is not a problem pertaining to the quality of the law proper). Primarily, these are issues dealing with nomination of different types of arbitrage managers and the objective criteria for the choice between liquidation and rehabilitation. The noticeable simplification of the procedure of initiating a bankruptcy (in the event of debt in the amount of 500-fold minimum monthly wage for juridical persons) meant also that it became much more easier to initiate this scheme of seizing property. The Russian experience has well demonstrated that by nominating “their own” arbitrage manager (temporary, trustee or external), the participants can almost guarantee that “their” problems are going to be solved, no matter whether they need protection or plot an aggression. At the same time, the problem of legal and practical insurance of protection for the rights and interests of all types of shareholders within the framework of a bankruptcy procedure has remained unsolved. In particular, the danger of enforced bankruptcy of many big corporations with outstanding debts to the federal budget in the year 1998 became one of the factors responsible for a rapid outflow of portfolio investors from the corporate securities market.

Some specialists have also noted the problem of deliberate bankruptcy which can be used as a way to protect the director from shareholders. CEOs may relatively easily have their trusted partners consolidate the enterprise’s deliberately made debts, buy out its bills and have it declared bankrupt, and nominate a representative of the former directorate the new man-

ager. Some representatives of the Ministry for State Property of Russia[49] have stated that bankruptcy is becoming also an instrument of protecting the state's ownership rights. For example, in some instances, during preparations for the privatization of an enterprise, potential buyers attempted to "dump" the price by threats of initiating a bankruptcy procedure concerning the object of privatization; in other instances, when the state attempted to apply her shareholder's rights to replace a director, the latter initiated a bankruptcy procedure as regards the enterprise in question.

As a result, the incidence of applying a bankruptcy procedure to enterprises has dramatically went up. Thus, as of 1 January, 1998, the proceedings concerning about 4200 bankruptcy cases were being carried out, as of 1 January, 1999 this figure went up to 10200 cases, as of 1 January, 2000 – up to about 15200 cases, as of 1 January, 2001 – up to about 23800 cases, and as of 1 January, 2002 - up to as many as 42800 cases. Further growth in the number of petitions was associated, in particular, with the task of "clearing the field" of the actually abandoned enterprises by means of declaring the absentee debtors bankrupt. The burden imposed on the infrastructure for applying bankruptcy procedures was growing accordingly (see Table 4).

Table 4

Movement of bankruptcy cases

	1998	1999	2000	2001
Uncompleted cases left as of beginning of year	4210	10171	15211	21080
Cases accepted for arbitration during year	8337	10933	19041	37916
"Total turnover" of cases during year	12547	21104	34252	58996
Completion of proceedings during year	2628	5959	10485	16194
Uncompleted cases left by end of year	9919	15145	23767	42802
Uncompleted cases left by end of year, in % of turnover of cases during year	79	72	69	73

These changes meant, obviously, not only the creditor's enthusiasm in connection with the legal prospects that had opened up before them, but rather the trials of new takeover schemes (seizure of assets), or, on the contrary, the protection of managers from hostile takeovers. The coincidence of this process with a general activation of property redistribution during and after the 1998 crisis has not been accidental, either.

The imperfection and vagueness of insolvency procedures, in combination with the temptation to use them to achieve dishonest aims, result in *a high degree of controversy* as regards their realization. While the number of conflicts in respect to the proceedings in bankruptcy has been visibly declining, the disagreements now coming to the fore are those occurring between the parties within the framework of the procedure of external control in the course of which the main events concerning property redistribution generally take place..

The new (**third**) Federal Law "On insolvency (bankruptcy)" No 127-FZ of October 26, 2002 contains the following major innovations:

– stronger protection of the creditors' rights and legal interests;

– widening of the scope of rights of the law-abiding owners (founders and participants) of an indebted enterprise, and also strengthening the protection of their interests in bankruptcy procedures;

– protection of law — abiding participants in bankruptcy procedures from any illegal actions on the part of other persons;

– a change in the status of the trustee in bankruptcy;

[49] Bekker A. Pogonshchiki slonov. (Interv'iu s V. Pyl'nevym). (The elephant drivers: an interview with V. Pyl'nev). Vedomosti, 7.06.2000

– a change in the status of government bodies participating in the bankruptcy procedure;

– an introduction of a new bankruptcy procedure applied to the debtor in order to restore solvency and provide for debt settlement (financial recovery).

Nevertheless, it should be pointed out that no laws can be perfect enough to immediately solve the problem. Specialists in the sphere of law note that regulation of insolvency is the most rapidly progressing field of law in developed countries, and that the economy itself necessitates constant renovation of the corresponding norms. The same approach is all the more objectively unavoidable for Russia's economy in transition.

Substantial, though apparently rather distant, prospects are associated with improving the whole of judicial practice in general. For example, in the interests of protecting the enterprises from illegal seizures of control over them (or some part of their assets) by means of bankruptcy procedures, it is necessary to widen the practice when judicial authorities refuse to use bankruptcy procedures as a usual method of debt settling. Such a use of the afore-said procedures should be considered an abuse of right in accordance with Article 10 of the RF Civil Code, and should require transparency of the judicial procedure and responsibility on the part of the judicial body.

1.3.3. The Corporate Control Market

Over the whole course of the 20th century, mergers and takeovers always attracted considerable interest from academic and social points of view. [50] Many economists ant politicians see them as one of important manifestations of market discipline; at the corporate control market, competition can lead to the passage of a firm into the hands of economic managers who would materialize a more effective strategy of the firm's development. "The corporate control market" (the threat of a hostile merger and replacement of the managers) as well as the threat of bankruptcy represent one of the key external mechanisms of corporate control. A number of researchers consider the mergers market to be the only mechanism to protect the shareholders from the managers. It is noted that mechanism is most efficient when it is necessary to "break" the resistance of a conservative board of directors not interested, in rationalization (splitting-up) of the company especially when the latter is highly diversified.[51]

At the same time, the efficiency of this method as a means for subsequent improvement of corporate control time and again comes under fire. In particular, it is pointed out that the danger of take-over stimulates the managers only to realization of short-term projects because of the fears that the market value of their shares would go down. Other skeptics presume that mergers serve just the interests of shareholders without taking into consideration the interests of all the "participants". And finally, there is always a risk of destabilization as regards the activities of both the purchaser company and the company taken over. The voluminous theoretical literature also thoroughly analyzes the interrelation between the takeovers yielding private (special) gains to big shareholders and the rise in economic efficiency after the passing of control into the hands of a new owner.

All this have resulted in active arguments concerning the role of mergers and takeovers in a modern economy as well as in the discussion regarding the optimum forms of regulation of the said processes. In the course of institutional and economic transformations taking place

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[50] For more details, see: Radygin A. D., Entov R.M. , Shmeliova N.A. Problemy sliianii i pogloshchenii v korporativnom sektore. (The problems of mergers and takeovers in the corporate sector). M., IEPP. 2002;

Rudyk N.B., Semenkova E.V. Rynok korporativnogo kontrolia: sliianiia, zhestkie pogloshcheniia i vykupy dolgovym finansirovaniem. (The corporate control market: mergers, aggressive takeovers and buyouts by means of debt financing). M., Finansy i statistika, 2000; Chirkova E.V. Deistvuiut li menedzhery v interesakh aktsionerov? Korporativnye finansy v uslovilakh neopredelionnosti. (Do managers act in the interests of shareholders? Corporate finances under the conditions of uncertainty). M., OLIMP-BIZNESS , 1999; Kulagin M.I. Izbrannye trudy. (Selected works). M. , Statut, 1997. etc.

[51] Coffee J.C. Shareholders Versus Managers. Oxford University Press, 1988

in Russia and other transition countries, the discussion on the role of mergers and takeovers and their specific features in conditions of transition to a market economy has become equally timely.

The first (isolated) experience of hostile takeovers in Russia (bearing in mind not the seizure of control by means of various mechanisms of privatization but public operations at the secondary market, dates to as early as the mid-1990s.[52] In the summer of 1995, there was a famous though failed attempt of the "Menatep" banking group at taking over the "Red October" confectionary by means of a public tender offer. Another equally well known event was the purchase of a controlling block of shares of the confectionary joint-stock company "Babaevskoe" by the "Inkombank" holding. Also worth mentioning is the public share auction notified by the "Menatep Bank" which aimed at buying 51 % of shares of the pulp-and-paper joint-stock company "Pitkiaranta" from several shareholders. Some controlling blocks of shares were also bought through the stock exchange. An example is the purchase of 59% of shares of the "Vladivostokskii likero-vodochnyi zavod" (the Vladivostok distillery) by "Ussuriiskii balsam" (Ussurian balsam). And there was an attempt of the "Ghernogorneft" oil-extracting company to work out - with the help of "The Salomon Brothers" – "a program of measures to protect the interests of shareholders" in the event of any changes in control over the oil company "Sidanco" which was its parent undertaking.

During the same period (and later on), many largest banks (financial groups) and portfolio investment funds practiced takeover of companies operating in every imaginable field and did it for their own needs or for subsequently reselling those companies to non-residents or strategic investors. Thus, starting in 1992, "Alfa-bank" and "Alfa-kapital" (structures of the group) have carried out more than 30 deals in the sphere of mergers and takeovers both for the sake of the group and for its clients (chemistry, communications, the glass industry, oil, etc).[53] In the years 1997 and 1998, the food industry once more was the arena for takeovers in the pharmaceutical and tobacco branches as well as in the sphere of production of consumer goods.

In the mid-1990s, takeovers of the classical type were taking place, first of all, in the branches not requiring any substantial concentration of financial resources. The positive character of this tendency is primarily related to the fact that, firstly, there emerges a certain regulation of the structure of joint-stock capital, and secondly, that this regulation is beneficial because of the all-around effect: other enterprises are also forced to take restructuring measures in order not to become the object of the next takeover (attempt at taking over).

Thus, the *first (initial) stage* between the mid-1990s and the 1998 crisis was characterized by isolated attempts to use the classical methods of takeovers. If all the privatization deals are taken into consideration, it is this period that the takeovers by means of privatization were most typical of. The above method was used both as mechanism in its own right and as an element of the expansionist strategy pursued by the first financial and industrial groups (first of all, the informal banking groups).

The second stage (post-crisis boom) dates to the period between mid-1999 and the year 2002 inclusive. It is during this period that the specific causes for the wave of mergers and takeovers were most vividly manifesting themselves. The major stimulus for their activization in the first post-crisis years was the continuing consolidation of joint-stock capital. Nevertheless, due to certain specific features of the methodology used, some analysts prefer not to use the tern "mergers and takeovers" and to limit themselves to the habitual expression "redistri-

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[52] Radygin A. Ownership and Control in the Russian Industry. OECD/World Bank Global Corporate Governance Forum. OECD: Paris, 1999.

[53] According to the data on the official site of the bank, though the actual number of the afore-noted operations within the framework of the whole group is apparently significantly higher if the operations carried out by the partners and the affiliated structures are taken into account.

bution of property”. In the period under consideration, the expansion of industrial groups was combined with the intensification of the process of asset consolidation.

The post-crisis financial situation conduced to a pronounced rise in the rate of mergers and takeovers in those sectors of the economy which, had already been potentially ready for them before the crisis. During this period, the process of mergers and takeovers initially touched off by the largest oil companies was most typical of ferrous and non-ferrous metallurgy, chemistry, the coal industry, machine building, the food-, the pharmaceutical- and the timber industries. The introduction of a single stock by oil companies can be also considered as a kind of merger.

The third stage (reorganizational “slump”) is beginning at the present time. It is characterized by a certain deceleration of the rate of expansion demonstrated by the fully-fledged groups, the completion of the consolidation processes, the first signs of restructuring amid the groups, and the beginning of juridical reorganization (first of all, legalization of amorphous holdings and groups).

Certainly, the estimation of the scope of the process of mergers and takeovers in Russia depends on the choice of a methodological approach. Thus, if the most extensive approach is used, many big privatization deals may be estimated either as friendly or hostile takeovers, and in that case the significance of this process for Russia’s corporate sector throughout the whole decade of its large-scale development (1992-2002) would be extremely high.

If a standpoint of the most strict and traditional definitions is selected, then, as far as Russia is concerned, one can speak only of the post-privatization period, isolated secondary transactions and large corporations. Alternative restrictions in this case would be of an objective character (both for mergers and takeovers): the need for substantial cash funds (credits) available only to the largest companies (banks), a possibility to mobilize substantial blocks of shares for exchanges, an absence of “legally clean” objects to be taken over as a legacy of privatization (possible breaches of law, unregistered first issue, limitation period for privatization deals, etc.).

Mergers as such *(friendly takeovers)* of corporations, strictly speaking (i.e., participation of firms of equal status, friendly and coordinated transaction between big companies without buying out small shareholders’ shares, exchange of shares and creation of a new company), have not yet become a noticeable phenomenon in Russia, although for this particular form no highly developed capital market is required. This process traditionally becomes activated at the stage of economic growth and a tendency of shares’ market rates to go up, whereas in Russia it traditionally is regarded as a possible anticrisis mechanism, in a political context or as an institutional formalization of technological integration (restoration of old economic ties, struggle for market space, vertical integration).

Despite a whole number of restrictions (the need for consolidating big blocks of shares, clear and fixed property structure within a corporation, substantial liquid resources), in Russia it is hostile takeovers, i.e. the corporate control market proper, that have become better developed. Its activization during various periods is associated, primarily, with the expansion of largest groups (holdings). Nevertheless, if one takes into consideration the whole spectrum of both classical (common for international practice) and specifically Russian methods of takeover (e.g., bankruptcy), then the volumes of such transactions, especially after 1998, would become very substantial.

The task of identifying the peculiarities of mergers and takeovers in Russia is of interest in itself. In this context it would be reasonable to distinguish several groups.

Group 1 of the peculiarities deals with the different causes of these processes.

Although waves of mergers and takeovers traditionally accompany the stages of economic growth, in the situation of a post-communist Russia, irrespective of any particular stages, great impact is produced by factors like post-privatization distribution of property, ex-

pansion and reorganization of large groups, and financial crises. An undisputable proof is provided by the spontaneous process of equity capital consolidation and takeovers of control within corporations after the 1998 crisis.

The direct influence of state regulation (as different, e.g., from the USA where the modification of the forms and methods of mergers was associated, beside other factors, with the introduction of new government regulation procedures) plays a very insignificant role. The process of mergers and takeovers, as far as specific forms and directions of integration are concerned, occurs mostly spontaneously. At the same time, mergers and takeovers (integration, consolidation) in an indirect way represents a self-protective response to the consequences (costs) of privatization, lack of protection of ownership right, and the taxation policy.

It is also necessary to take into account general factors like the initial preservation of the conditions for monopolization of the economy, the orientation (in fact) of the main export flow toward 2000 Russian enterprises, inclusion of most of the exporters in specific groups, and the relatively stable structure of their shareholders (by August 1998). These factors have accounted for the "frequency" of such operations.

Group 2 has emerged due to the specificity of Russia's stock market. The securities market in Russia from its very onset has been developing as a market of corporate control. The present situation is characterized by a lowering volume of transaction aimed at forming portfolio investments and by an increase in the scope of buy-outs of shares with the purpose of property redistribution. Nevertheless, mergers and takeovers in actuality have little to do with the organized stock market, and the market price of shares on the secondary market is of little significance. The biggest "blue chips" with a relatively liquid market have the least chances to participate in a merger, even if their market value is much lower than their true potential.

Group 3 of the specific features is associated with the specific structure of the property owned by Russian companies and the participants in transactions:

– despite the existence of certain legal mechanisms, minority shareholders of a target company play a passive role and cannot act as full-capacity participants of the corporate control market. They can either gain due to a higher price offered for their shares ("merger premium"), or lose (if the new owner is going to implement a policy that would encroach on their rights). Besides, non-liquidity of their shares, in most cases, would not allow them to estimate the profitability of sales;

– especial significance of the factor of the CEOs' personal considerations (although such motivations are usually not voiced publicly and are assessed very negatively as having nothing to do with economic efficiency). The almost total identity of enterprises' managers and owners (in addition to the usual ambitions of hired managers that are also common for other countries) results in a situation when the merger with a bigger competitor is often perceived as losing to this competitor;

– the intricate and non-transparent structure of (the property of) companies accounts for a minimum of openness when carrying out such transactions;

– the corporate organization as "a group of companies" makes the buyout of the assets of an already active enterprise a much more "technological" and less risky deal than the reorganization of two merging companies;

– comparatively higher requirements to the stake in a stock capital needed for achieving control over an enterprise (ideally – up to 100 % of the stock capital);

– the relationships between companies, including those within group structures, are only slightly and relatively inefficiently regulated by legislation;

– quite often, informal control (through "contact groups", control over cash flows, "give-and-take" mechanisms, agreements for using "surrogate money", etc.) is more preferable than legally registered mergers or takeovers. In addition to the financial cost of legal reg-

istration, it is often necessary to overcome the opposition of regional authorities, competitors, and criminal structures, which often can be managed only by very big structures with connections in federal power agencies;

– regional authorities are not able to directly regulate the integration processes by means of legislation (in contrast to the practice applied in the USA), however they usually participate in transactions in favor of one of the parties;

– private creditors can benefit in a certain way from buying out their claims from the taking-over company, and creditors representing certain government institutions are often used to initiate a bankruptcy procedure;

– as a "white knight", any structure can be used (not only a "friendly" buyer of shares, but also a federal agency, regional administration, a crediting bank, a judicial agency, or a criminal group, who obviously do not need to buy the shares of a target company).

Group 4 of the specific features contains the most typical forms of mergers and takeovers:

– there are no mergers on the basis of equality, which may also be accounted for by the underdeveloped stock market (correspondingly, payments are more often effected in cash and bills, instead of shares);

– the aggressive buyouts of companies underestimated on the stock market, with the purpose of a short-term increase of their market value and subsequent resale, often after a split-up, with applying leveraged buy-out (LBO), and issue of "trash bonds" ("business raiders"), which has been a known practice in the USA since the 1980s, occur very seldom, if ever;

– despite the rare appearance of business raiders, the voluntary "friendly" mergers and takeovers (which were a common occurrence in continental Europe at least until the 1990s) are also rare);

– there exist financial restrictions for an aggressive takeover of companies through offering a premium to shareholders on the value of their shares;

– a prevalence (since 1998) of aggressive takeovers through bankruptcy and various debt schemes);

– exchange of shares has in fact not been applied yet in the Russian practice of takeovers;

– financing for the deals of purchasing shares has been provided mostly at the expense of a company's own shareholders;

– among the protective measures, the methods of applying administrative force and the judicial system prevail (before and after a takeover), though this can equally be said about the aggressor's tactics;

– the creation of conglomerates is relatively common, although internationally this type of mergers has already lost its former significance.[54]

Russia's key feature is *the prevalence of "hard" hostile takeovers (in essence, "seizures" in the language of some researchers) by applying "an administrative resource".* In a most general way, the methods of mergers applied in Russia demonstrated no marked changes during a decade, though some accents were shifting, no doubt. In fact these can be reduced to six main groups: buying-up of various blocks of shares on the secondary market, lobbying of privatization (trusteeship) deals with government blocks of shares, administrative involvement in holdings or other groups, buying-up and transforming debts into shared participation

[54] For the specific features of mergers and takeovers in Russia also see: Materials of the Conferences at the PH "Kommersant": Restrukturizatsiia kompanii, aliansy, sliianiia, pogloshcheniia (Restructuring of companies, alliances, mergers, takeovers) (2000), Uspeshnaia restrukturizatsiia predpriiatii. Problemy i taktika reshenii (Successful restructuring of enterprises. Problems and tactics of decision-making) (2001), papers by T. Andreeva, O.Belen'kaia, I.Vladimirova, R.Leonova, and others.

in property ownership, seizure of control through bankruptcy procedures, initiation of court decisions (for recognizing certain previously concluded deals as null and void, restricting voting right or the right to own blocks of shares, to call general meetings, to nominate bankruptcy commissioners, etc.). Especially common is taking advantage of issuer's inaccuracies in registering the results of securities issues.

It is commonly believed that Russian legislation grants to an enterprise's owner almost unlimited opportunities to protect a business from takeover. Therefore, firstly, almost any takeover technique is available primarily to those structures that possess the resources necessary to exert a political pressure on an owner. Secondly, Russia is characterized by a comparatively rare phenomenon – the existence of companies whose purpose is to effect mergers and takeovers. The scheme of their activity is as follows: a company merged with the client who "has ordered" a takeover is created, then the whole group is restructured, and next there occurs participation in the profits and assets of a unified company, or the stake in its equity is sold to the client.[55]

The principal "protective measures" applied in Western practice by the managers (shareholders) of a company being taken over are well known and can be subdivided into two main groups: preventive ("shark repellents", "poison pills", various "parachutes", employees' participation in the capital, register protection and change of the location of a corporation's registration, creation of strategic alliances, etc.) and those to be applied after the declaration of a tender offer (filing a lawsuit, inviting a white knight, agreement of a non-takeover, repurchase with premium, counterattack on the capturer's shares, restructuring of assets or obligations, PR protection, etc.).[56] Among the known in Russia methods of resisting a potential aggressor that have been applied by the managers (shareholders) of a target company there may be encountered almost any of the internationally known methods (adjusted by the markets' specificity). Nevertheless, preventive protective methods (if one disregards methods like register control, maximum concentration of equity ownership or "dispersion" of assets within a group) are comparatively rare. Among the measures applied in the presence of a direct threat the protective role of "administrative resource" is especially important (federal and regional authorities, local courts of justice, power structures, the employees of an enterprise), as well as that of counteractive "black PR", restructuring of assets and liabilities, counterattacks on the enemy's shares and counterclaims ("lawsuits").[57]

As world experience has shown, the problem of mergers and takeovers, from the point of view of state regulation, may involve several areas: compatibility with industrial policy and the overall reorganization strategy within the framework of appropriate sectors and branches, support of active functioning of competition mechanisms in an economy, ensuring transparency of operations on the corporate control market, protection of shareholders' rights (including minority shareholders), regulation of social conflicts resulting from mergers and takeovers.

Existing Russian legislation, beside the general norms contained in the RF Civil Code, focuses (to a considerable degree, quite formally) primarily on antimonopoly aspects (eco-

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[55] See: Materials of the Conferences at the PH "Kommersant": Restrukturizatsiia kompanii, aliansy, sliianiia, pogloshcheniia (Restructuring of companies, alliances, mergers, takeovers), 2000.

[56] Herzel L., Shepro R. Bidders and Targets: Mergers and Acquisitions in the U.S. Basil Blackwell, Cambridge, Mass.,1990; Ruback R. An Overview of Takeover Defences. Working Paper № 1836-86. Sloan School of Management, MIT. September. 1986. Tab. 1-2.

[57] Of a specific interest are the applied in Russia methods and forms of financing the deals of hostile takeover of enterprises, as well as the methods of evaluating the target companies in the process of hostile takeovers. For more details, see: Vrazhdebnye pogloshcheniia. Materialy spetsial'nogo seminara zhurnala "Rynok tsennykh bumag" i kompanii "InterFinans AV" (Hostile takeovers. Materials of a special seminar of the journal "The Securities Market" and the company "InterFinans AV". In: Rynok tsennykh bumag (The Securities Market), 2001, No 11, pp. 8-17.

nomic concentration) and some selective issues dealing with transparency and protection of shareholders' rights. The problems of compatibility between the requirements established by legislation on mergers and takeovers, and industrial policy are unlikely to be worth considering, due to the absence of any concept of industrial policy in the RF. Social conflicts emerging as a result of reorganization are very well known from practice, however there is no any specific regulation (as does exist, for example, in several of the EU's directives).

It should be also noted that the forms of reorganization of juridical persons, as established by the RF Civil Code, do not reflect the whole spectrum of various economic forms of restructuring.[58] At the same time, the economic forms of restructuring that differ by their economic motivations and the resulting structures of ownership often are classified as a unified form of reorganizing a juridical person. Presently there has emerged an obvious need to reconsider the existing basic legislation along several lines:

– enactment of the federal law "On reorganization and liquidation of commercial organizations", or, at least, considerable renewal of the corresponding norms within the RF Civil Code and some other acts;

– improvement of the regulation of economic concentration within the framework of antimonopolistic legislation;

– development and more detailed elaboration of the legal mechanisms ensuring protection of the rights of both the offeror and of minority shareholders in the event of a merger (public offer, the right of decision-making, "fair price", the right for "ousting" small shareholders when purchasing a certain percentage of the stock, etc.), of creditors and other interested parties;

– development of the norms (requirements) for disclosing the information concerning the procedure of a merger or takeover;

– ensuring coordination on the part of regulating agencies (conformity between departmental acts, a unified control system, etc.);

– ensuring "transparency" of the judicial practice of resolving conflicts arising in the process of mergers.

1.3.4. Enforcement

By today Russia has entered the group of leaders among transitional economies in terms of level of comprehensiveness of economic law. At the same time, the country still demonstrates a far greater backwardness, as far as "efficiency" of its application (the court system, etc.)[59] is concerned. Enforcement now constitutes one of the weakest components in the system of protection of property rights and honoring contract obligations. Should there be no radical change in this particular area, other measures on protection of property rights appear senseless.

At the same time, comprehensive development of the enforcement system suggests further improvement of legal provisions, judicial regulation (including the quality of court's rulings and material penalties it sets for the failure to honor contractual obligations, among others), shaping new judicial and legal establishments (arbitration courts, etc.), development of professional associations that ensure implementation of the said provisions (self-regulating organizations). More specifically, the latter should focus on such a key objective as fostering a civilized «culture of contract".

The judicial statistics does not single out cases associated with corporate governance (protection of stockholders' rights), which makes it impossible to cite accurate figures on this particular category of trials. The Chairman of the Supreme Court of RF V. Yakovlev reckons

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[58] L'vov Iu.A., Rusinov V.M., Saulin A.D., Strakhova O.A. Upravleniie aktsionernym obshchestvom v Rossii (Managing a joint-stock company in Russia). M., Novosti, 2000.

[59] For greater details, see: EBRD Transition Report "Ten Years of Transition". London, EBRD, 1999

that categories of trials change depending on the particular economic processes. Given that in the early 1990s there were numerous disputes on recognition the nullity of privatization acts, the number of such trials has fall substantially by now. It should be noted that given that arbitration courts until recently have had to deal with disputes in the area of legal relations and bankruptcy, while those falling within the corporate governance area accounted for a minor proportion of the overall number of trials, the latter demonstrated a considerable growth over the past two years.[60]

Complexities associated with the application of law in the corporate governance area arise due to both "flaws" in, and inconsistency of the procedural law and imperfection of the material law. According to O. Kozyr, as long as the application of means of legal enforcement of protection of stockholders' rights and legal interests is concerned, it is evident that to the greatest extent it is attributed to minority stockholders[61]. As concerns majority stockholders, they can (at least, formally) protect their rights efficiently enough by means of "pushing" their decisions at a general meeting as well as through individuals they elect into the company's board. At the same time, speaking of preclusion of loss-making actions undertaking by elected managers, any stockholder, including those in possession of the control bloc, can appeal to the court of law with the request to consider such deals null and void. As the judicial and arbitration practices have just begun taking shape, they do not always form the base sufficient to draw conclusions on judicial interpretation of these or those complex or disputable provisions of the law on joint-stock companies. As well, many disputable situations have not yet matured and formed an object of judicial consideration, or they have not passed through all its stages.

Nevertheless, likewise the whole structure of cases considered by arbitration courts, the situation changes quickly. More specifically, by the late 1990s one could usually single out the following provisions of the law "On joint-stock companies" that stockholders could use to protect their interests and rights (a lawsuit against or to protect the company): appealing against a decision ruled by the general stockholder meeting or other AO's governing bodies; 2) lawsuits to force the company to redeem stock in the case when a stockholder has such a right as per the law; 3) to recover in favor of the company the losses that were caused by its executives or any other company or entity controlling its operations; 4) lawsuits on recognizing the nullity of transactions bearing an element of interest of the individuals that exercise influence on the company's operations; 6) lawsuits on charging the company with sums of dividends; 7) lawsuits associated with an abuse of the stockholder's right for information the access to which is stipulated by the law. At the same time, there were practically no suits listed under the 2nd, 3rd and 7th positions. Overall, the practices of the period between 1996-the early 2000 allow singling out a few most widespread categories of cases.[62]

In his first Address to the Federal Assembly of RF "The State of Russia" (2000), the incumbent President cited just humiliation of courts (local authorities' ignorance of their rulings) as a particular manifestation of the general decentralization trend, while "Priority Objectives of the Government of the Russian Federation for 2001-02" did not contain any reference to this problem at all, and the fundamental document "Main Long-term Guidelines of the

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[60] Yakovlev V.F. Stabilizirovat otnoshenia sobstvennosti. In: "Zhurnal dlya aktsionerov", 2002, # 4, P. 5-9

[61] On judicial practices as of the late 1990s, see: Kozyr O. Prava aktsionerov v Rssiyskoy Federatsii:sudebnaya practika. An introductory report..- The Round Table on corporate governance in Russia. M., OECD and the World Bank, with the support of USAID, February 24-25, 2000.

[62] The examples cited below do not mirror any stands or partiality for the issuers concerned – they were selected from the perspective of maximal highlighting on disputes characteristic of the corporate sector. In addition, due to objective reasons, the disputes associated with amendments to the law 'On joint-stock companies' of August 7, 2001 (became effective as of January 1, 2002) have not been considered in this regard.

Socio-economic Policy of the Government of the Russian Federation" tackled the problems facing the judicial system only selectively, along with other concrete challenges.

The concept *for judicial and legal reform* developed specifically for the President in 2000 (which has not become official program document as yet) suggested the following judicial reform avenues: a 2-fold increase in the number of judges over 5 years and in their salaries along with a simultaneous reduction in the current burden per judge, to enhance the quality of consideration of cases, an introduction of the 15-year tenure instead of the lifetime appointment, solving the problem of imposition of disciplinary responsibility measures on judges and differentiation of judicial responsibility measures applied to them, ensuring the 'transparency' of the judicial corpse and their operations, refusal from the practice of clearance of judges' appointments with the legislature of the Federation's Subjects, unification of the three supreme court instances (The Supreme Court, Constitutional and Supreme Arbitration courts), creation of a single judicial system by merging general courts with arbitration ones, transition to a system that should mostly imply an inconsistence between circuits and of the country's administrative division, introduction of appeal provisions to the national judicial process, reforming the procedural law, and development of a system of a pretrial consideration of disputes.

It should be noted that legislative acts passed between 2001-2003 have already fixed many provisions of the above concept: more specifically amendments were introduced to the Federal Constitutional Law "On the Constitutional Court of the Russian Federation" (of December 15, 2001, # 4-FZ); Federal Law 'On Introducing Amendments to the Federal Law "On the Status of Judges in the Russian Federation" was passed on December 15, 2001, #169-FZ; Federal Constitutional Law "On Introducing Amendments to the Federal Constitutional Law 'On Judicial System'" was passed on December 15, 2001, # 5-FZ. As well, after several years of discussion, on March 14, 2002, Federal Law # 30-FZ "On Judicial Community Bodies in the Russian Federation" was passed, and in the framework of the judicial reform on December 18, 2001, instead of the obsolete Criminal Code of RF whose provisions would often conflict with the effective law, practices and the RF Constitution, the new one was enacted.

Despite the adoption of a number of important statutes (that still contain disputable provisions), yet a lot should be accomplished to implement the judicial reform. More specifically, it is the Civil Procedural (in force as of February 1, 2003) and Arbitration Procedural (effective as of September 1, 2002) that need further improvement. It was hoped that the enactment of these Codes would allow to solve a very pressing problem: that is, the competence of general courts of law and arbitration courts with regard to disputes in the corporate law area as a whole and particularly protection of stockholders' rights. However, the changes introduced to the Arbitration Procedural Code of RF and the Civil Procedural Code of RF have failed to solve the problem of the ambivalent judicial competence in the area of corporate disputes. The arbitration courts' competence extends only to the cases "involving disputes between the shareholder and the joint-stock company." At the same time, for example, the disputes that often arise between stockholders within the given company are not qualified for the noted category of disputes.

It should be noted that on 30 December 2001 the RF Code of Administrative Abuses was adopted[63], which provides the following innovations, among others: regulation of liability for violation of property rights (unauthorized occupation, use, reassignment of a land or forest site or a water object), unlicensed use of sub-soil reserves, etc., penalties for the failure to comply with procedures of the state registration of rights for real estate and transactions, the system of penalties for violation of investors' rights on the securities market. Nonetheless, the Code still lacks measures against civil servants' arbitrariness (according to some estimates,

[63] Federal Law of December 30, 2001, # 195-FZ

that is related to the Code maintaining the possibility for a civil servant to opt for a reprimand or a fine, the size of the latter, etc., rather than fixing a concrete liability for a concrete abuse).

We believe that the next steps should imply ensuring the "transparency" of the judge corpse and in judicial operations, a full transition towards the system of exterritorial courts, furthering the reform of the procedural law, and development of a system of the pretrial consideration of disputes. To deal with the cases concerning infringement of property (investors and shareholders') rights, it would be expedient to form specialized court compositions to consider, particularly, administrative cases, establishment of a specialized division of arbitration courts to deal with corporate suits and those involving securities, development of the institution of arbitration assessors, investigation of serious fraudulent activities of top executives of the companies whose stock are quoted on the open market, dissemination and provision of a free access to court's rulings and verdicts executed in writing in the corporate law area, thus contributing to both the control over, and judges' interpretation of the law.

The establishment of a specialized and centralized court as per the law "On the court system in RF" should be based upon the following prerequisites: a strict limitation of powers (for instance, the specialization exclusively in the law on securities, bankruptcy and corporate governance), impartial procedures of appointment of highly qualified (acknowledged by the professional community) judges, increase of the judicial system's funding, implying particularly wage rise of the judge corps.[64]

Development of a system of self-regulating organizations in different professional spheres appears of fundamental importance to the emergence of a private civilized enforcement. It is already today that arbitration courts *can diminish the public courts' workload without increasing budget costs* for maintenance of the latter and provide them with highly professional materials on the cases they consider.

Such structures should further form a crucial component of the system of pretrial consideration of disputes. The bill "On self-regulating organizations" submitted to the State Duma is far from being perfect, nevertheless. Apparently, one needs first to arrive to the conceptual decision as to whether SROs should form a bureaucratic appendage to federal agencies that would just realize their interests through them, or there would be the principle of their independence of the public agencies underlying their operations.

The uncertainty on the above still contributes significantly to high risks associated with investing in Russia. Accordingly, the judicial reform (the ideal of which should be an independent and transparent court that should form the only instance where in polemics with defense prosecution has to prove the necessity of certain procedural acts approved by the court of law only) still is a crucial indicator of the institutional reform as a whole.

1.4. Outcomes in Practice

During the first years of the post-privatization redistribution of ownership (1993-1996) the most widely used were different methods involving transactions at the primary (privatization) and secondary markets. Although during 1997-1999 we still cannot speak about any significant improvement as regards the protection of shareholders rights, it was during the period of 1993-1996 when the violations of the corporate legislation resulting from the struggle for control were taking their most "savage" forms (undesirable shareholders were deleted from the registers, the voting during the general assembly was done by raising hands and not according to the principle "One share – one vote" etc.).

[64] See also: Belaya kniga po voprosam korporativnogo upravlenia. Paris. OECD, 2002; Strakhota R. Principy corporativnogo upravlenia OECD: budut li oni rabotat v Rossii. Theses of presentation, the FSC workshop, NAUFOR, 1999.

It should be pointed out that these processes were typical mostly for that part of the Russian enterprises where, first, was a potential for competition between insiders and outsiders (that is, profit-making or those with good prospects) and, secondly, the managing board itself had concrete strategic plans for the future. If the managing board continued to lead a passive existence paying little attention to the future of the company, then, such a company in the best possible case could only expect a takeover by an outsider and in the worst – the use of its assets by the managers for their personal needs.

Actually the key conflict of all these years was the conflict between the old managers trying hard to defend their positions and the newcomers, who could potentially seize control. This was true in case of the majority of the Russian enterprises, although for different reasons (financial flows and profits, accounting, export orientation, the site or other real estate, segment of the market or branch specialization which is of interest to a foreign company with the same production profile etc.).

Obviously the initial strategy and motives may differ significantly depending upon who is interested in this particular shareholding. For example even in case of a few largest Russian oil and gas companies the strategies they resorted to at the initial stage in order to cut off outside shareholders were completely different: LUKoil tried to disperse the issued shares to the maximum possible extent with the subsequent buy-up through the affiliated and friendly companies, RAO Gazprom introduced rigid limits for outsiders and organized a dual (domestic and foreign) market for its stocks, Surgutneftegaz used its own pension fund for the "self-buy-out" and tried to dilute the outsiders' stakes through new issues, oil company YUKOS resorted to a "friendly" take-over by the bank with the subsequent legalized dilution of the government stake using the debt restructuring schemes as regards its arrears to the federal budget.

In a number of cases consistency in creating and privatizing many of the largest holding companies, primarily vertically integrated ones, turned out to be a separate source of tensions between shareholders. So, in the oil industry the process of institutional restructuring started with the creation of separate oil production companies and their privatization in 1992-1993. Subsequently state-owned blocks of shares were merged into corresponding holdings (similar trends in a number of industries were also typical of 1999-2000 – see below) that were privatized in a new wave of privatization in 1995-1997. The "second-wave" purchasers who obtained a majority control in such holding companies inevitably found themselves at loggerheads with minority shareholders of the "first wave." It is estimated that this conflict held up the emergence of "efficient owners" in the oil industry for at least 3 years. The LUKoil oil company appears to be an exception of sorts, since it switched to a single share as far back as 1995. This conflict of "two privatizations" became a symbol of corporate wars in Russia in 19997-1999, and also a constant source of destabilization in the area of ownership rights.

The well-known conflict between the management and foreign minority shareholders of RAO UES in 2000 was also caused by an ownership structure that dates back to the mid-1990s. It is well known that RAO UES' shareholders include the state, which holds a controlling interest in it (long-term strategic interests coupled with a powerful social factor, but at the same time realization of the need for a radical technical and technological restructuring), minority shareholders (short-term interests related to the dynamics of share prices), employee shareholders (immediate interests of keeping their jobs and wages). Conflicts involving the last group have prospects of their own[65], but they also have a bearing on RAO's relationship with regional authorities (social interests and control of regional utility structures). Although it is the non-optimized ownership structure that generates potential conflicts, a certain compromise can be found in formulating still non-existent principles of corporate governance.

[65] A similar example can be found in the year 2000, when workers of the AvtoVAZ joint-stock company held a strike to protest the announced plan of restructuring and converting the company into a holding.

When the law "On joint-stock companies" went into force and a whole number of other legislative and regulatory documents were enacted and the situation in law enforcement somewhat changed for the better,[66] the purely procedural methods began to be used more and more often including those which constitute a violation of the corporate law:

– shareholders are either not getting notified at all about the shareholders meetings or are not notified on time or are not notified about the substantive issues on the agenda of the meeting;

– boards of directors are not elected at the general meeting as is required by the law;

– outside investors under different pretexts are not allowed to become members of the board, which are "closed" to outsiders;

– there is an opposition to the independent audit of the financial activity of the company although outside shareholders insist on it;

– the procedural requirements concerning the voting during the general meetings are not observed;

– the rights of small shareholders are infringed upon during the distribution of dividends;

– the rights of shareholders are violated during the exchange of shares (when shares of the holding solely are introduced) etc.

Nevertheless, the most widely used way to get rid of outsiders was still the dilution of the outsider's share (both in the Board of Directors and in the issuer's equity) in favor of the majority shareholders (of a holding). The derivative mechanisms may also be used for this purpose: convertible bonds, fractionalization or consolidation of shares, transition to a single share etc. In the holding companies in case if an outsider has the veto right (more than 25% of the voting stock) and can block the additional issues the so-called transfer prices are used and the assets are redistributed between the parent company and affiliates without taking into account the interests of minority shareholders.

The more widely known conflicts of 1997-1998 took place in the oil companies YUKOS (transfer of funds from the subsidiaries), SIDANCO (an attempt to issue convertible bonds at the price lower than the market one and place them with the friendly entities), Sibneft (transfer of assets to the holding and discrimination of the minority shareholders of subsidiaries during the transition to a single share).

Among the violations of the shareholders rights are the widely-spread practices when the managers unrestrainedly "pump over" the assets of the company they work for into their own companies and their accounts both in Russia and abroad or, in the best possible case, fix exorbitantly high salaries for themselves (while the rank and file employee-shareholders are not being paid their wages and /or dividends for months and months).Such behavior is primarily explained by the unstable situation in the corporate control, which provides an incentive to the management to prepare the "golden parachutes" for themselves.

The financial crisis of 1998 brought about more active use of the additional issues of shares and derivatives, debt schemes (securitization of debt), the mechanism of bankruptcy (starting from March 1, 1998, when a new law came into force) and company's reorganization. The most common of these types of violations was an attempt to squeeze out individual shareholders into newly-created companies beset by all sorts of financial problems. Under such conditions the attempts by the regional elite to establish control over the major enterprises of their regions became more noticeable and successful. These tendencies are going to continue, what may increase the instability of the property rights and would demand a tighter policy of the investors (shareholders) rights protection. Existing loopholes in the Russian cor-

[66] In this context we do not have in mind any real achievements in the field of enforcement or positive shifts in the judicial system but rather the declarations about turning the screw on the violators and the use of demonstrative measures (because of the objective impossibility to control all the violations).

porate and privatization legislation make it possible to give a semblance of legality to what in essence amounts to unlawful tricks.

According to the Federal Securities Commission, the following violations by issuers were most typical:

– Violation of the procedures for keeping a shareholders register (if the register is kept by the issuer);

– Violation of requirements that amendments be made to constituent documents in connection with changes in the nominal value of the Russian legal tender or the scope of prices;

– Violation of the procedure for acquiring shares placed by the issuer;

– Failure to publish in the mass media annual reports, accounting balance sheets, profit and loss accounts, and lists of affiliated persons;

– Violations in the payment of dividends;

– Issuance and circulation of securities that have not been properly registered.

Table 5

Main risks of corporate governance

Risk	Risk degree ("+++" - maximum risk)	Is it this risk unique to Russia	Similarities in other emerging markets
"Dilution" of authorized capital	+++	No (but is more manifest and aggressive until 2002)	Korea
Asset stripping and transfer pricing	+++	No (but is wider spread)	Indonesia, Malaysia, Korea, Mexico
Information disclosure	++	No (but considerably worse than in other countries)	Virtually everywhere
Mergers and reorganizations	+++	No (but conditions are often arbitrary and not transparent)	Malaysia, Korea, Indonesia
Bankruptcy	+++	No (but is often used as a means of takeover or asset stripping)	Virtually everywhere
Attitude (behavior) of managers	++	No (but many companies have vague idea about corporate governance)	Lots of examples in all countries
Restrictions on share ownership and exercise of voting rights	+	No (restrictions are relatively rare in Russia)	Korea, Mexico, Thailand
Registrar	+	No (in rare cases but is more manifest and aggressive in 2002-2003)	India (partially)

Source: Brunswick Warburg.

Although the legislative framework of corporate governance was steadily expanding in the second half of the 1990s, the main risks relating to corporate governance have largely retained their importance up to this day (Table 5). In that respect it is important to point out that Russia is not an exception: many of these risks are typical of other transition economies and emerging markets.

As has already been noted above, with the emergence of corporate legislation in the second half of the 1990s one can speak about some stabilization in the area of ownership rights – the struggle has shifted to the *legal domain*. Although the factor of corrupt courts and state institutions has left its mark on the results of this struggle, mostly quasi-legal – or borderline – methods (or loopholes in legislation) have been used for this purpose. These methods, as was the case before, are mostly procedural in nature: keeping a double register, establishing dual power in the joint-stock company (two meetings, two boards of directors, two general directors), switch to a single share, and also the buying-up of shares and debts, bankruptcy, bribing of managers (not owners), and so forth.

Yet breaches of shareholders rights have again turned into an acute problem in 2000. In a number of cases, the *armed takeover* of companies, a reminder of the "no-holds-barred" period of 1993-1995, has again become a wide-spread means of gaining control over corporations. More often than not such conflicts are characterized by legal nihilism, where the conquerors ignore the actual equity structure and procedural nuances of management. In order to step up pressure, tensions are often ratcheted up in "workers collectives" (up to staging demonstrations, organizing pickets, and armed resistance by workers). Such aggravated situations occurred in a number of large companies due to the desire to complete the redistribution of property *by hook or by crook* before the presidential election of 2000, so as to present the new federal government with a fait accompli. There were also more profound grounds for doing so: corporate raiders counted on support from regional authorities and a general crisis of law enforcement.

Some of the best known corporate conflicts include the stand-off between SIDANKO and TNK, Transneft, Lomonosovo Porcelain Factory, Vyborg CBK (armed takeover), Achinsk Alumina Plant (armed takeover), Kuznetsk Metallurgy Combine, Kachkanar Mining and Refining Combine (armed takeover), Nizhnesandinsk Metallurgy Combine (armed takeover), coal pits in the Krasnoyarsk Territory and Kuzbass, aluminum plants, Moskhimfarmpreparat (a unitary enterprise, an attempt of armed takeover), Orsko-Khalilovsk Metallurgy Combine (essentially for the first time in Russia's corporate history alternative extra share issues took place).

It is essential to point out a new trend that emerged in 2000-2002, a transition from relatively amorphous associations of the conglomerate type towards more homogeneous integrated structures with clear-cut organizational and legal boundaries. This process has been particularly manifest in the oil and metallurgy industries, but there have been similar examples in the chemical, food and other industries. Similar trends have been registered in civil aviation construction and several sectors of the military-industrial complex. Criteria for setting up such structures – compared to the previous financial-industrial groups – have changed too: they include the technological and financial-economic advisability of taking over new assets (enterprises), a considerably higher level of corporate control over affiliate companies (up to 75 percent or higher), organizational and legal transformation (including mergers, consolidation within and between holdings, the switch to a single share. Evidently this process means that there is still a large room for further corporate conflicts.

Among basic tendencies that are typical of the corporate sector development in 2002-2003 it is noteworthy to single out both the continuing process of share capital concentration, amalgamation of enterprises and reorganization of already existing business-groups and a whole series of new tendencies related to intracorporate programs of a number of the largest companies (groups). It is essential that an analysis of reorganization changes in 2002-2003 allows us to reveal different strategic motives – depending on the groups' "maturity". The development of corporate governance standards within a company is directly connected with its reorganization and long-term strategy. Peculiarities of the latter are also defined by potential views of group's owners on the features of its international expansion in the nearest years.

In oil, coal and metal branches in 2002 the intensive process of redistribution of property was to a great extent finalized (due to the fact that the last government share holdings got privatized and spheres of influence between the largest industrial groups got distributed). A further development in the redistribution processes in these sectors is primarily defined by transactions connected with reorganizations of large holdings, optimization of their assets (withdrawal of non-profile assets), or alliances among groups.

At the same time a certain stabilization in the sphere of property interests (in a certain sense - a post-crisis fixation of property interests' spheres) creates prerequisites for a new phase of hostile absorptions. Both the deficit of "available" takeover objects and gradual ex-

haustion of available financial resources give ground to suppose that the takeover style in the nearest years will to a considerable extent be "administrative", using debt schemes, actions at law about insignificance of previous transactions, etc. On the other side in a number of branches that possess a considerable growth potential and/or relatively scattered assets intensive concentration (takeover) processes and glaring corporate contradictions persist, the latter being typical of unstable institutional structures.

A concentration process of relatively scattered assets in the meat industry started in 2002, which was initiated to a considerable degree by agricultural sub-holdings belonging to large oil and metallurgy groups. On the whole the tendency of interest growth on the part of largest Russian groups to the agricultural sector has been characteristic for the past 3 years, which is connected both with the effective demand outlooks in this branch and the possibilities to legalize capitals.

A parallel process of getting rid of non-profile assets and diversification allows us to speak about moving of financial resources between branches that started in the past two years and is being serviced by the absorption market. Meanwhile, two basic features are typical of the recipient branches: lack of strategic (controlling) owners and an acceptable (higher than the average) level of profitability. The acuteness of corporate conflicts persistent in the majority of branches also testifies to the effect that hostile takeovers (including those containing specific Russian features – usage of the "administrative resource"[67]) keep being the predominant method of share capital concentration. For the nearest years (taking into consideration the plans to privatize state-owned enterprises and turn them into joint-stock companies) one can also forecast corporate conflicts connected with shift of control at these enterprises prior to and in the course of privatization transactions.

Finally, one can point to certain rather contradictory changes in the market's approach to corporate governance issues on the whole.

Given that the corporate governance practices of the late '90s clearly have a negative image, between 2000 to 2001 an efficient corporate governance has arisen as one of the most fashionable matters in Russia and formed the agenda for dozens, if not hundreds, of conferences and workshops. The largest corporations that in just 2-3 years before that had found themselves in the lists of the most malicious violators of shareholders' rights, are keen to adopt "corporate governance codes," create "shareholder-interest-watchdog" departments, introduce "independent" directors to their boards, and ensure "transparency". Russia's FCSM issued its own "corporate governance (behavior)." In 2001-2002 several private organizations offered their competitive "corporate governance ratings" on the market, while bureaucrats have mastered the term and gradually transform it into a new fetish. On the crest of this situa-

[67] The "administrative resource" notion (materially motivated decisions of courts, federal and regional authorities, etc), which is so wide-spread at present and being rather evident in its essence, is at the same time difficult to be interpreted and even more difficult to be legally proved (which was spoken of with confidence in one of his interviews by the president of "Alpha-Bank" and leader of one of the most aggressive Russian groups in the sphere of corporate absorptions M. Friedman). The president of "Sibneft" Y. Shwidler stated for example that each of oil companies in the course of its development got its share of the administrative resource and it is namely this fact that defines the real competitions at the oil market (Kommersant-Vlast, 2003. January 20-26, p. 25). It is noteworthy that according to the original version of the same source, the standardisation and the mass character of using the procedure of the "administrative resource" in 2002 led to a reduction of its price and simultaneously caused a situation when rivalling parties use same methods (balanced support actors) and are most often uncapable of bringing their cases till final victory of one of the parties. In such a situation expenditures that correspond to the corporate conflict become comparable to the real price of the assets and civilised negotiations become more economical.

tion there appeared a visible trend to emasculation of the sense and concept for corporate governance and its transformation into a new slogan for a new campaign.[68]

The “repairwork” started in many large corporations relating to the improvement of corporate governance(“codes of corporate governance,” “independent directors,” “departments of shareholder relations”, ensuring “transparency” etc.) will hardly be able to delude anybody. Obviously, this renovation is predominantly a redecoration that does not affect the system of relations established in the Russian corporate sector in the 1990-s. This has been caused, above all, by lack of serious conditions for fundamental improvements in this field (especially within the context of equal treatment of all shareholders and of shareholder rights) – lack of serious conditions in the structure of ownership and control, in the field of financial sources and business organization charts, in the outside environment (taxes, politically engaged selective enforcement etc.).[69]

In this connection, it would hardly be wise to take seriously declarations made in 2001 - 2003 by a number of large Russian companies on the problems that the business faces due to the lack of civilized ethical business norms. Such declarations partly expressed in the so-called Charter of Corporate and Business Ethics of the Russian Union of Industrialists and Entrepreneurs adopted on 25 October, 2002. The advocates of “generally accepted moral rules and ethical norms” that put their signatures on the Charter include participants of the notorious “loans for shares” deals of the mid-1990-s and initiators of many corporate conflicts and scandals of the late 1990-s - early 2000-s. The Slavneft deal in December, 2002, does not inspire any optimism in this connection, either.

At present there exists one more factor that supports the above statement. In reality, initial interest in corporate governance appeared only upon the mass privatization of 1992 - 1994, although a number of economists had recognized the importance of its long-term nature for Russian companies earlier. The Law “On Joint-Stock Companies” (No. 208-FZ of 26 December, 1995) became a legal landmark, but one can contend that the discussion on corporate governance (or, to be more precise, on the discrimination of outsider rights) shifted into the sphere of practical application against the background and as a result of the stock boom in 1996 - 1997. The most notorious conflicts of that period (Noyabrskneftegas, YUKOS, Yugansknefegas, Samaraneftegas, Sidanco, Nosta, Varyeganeftegas, Chernogorneft, the Vyksun Metallurgical Plant, Magnitogorsk Metallurgical Enterprise, Baltic Shipping Company, Leningrad Metallurgical Plant, Akron, numerous telecommunication and power industry companies etc.) became a joint signal testifying to the problem's mass and chronic nature. The discussion was to a large extent initialized by foreign investors not yet accustomed to the Russian corporate standards. The financial crisis of 1998 brought about another wave and created new tools of property redistribution, which made the discussion only more intense. This occurred primarily owing to and in the course of strengthening of the management's property positions and to appearance of new shareholders that bought out blocks of shares in the post-crisis period at a low price.

While in the mid-1990-s the calls for reforming corporate governance norms were generated rather by Western portfolio investors, at present the factor of 'pressure from the West' is losing dwindling. Apparently, at present one may speak of adaptation of the Western business community to the specifics of corporate relationship organization in Russia: above all, conducting business through a groups of formally unconnected companies reporting to one owner

[68] In this respect, it would be useful to remember the campaign of 1993-98 on creation financial-industrial groups as a panacea for the national economy. The 1998 crisis has destroyed the myth, though apologias of such structures are still published sometimes.

[69] For details see: *Radygin A.* Corporate Governance in Russia: Limitations and Prospects // Voprossy Ekonomiki, 2002, Issue # 1, Pages 101 - 124; *Radygin A., Sidorov I.* Russian Corporate Economics: One Hundred Years of Solitude? // Voprossy Ekonomiki, 2000, Issue # 5, PAGES 45 - 61.

or a number of partners, and the corresponding structure of financial flows70. Thus, one could assume that many Western partners have found creation of a formal image of the company (group) with elements of civilized corporate governance standards sufficient and taken the fundamental system of business organization (including non-dividend sources of income and transfer pricing) as a matter of course.

Undoubtedly, there are a number of objectively positive trends in the development of corporate governance standards applied by Russian issuers. According to the Institute for Corporate Right and Governance (ICRG), corporate transparency has been increasing in the course of 2002-2003 (information is disclosed in greater detail and quicker, in particular, in issuers' quarterly reports and on the web-sites), the contents of the companies' constituent and internal documents have considerably improved. These shifts are reflected, in particular, in the ICRG corporate governance ratings. E.g., during the 12 month–period (Quarter II, 2001, to Quarter II, 2003) out of 23 companies that account for 90 percent of capitalization of the Russian stock market, corporate governance improved in 18, deteriorated in four and remained unchanged in one. Certainly, the companies in question are the largest Russian companies, therefore it is so far impossible to speak of large-scale changes in the corporate sector in relation to the corresponding standards.

Although legal novelties in the field of corporate law proper (protection of shareholder rights) had, to a considerable extent, achieved their limit from the point of view of the existing economic conditions, the prospects for the improvement of the existing norms are quite good. This regards both the fundamental law "On Joint-Stock Companies" and the more specialized fields, such as reorganization, acquisitions, groups of companies, affiliates, insider deals, information disclosure, reporting, bankruptcy and others. It is also apparent that it will be impossible to develop the methods used to protect shareholder rights any further without adequate general measures in the field of enforcement and changes in the law of procedure.

1.5. Conclusions

1. As far as key specifics of the emergence of the national corporate governance model is concerned, one should single out:

– the permanent process of ownership redistribution in corporations;

– specific motivations of many insiders (managers and large stockholders alike) related to control over financial flows and stripping a corporation of its assets;

– a weak or untypical role played by traditional external corporate governance mechanisms (the securities market, the market for bankruptcy, and the market for corporate control);

– a considerable government share in joint-stock capital and problems in the management and control areas related to it;

– the federative structure of the state and an active role played by regional governments operating as independent agents in corporate relationships (more specifically, the agents that operate in the framework of the conflict of interests as owners, while exercising their administrative powers – as regulators, and as economic agents, too;

– an inefficient and/or selective (politicized) government enforcement (with a relatively developed law in the area of protection of shareholders' rights, though).

2. As far as the prospects of emergence of a national corporate governance model are concerned, one can single out the respective crucial processes as follows:

– the latent state of separation of ownership from management (convergence of controlling shareholders and managers) will be there in the medium term;

[70] E.g., I. Rozinski gave this assessment of the present situation at the conference of the Higher School of Economics "Modernising the Russian Economy: Results and Prospects" (Section 2, "Institutional and Structural Reforms"), 3-4 April, 2002.

– a very low probability of expansion over the upcoming years of an outside shareholder financing as the other key economic prerequisite for an efficient corporate governance;

– the current uncertain state of the national financial system does not allow even to presumably estimate gravitation of the Russian corporate governance system to any classical examples (primarily any other than self-financing, sources and, accordingly, types of control);

– the concentration of joint-stock capital is an evident process in the frame of which there takes place both consolidation of control and implementation, by economic means, of a 'self-sufficient' corporate governance model (proposed in the mid-'90s for the transitional economies in the enforcement context);

– given the economic conditions, legal innovations in the corporate law (protection of shareholder rights) area to a significant extent have reached their limits;

– without adequate general measures in the enforcement area, methods of protection of shareholders' rights may not be developed;

– in the absence of a developed system of competitive product markets, markets for capital and labor, and bankruptcy, the methods of monitoring of management will remain inefficient.

3. A whole series of empirical and legal data testified to the existence of a stable and fundamental contradiction in the emerging corporate governance system. That is, the latter implies the co-existence of two conflicting approaches: concentration of joint-stock capital that suggests a minimum set of legal shareholder protection means; the Anglo-Saxon legal tradition that implies maximization of means of legal protection of minority shareholders (which is fairly directly related to the ideological stance of the respective policy makers, however, adopted by parts, because of rather a strong resistance).

Their combination created a unique situation of mutual neutralization: a gradual reduction in the number of small shareholders decreases the significance of broad means of protection of minority shareholders from the perspective of the corporate sector as a whole, while the instruments of protection of small shareholders are transformed into corporate greenmail instruments; at the same time the creation of a developed system of legal means of shareholder protection, in turn, constrains the further development of the process of concentration of joint-stock capital (as a factor of the reverse impact of the law on economic processes). At the same time, one should take into account that protecting one's interests through furthering concentration is large shareholders' prerogative. They react to the enforcement "on request" rather than the absence of legal protecting means, while minority shareholders see no conditions of consolidation, nor they can effectively defend their stand in the court of law.

Considering a more optimistic interpretation, one can speak about reaching in 2000s some "model" balance between the level of concentration (adjusted for affiliated relationship and alliances) and a certain set of means of protection of small shareholders. A certain stabilization of the system suggests some optimism.

4. Does all the above mean that Russia so far lacks actual economic and institutional prerequisites for discussing a classical corporate governance problem? The model implying the dominance of small shareholders' interests (or a strong emphasis in the law on an absolute protection of them) is, perhaps, possible. However, in practice, there are no conditions for it. Nonetheless, the role played by small shareholders is critical to ensure companies' "transparency." Overall, in perspective one undoubtedly should head for some mixed model. The latter should take into consideration the aforementioned economic principles and trends and suggest the balance of interests of all shareholders and – in a broader sense – co-participants. At this point, the respective basis could be formed by model principles developed by OECD.

5. In the long-term perspective, one should take into account the global trend to unification of corporate governance models. In some sense, this proves the viewpoint that a legal de-

sign for a corporate governance model is secondary per se and based upon actual economic processes, particularly globalization ones.

In terms of applied approaches, it means an inexpedience (impossibility) of such a legal design of a "national" corporate governance model that would match a certain classical sample (as such samples become increasingly amorphous). From the governmental perspective, a fundamental task is to consider corporate governance in the context of protection and guarantees of property rights (rights of investors, shareholders) and ensuring the balance of interests (rights) for all the participants in corporate relationship. As well, to maintain such a balance, the priority mission is to develop clearly set legal procedures.

Overall, one can draw a correct conclusion that currently there exist single applied tasks that allow to consider the corporate governance problem not at the mythological level. From the perspective of coping with such challenges as regulation and ensuring equity among shareholders, it would be appropriate to single out such areas as mergers and takeovers, control over big deals, affiliated structures, beneficiary ownership and owners' responsibility, the collision "trust management vs. trust," groups of companies, bankruptcy. Should there be no efficiently functioning infrastructure and the political will to ensure enforcement, any attempts to advance in these areas would clearly become senseless.

2. New Corporate Legislation in the USA and Russia's Current Trends

The bankruptcy of Enron, as well as the scandals associated with companies like Worldcom, Citigroup Tyco, Adelphia, the auditing firm "Arthur Andersen" and some others, have resulted in tightening state regulation in the sphere of corporate management and the securities market in the USA. Among the problems that provided an impetus to these legislative innovations the following ones should be pointed out: violations in the system of corporate financial reporting, overestimated volumes of operations as a result of "circular transactions", concealment of the true financial status of companies, abuses on the part of CEOs, cover-up of losses, etc.

The occurrence of these problems has exposed the limitations of the legislative regulation of corporate management, the system of accounting and the securities market, and therefore presently in the USA the legislation concerning those spheres is being changed. In July 2002 the Sarbanes-Oxley Act was passed in the USA; it addresses the issues of corporate management, the securities market, an auditor's responsibility and independence, the auditing and accounting systems, the protection of shareholders' rights, etc. We are going to discuss its basic provisions, at the same time focusing on similar trends that are characteristic of Russia. [71] It would be rather difficult to assume that there exists a direct influence of the innovations that appeared in the USA on the Russian practice, however a certain similarity between the current trends is beyond doubt.

1) This Act increases *the personal responsibility of a company's managers for its financial reporting*. In this connection, a company's CEOs and officials responsible for financial affairs, when registering or submitting quarterly reports, must, in addition to simply signing the latter, also certify that the financial reporting and other financial information contained in their report reflect the issuer's true financial status and the true results of operations as of the date of reporting and during the periods covered by the report. Intentional certification of financial reporting that do not meet the requirements of legislation is subject to punishment by a fine in an amount of up to $ 5 million, and/or a prison sentence of up to 20 years.

[71] Hereinafter the materials are cited from "The review of the basic provisions of the 2002 Sarbanes-Oxley Act". Ernst and Young, September 2002.

In this case it should be noted that in Russia similar attempts have been made quite recently, aimed at increasing personal responsibility of corporate CEOs for having submitted false information. Thus, the Federal Law "On introducing changes and amendments to the federal law 'On the securities market'" established a norm according to which the persons who have signed a prospectus, in the event of an evidence of a fault are jointly and severally liable, and bear subsidiary liability with the issuer for the losses inflicted on the owner of securities as a result of any false, incomplete and/or misleading information contained in the prospectus in question (Item 3 of Article 22 of the federal law "On the securities market").

2) The Act prohibits granting loans to companies' officials for their personal purposes, excepting loans granted as part of routine economic operation of the issuer, and on the condition that the type of such a loan is similar to those that are offered on the open market in a routine procedure and are granted on the market terms. It should be noted that in Russia it has become a widespread practice among companies to grant interest-free loans to their employees for various personal needs: purchases of dwellings, cars, etc. These loans very often are not repaid, and the debit indebtedness against these loans is written off, which influences the companies' financial results.

3) The Act extends the requirements concerning *disclosure of the information on companies' activities*. Thus, in accordance with the new requirements issuers are obliged to timely and regularly disclose the additional information concerning any important changes in their financial status or activity. In this connection it should be noted that the Russian legal regulation of the securities market has lately also been characterized by a tendency to further extend the requirements for the disclosure of information by issuers. Thus, on December 28, 2002 the following amendments were made to the federal law "On the securities market" in the part concerning the disclosure of information by issuers:

- the right of access to the information contained in a prospectus now belongs not only to "potential owners" but to all interested persons, irrespective of the purpose of receiving this information (Item 1 of Article 23);

- the procedure of publishing the information concerning State registration of an issue (or an additional issue) of securities in the event of an open or closed subscription is now differentiated, which is beneficial for issuers as well as for investors;

- the provision stipulating that registration of a prospectus was necessary in the event when the aggregate volume of an issue exceeded 50,000 minimum salaries (the prospectus must be registered in two instances: when the securities issued are offered by means of an open subscription or by means of a closed subscription among persons whose number is over 500) was eliminated. This is important, because it is the registration that is associated with acquiring by an issuer the responsibility to disclose information in the form of a quarterly report on the significant facts (events, actions) relating to the financial and economic activity of an issuer;

- the requirements to the content of an issuer's quarterly reports were changed: in accordance with Article 30, an issuer's quarterly report must now contain information whose content and volume meet the requirements to a prospectus of an issue of securities stipulated in the law "On the securities market", excepting the information concerning the procedure of and the conditions for issued securities.

4) The Act also stipulates a requirement that *the fund for compensations* to be paid to the company's investors bearing damages be created: in the event of a judgment of a court or an administrative decision concerning a violation of the legislation on securities, with which in connection the SEC receives an order for recovery of losses or exaction of penalties, on the SEC's suggestion or instruction the amounts of penalties may be included in *the fund for compensations* to be paid to the victims of this violation.

In Russia, in accordance with Decree of the President of the RF of 18 November, 1995 No 1157 “On some measures aimed at protecting the rights of depositors and shareholders”, the federal public-government fund for protecting the rights of depositors and shareholders was created – a non-commercial organization whose founders may be federal executive agencies together with public associations created with the purpose of protecting the rights of depositors and shareholders and registered at the Ministry of Justice of the RF. In particular, one of the goals of the Fund was to pay compensations to those persons on whom damages had been inflicted as a result of breaches of law in the sphere of finances and crediting, and on the financial and stock markets of the RF. In 1997, the fund paid about 10 billion roubles to those who had become victim to the fraudulent actions of financial companies during the years 1994-1995.

5) The provisions of the Act also address the issues dealing with *the activity of stock analysts*. Thus, the Act requires that the SEC directly or through a national association for operations with securities, or through a stock exchange impose the rules that would regulate the instances of a conflict of interest occurring during a preparation of recommendations for securities analysts, brokers and dealers to disclose in publications or analytical reports the instances of a conflict of interest.

By way of example, in Russia there was a notorious scandal that involved analysts. On August 7, 2002 the oil company “Rosneft’” filed a lawsuit for protecting its business reputation against the investment company “OLMA”. “Rosneft’” claimed that a report written by the company’s analysts inflicted on the open joint-stock company “NK “Rosneft’” damages in the amount of $ 1 million (later the amount claimed was increased to $ 26.8 million). The reason for the claim was the report that “OLMA” posted on its website where the decreased market value of “NK “Rosneft’” was explained as follows: “low corporate culture of the company’s managers and their attitude toward minority shareholders, the actions of managers that were aimed at decreasing the company’s degree of capitalization and did not correspond to the interests of the main shareholder – the state; intentional delay in the sale of the oil company, parallel buying-up of the shares of subsidiaries”. On the basis of this judgment “OLMA” estimated the value of “Rosneft’” as of the beginning of the year 2002 as being equal to $1.253 billion. “Rosneft’” found this to be a gross underestimation, and therefore brought a legal action.

This scandal highlighted the problem of the lack of proper regulation of the activity of stock analysts both in terms of legislation and in terms of professional ethics. In particular, there is an obvious need to establish certain standards for resolving the conflict of interest of analysts and for their professional responsibility. At present, attempts are being made to develop the standards of professional ethics for analysts: the Guild of Investment and Finance Analysts (GIFA) in collaboration with control agencies and market participants has developed a Code of Professional Ethics for Investment Analysts. In this Code the basic moral and ethical principles of the analysts’ activity are stipulated, and the possible conflicts of interests that may occur between clients, employers and issuers are described, as well as the measures that can be taken to prevent such conflicts. This document also establishes standards for working with clients, the methodology of research, distribution of reports and disclosure of information.

6) Most of the provisions of the Sarbanes-Oxley Act address the regulation of *auditing and accounting rules;* the following subjects are specified in particular:

- the Board for controlling auditing and accounting procedures at public companies, under the SEC’s supervision;

- the duty of auditors to prepare and keep for at least 7 years the working papers of audits and other information pertaining to any auditing report is established, and such papers and information must be sufficiently detailed to adequately justify the conclusions drawn;

- auditing companies, in accordance with the Act must ensure that auditor's reports (and other associated information) be checked and confirmed by one or two partners, and also by a qualified expert;

- more strict requirements to auditor's reports have been established;

- the standard procedure for appointing an auditor has been introduced;

- the responsibility of auditors and auditing companies in terms of disciplinary sanctions and civil law was established for violations of legislation, of the rules established by the Board, and of professional standards;

- it is prohibited to combine auditing activity with rendering accounting services or other services pertaining to bookkeeping of preparing financial reports for the client who is subject to auditing; developing and implementing financial information systems; services dealing with evaluation, preparing reports concerning fair value or confirmation of contributions of property to a capital; actuarial services; services pertaining to organization of internal audits; administrative or personnel-related services; broker's, dealer's, investment consultant's or investment bank's services; legal or expert's services that are not pertaining to auditing; or other services that by the Board's decision may be recognized as impermissible.

It should be noted that large auditing companies have either sold their consulting businesses or separated them as autonomous companies[72]. In this situation the separation of a consulting business as an autonomous company cannot always prevent a conflict of interest, because the newly created company retains its close ties to the auditor, although formally these companies are no longer affiliated.

In Russia certain steps have also been taken to change the existing system of auditing. Thus, there exists the Institute of Professional Auditors that examines the quality of auditors' services. Besides, the Federal Securities Commission has created a joint group of auditors and participants of the securities market in order to develop ethical standards for auditors, as well as to discuss, develop and submit draft laws regulating auditors' activity. Also, the work to prepare for enactment the law "On self-regulatory organizations" (which, among other issues, will also contain the norms pertaining to the legal status of professional auditing organizations) is currently under way.

It must be said that the Sarbanes-Oxley Act prescribes that the USA Securities Commission introduce amendments to certain laws regulating the securities market in accordance with the Act being in effect. First of all, amendments are needed to be made to the 1934 Securities Exchange Act[73]. The new provisions, in particular, are to protect the rights and lawful interests of investors, as well as to prevent asset withdrawal by CEOs during court trials. Also, the Securities Act of 1933 and the Investment Company Act of 1940 were amended and brought in conformity with the Sarbanes-Oxley Act[74]. In connection with the passing of the Sarbanes-Oxley Act, amendments were also made to the Investment Advisers Act[75].

The Enron scandal prompted the New York Stock Exchange (NYSE) to somewhat alter *the requirements to companies to be listed* on the exchange.

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[72] For example, in July 2002 PricewaterhouseCoopers sold its consulting subdivision to IBM. The consulting subdivision of the KPMG company - KPMG Consulting – was also separated and renamed as BearingPoint. In February 2002 Deloitte Consulting separated from Deloitte & Touche and later changed its name to Braxton, while since January 2002 the former Andersen Consulting has been operating under a new name - Accenture.

[73] «Securities Exchange Act» of 1934 (http://www.law.uc.edu/CCL/SOact/SOtable.html).

[74] Securities Act of 1933, Investment Company Act of 1940, http://www.law.uc.edu/CCL/SOact/SOtable.html

[75] Investment Advisers Act of 1940, http://www.law.uc.edu/CCL/SOact/SOtable.html

Thus, on August 1, 2002 the Board of Directors of NYSE approved the Proposal on new amendments to the corporate governance rules[76] that envisages granting to investors the fullest possible scope of information and reorganizing the issuers' corporate management. Firstly, in the Proposal new requirements to companies' Boards of Directors are stipulated. For example, independent directors must constitute a majority on a Board of Directors. According to NYSE, the new requirements will improve the quality of the Board of Directors' operation and reduce the probability of a conflict of interest. Secondly, the notion itself has changed concerning what an independent director is. Also, in accordance with the Proposal, in listed companies a nomination committee, which is to consist only of fully independent directors. Moreover, in accordance with NYSE's draft, within a company's Board of Directors there must be elected a compensation committee consisting only of independent directors, and also an audit committee.

Besides, according to the draft, the listed companies must disclose the information concerning the company's principles of corporate management, including the following issues: the qualification standards for the members of the company's Board of Directors, the responsibilities of the members of the company's Board of Directors; the possibility for the members of the Board of Directors to appeal to the company's management and, if necessary, to independent consultants; remuneration to the company's CEOs; the lines along which the company's management is to operate; succession in the company's management; annual performance evaluation of the company's Board of Directors. According to the Proposal, besides the principles of corporate management, companies must also have a code of corporate behavior and ethics and disclose the information thereof.

It should be noted that presently in Russia there exists neither a detailed legal definition of "an independent director", nor any requirement concerning a mandatory election of independent directors to the boards of directors of Russian joint-stock companies. Nevertheless, in the last few years the institution of independent directors has been developing rapidly enough. The Association of Independent Directors founded in 2001 has since then been implementing the Project for offering candidates to the boards of directors of Russian companies. Now the Association is developing the Code of an Independent Director for subsequent approval and enactment.

It is noteworthy that lately many large Russian companies have been including in their charters or codes of corporate management the requirement that independent directors be elected to the Boards of Directors. In many companies, committees under the Boards of Directors are being created.

Another important fact is that today in Russia the acceptance and implementation of the principles of corporate management by companies (beyond those established by corporate legislation) are purely voluntary. Legislation contains no provisions concerning mandatory adoption of such documents. Nevertheless, recently a positive trend has revealed itself – that of improved indices of the disclosure of additional information concerning companies' corporate management. Thus, for example, many large Russian companies have been adopting their codes of corporate behavior and posting on their websites the information about their state of affairs that is necessary for investors. We believe that in future it will be advisable to adopt standards that would make it mandatory for large Russian companies to post on websites the information on their activity in real-time mode. In this connection, as far as Russia is concerned, it would be more important to post up not only the information concerning the principles of corporate management and the measures taken in order to improve the companies' corporate management, but also to mention significant corporate events (especially concern-

[76] Corporate Governance Rule Proposals Reflecting Recommendations from the NYSE Corporate Accountability and Listing Standards Committee As Approved by the NYSE Board of Directors August 1, 200, www.nyse.com.

ing general meetings of shareholders) because due to the distant location of quite a number of Russian regions, the shareholders often get the information about general meetings only post-factum.

On November 28, 2001 the RF Government approved the Code of Corporate Behavior, its provisions containing recommendations to the effect that Russian joint-stock companies adopt their own codes of corporate behavior.

Later on, on April 4, 2002 Direction of the Federal Security Commission No 421/r "On the recommendation concerning the application of the code of corporate behavior" was adopted. In this Direction, it was recommended that the joint-stock companies created on the territory of the Russian Federation follow the provisions of the Code of Corporate Behavior attached as Appendix and disclose in their annual and quarterly reports the information as to whether the companies comply with the provisions of the said code.

Also, in accordance with the provisions of the Direction, the following was recommended to the organizers of the trade on the securities market and to stock exchanges: - to envisage in the rules for the access of securities to circulation and for the withdrawal of securities from circulation through an organizer of trade on the securities market, as one of the conditions for placing the issuers' securities on the quotation lists of the organizer of trade on the securities market, the disclosure by the issuers of securities to the organizer of trade on the securities market of the information concerning their compliance with the provisions of the Code of Corporate Behavior;

- to disclose the said information by posting it on the website of an organizer of trade on the securities market or publishing it in the press, or otherwise.

These recommendations of the Federal Security Commission, as well as the example set by NYSE, were followed, e.g., by the Moscow Stock Exchange. The Moscow Stock Exchange Board as of June 2, 2002 approved the "Rules of listing, admission to distribution and circulation of securities and other financial instruments on the Moscow Stock Exchange". In particular, according to these "Rules of listing…" , one of the Stock Exchange's requirements for placing and keeping securities on level I and II Quotation Lists A is the disclosure to the Stock Exchange by the issuer of the information specified in Chapter 7 of "The Code of Corporate Behavior of an Issuer" concerning the issuer company's information policy[77].

Also, on January 30, 2003 the new Rules of admission to circulation of the securities issued by the "Non-Commercial Partnership "Stock Exchange RTS'" came into force. In accordance with Item 5.2.6. of these Rules, the issuer, for the securities to be placed on any of the Quotation Lists A, must submit, among other documents, also the document confirming a compliance with the requirements of the Code of Corporate Behavior recommended by the Federal Security Commission of Russia.

However the Rules do not specify which particular document must serve as a confirmation of the fact of compliance with the Code of Corporate Behavior, which may be an obstacle to efficient practical implementation of this requirement, because this document may be either an annual or quarterly report containing such information or a decision of the company's Board of Directors or Director General.

The new "Rules of listing, admission to distribution and circulation of securities and other financial instruments on the Moscow Stock Exchange" that have been in effect from February 1, 2003 contain similar provisions. As stated in article 18 of the said Rules, "in the event of placing and keeping a security on the (level I and II) Quotation Lists A of the MIFCE, the Issuer shall submit to the Stock Exchange the information which is to be disclosed in accordance with Article 7 of the Code of Corporate Behavior recommended by the

[77] I. 3.2.1.6, "Rules of listing, admission to distribution and circulation of securities and other financial instruments on the Moscow Stock Exchange": http://www.mse.ru/docs/listing/prav_lst.htm.

Federal Security Commission of Russia, and to submit to the Stock Exchange documents confirming the said information".

Besides, in March 2003 the Moscow Interbank Foreign Currency Exchange (MIFCE) began to develop the Code of Corporate Behavior for stock exchanges with the goal to regulate the relationships not only in the sphere of corporate management of issuers but in that of the Stock Exchange itself.

Also, another activity has been lately under way in Russia which is aimed at altering the legislation pertaining to corporate management and the securities market, as well as to accounting and auditing.

Thus, there has appeared a tendency to extend the list of the grounds for bringing to responsibility the CEOs of joint-stock companies, as well as professional participants of the securities market, for violating the legislation on the securities market and corporate management.

Thus, in 2001 the Code on Administrative Abuses was adopted, wherein one chapter is devoted to the instances of bringing to administrative responsibility for breaches of law in the sphere of the securities market and for violations of the rights of investors. The criminal responsibility for abuses associated with issues of securities has also been made more severe. Also, criminal responsibility for withholding from an investor or a controlling agency the information determined by the legislation on securities of the Russian Federation.

Besides, a draft law concerning insider information is now being discussed; its enactment will make it possible to bring to criminal responsibility corporate officials, as well as professional participants of the securities market, for the use to their own ends of confidential employment information.

Large-scale activity is under way to implement in corporate operation the international financial reporting standards, as well as to improve accounting and taxation procedures in the RF on the basis of the principles accepted in the international system of financial reporting.

On the whole, the following general conclusion can be drawn: although the regulation in the sphere in question in the USA markedly differs from that in Russia, the common trend of further improvement of the legislation pertaining to corporate management, accounting procedures, auditing and the securities market does exist. The core of thus process, obviously, is not the similarity of national models of corporate management but the global tendencies of growing responsibility and transparency of business.

3. Corporate Governance Mechanisms and Outcomes in Poland[78]

3.1. Introduction

Polish legal system represents the Roman model, where all rules and regulations are codified. In unclear and contradictory cases, supreme legal authorities interpret the existing law, providing guidelines for courts.

Poland has all main legal acts which regulate economic activity of legal entities and their governance, as well as functioning of capital, financial and other markets. The law regulates both institutional building and behaviour of participants of economic relations.

In our field of interest, legal acts regulate the following spheres:

– de-etatisation and privatisation processes (analyzed in Chapter II);

– internal structure and functioning of companies;

[78] The author wishes to thank Barbara Błaszczyk and Richard Woodward from CASE for their helpful comments and suggestions.

– external conditions for the companies, including markets and institutions with whom companies have to interact.

Quite often specific legal acts cover more than one sphere of regulation; on the other hand, specific elements of companies' life are often regulated by more than one legal act.

3.2. Corporate Governance Structures within an Enterprise

The main act which regulates corporate governance relations at a company level is the Company Code of September 15, 2000 (enacted on January 1, 2001). It replaces the Commercial Code of June 27, 1934.

At it was already mentioned in Chapter II, in Poland the continental model of corporate governance structure is developing. This model adopts the principle of strict separation between the management function and the ownership control function, as distinct from the Anglo-Saxon model in which these functions are to a large extent combined. The adoption of the continental model as the target, assuring a strict owner control over the company's executive bodies is particularly important, as in Poland, as well as in other post-communist countries, the influence of external control (in the form of commodity, financial, take-over and other markets) is in many cases still not sufficiently effective. In such conditions, efficient functioning of the internal supervision assumes fundamental importance. Moreover, the continental model assumes the significant role of a strategic investor, who, especially foreign one, is able to bring to a company not only capital, but also a new culture of management, of company's behaviour towards its environment, new technology etc. which are badly needed in a post-Communist country.

On a company level, it means two-tier system with separate executive and supervisory boards. Supervisory boards are compulsory in all JSCs and large LLCs. As a rule, supervisory board members are elected at the shareholders' meeting (group voting is possible). In most cases, supervisory board appoints the members of the executive board (in general, the supervisory board's position *vis-à-vis* executive board has been strengthened in the new Code). Formally, supervisory board has a wide range of powers, especially controlling ones, as a safeguard against opportunism of managers. It supervises all spheres of the company's functioning and has a right to study all documentation and to receive all necessary information not only from executive board members, but also from every employee in the company. Supervisory board's powers can be fine-tuned in order to reflect the needs of corporate governance in a specific company. In practice, however, widespread weak role of this body in the corporate governance system is reported in the surveys, executive boards often being the most influential body (this situation is jokingly called "Vistula model" of corporate governance,[79] as opposed to continental and Anglo-Saxon models).

In most cases, Polish legislation does not take into account concern of stakeholders in corporate governance structures. For example, there is no requirement to include representatives of stakeholders (e.g., employees) into the supervisory board. However, the surveys show that in many privatised companies stakeholders (first of all managers and employees) a represented in this body as a part of personnel policy of core shareholders.

The peculiarity of the Polish legal system is that the main vehicle for representation of stakeholder interests is privatisation legislation, rather than regulations affecting the enterprise sector in general. Thus, there are fundamental differences in the corporate governance regime depending on whether an enterprise originated in the state sector or the *de novo* private sector — a situation which is, to our knowledge, not found in any other European country. Apart from above-mentioned insider-dependent originating of privatisation cases and establishing

[79] The term was coined by Krzysztof Lis, Chairman of the Polish Privatisation Agency at the beginning of transformation.

preferences for insiders and some suppliers in buying shares, privatisation legislation introduces legal support for stakeholder interests in corporate governance bodies. In both cases theses are insiders' interests in privatised enterprises:

– in the course of indirect privatisation, when employees of the former SOE and some categories of suppliers are granted an option for free shares, and employees have a right to appoint 40 per cent of members of the supervisory board as long as the Treasury remains the sole shareholder;

– in the companies that have been privatised through commercialisation and are employing more than 500 persons, employees elect one member of the Executive Board. This provision is very unclear. For example, it is not known for what period after privatisation employees have such a right.

There are also provisions dealing with conflict of interests of members of the executive board, supervisory board, and shareholders. It covers personal capital links with other firms and responsibility towards the company. At the same time, there is no legal requirement to include independent members in supervisory boards, although such a provision can be found in charter of a few Polish companies. However, the Warsaw Stock Exchange has recently introduced a requirement for all listed companies to include before the end of 2004 at least 50 per cent of independent members to their Supervisory Boards (see below).

There is another sphere where conflict of interests is not properly managed. Although auditor has to be independent from the audited company (do not possess shares, not to be the company's attorney, etc.), there is no legal prohibition for an auditor to be simultaneously a consultant for the same firm. Moreover, if such an auditor provides bookkeeping for a firm, he still can perform audit (except for those part of financial documents which has been prepared by himself). Lack of proper regulations in this sphere is potentially very dangerous, which is confirmed by latest bookkeeping scandals in the USA.

The Commercial Code also contains a system of safeguards against minority shareholders abuse. Shareholder has a right to appeal against a decision of the shareholder's meeting if such a decision violates the company charter, good practices or the company's concern. By the way, such a right belongs to executive and supervisory boards' members as well. Minority shareholders have extended rights for group voting. There are three types of preferential shares:

– privileged shares, giving their holders greater than one and no more than 2 voices per share (till the end of 2004, the Treasury can have up to 5 voices per share);

– golden share;

– non-voting share (since 2001).

A voting cap can be introduced for shareholders that possess more than 20 per cent of voices. On the other hand, most important decisions should be approved by qualified majority of voices on the shareholders' meeting (2/3 to 3/4). There are provisions against collusion of shareholders. Every member of the supervisory board and a shareholder who possess at least 10 per cent of shares has a right to call an extraordinary shareholders' meeting.

The Act of August 21, 1997 on Public Securities Trading, which regulates only publicly listed companies, grants a shareholder or a group of shareholders that possess at least 5 per cent of votes a right to appoint a special controller whose task is to investigate a concrete problem of the company's functioning. The same act imposes on a strategic investor an obligation of mandatory bid if he possesses more than 50 per cent of votes. Such a bid must be also announced when someone is going to buy more than 10 per cent of shares. There is a system of safeguards which is intended to ensure proper prices for sellers of shares. In publicly listed companies, an investor must obtain a permission of The Securities and Exchange Commission to pass a threshold of 25 per cent, 33 per cent, and 50 per cent of voices. All blocks of shares which give their owners at least 5 per cent of voices must be registered.

One of the most important means of preserving shareholders rights *vis-à-vis* managers and large shareholders are information and disclosure requirements. The rights of the supervisory board were mentioned above. The Company Code grants a right for any shareholder to ask the executive board for information that is necessary for evaluation of topics discussed at the shareholders' meeting. According to the Act of September 29, 1994 on Accounting, financial statements of companies must include information on remuneration of top managers and supervisory board members, as well as on any loan they may receive from the company. Information must be provided about capital groups (other companies in which the company possess at least 20 per cent of shares). The Act on Public Securities Trading provides publicly listed companies with additional requirements regarding informational transparency. These companies have to publish all information which may influence the prise of shares. There are special disclosure provisions devoted to selling and buying shares by major shareholders.

On the other hand, there are provisions of the Polish law which are intended to withstand the misuse of the above-mentioned safeguards. When a shareholder starts a legal action against a decision of the shareholders' meeting, this does not stops its execution; in case if the court decides that the protest is groundless, the suer has to pay a penalty up to ten times of the cost of the court examination. A company has a right to deny a shareholder an access to some data if it would cause damage to the company.

In practice, in Poland there are a lot of cases both of abuse majority and minority rights, as well as of managers' opportunism. There are three main causes which make those violations possible:

– the problems of corporate governance formation in Poland. As a result of consensual privatisation, dispersed and highly insiderised patterns of ownership structure often emerged with strong positions of managers and to some extent non-managerial employees. That hampers the effective control of shareholders over managers and outsiders over insiders (given generally still weak outsider investorship in Poland). This provides to preservation of "legacy of Socialism" in former state-owned enterprises with very strong position of managers (most of them being directors before privatisation). On the other hand, if a company is sold to outsiders, highly concentrated pattern of ownership structure emerges which makes possible minority abuses. High role of the Treasury in many firms which are undergoing indirect privatisation is also important;

– the inadequate law. First, the law that describes corporate governance structures in companies is not instructive enough, too often giving general idea and principles rather than concrete solutions. Second, the system of rights and safeguards that regulates corporate governance relations within companies is not extremely efficient. For example, minority interests can be (and sometimes are) abused with the help of anti-collusion provisions. Disclosure requirements do not cover all cases of gaining control over a firm with the help of affiliated and subordinated companies. There are situations when mandatory bids can be avoided without breaking the law. Prevention of hostile takeovers by outsiders is also possible. Manipulations of the dates of shareholders' meetings are widespread. Managers have legal possibilities of profits stripping and tunnelling. Disclosure provisions are often regarded as very complicated and there is a widespread opinion among managers, that some of them are impracticable. Third, legal acts sometimes contradict each other and overlap (first of all, Company Code, Act on Public Securities Trading, and Act on Commercialisation and Privatisation of State-owned Enterprises);

– poor enforcement of the law. Nor the courts, neither the prosecutors have sufficient capacities or skills to cope with cases of illegal actions in companies. Within the Warsaw Territorial Public Prosecutor's Office a department of capital market offences has been established, but positive results are still hard to be seen. Fiscal administration is incapable to cope with transfer pricing.

In recent years, attempts have been made to strengthen corporate governance by elaborating and introducing best practices of corporate governance. The main idea behind this approach was that because legal regulations themselves are incapable of dealing with all the problems of corporate governance, a set of principles should be prepared which would both serve as instruction on how to behave correctly and as a form of moral pressure on companies to introduce these principles. In Poland, two teams prepared their own best practices codes: the Polish Corporate Governance Forum affiliated with the Gdansk Institute for Market Economics, and Corporate Governance Forum affiliated with the Institute for Business Development. The idea of the first project was rather to explain the idea and main principles of proper corporate governance practice, whereas the second one was aimed more at giving concrete suggestions how corporate governance bodies within a company should behave, what decisions they are to make, etc.

In 2002, the Warsaw Stock Exchange adopted a Best Practices Code for listed companies, based on the second project, but also using some ideas from the first one. As a result, the Code became less concrete and instructive, but at the same time tried to show some general idea of good corporate behavior. The Code includes a few concrete provisions absent in Polish company law:

– at least 50 per cent of supervisory board members should be independent (they are granted extended rights);

– management remuneration must be disclosed in detail;

– decisions of the general assembly of shareholders must be formulated in a way which makes it possible to sue them;

– auditors must be changed at least every five years;

– the special controller must be fully independent;

– when a company buys back its own shares, all shareholders must have equal rights to sell their shares.

Other provisions seem to be too general and declarative and therefore not enforceable in practice. Beginning July 1, 2003, all listed companies must report whether they comply with the provisions of the Code, and if not, what specific provisions are not introduced and why. But in fact even the above mentioned concrete provisions will hardly be enforced in a large number of companies, because there is no effective punishment for not introducing those measures into companies' charters and everyday behavior. At most, the WSE can publish a list of companies which do not comply with the best practices regulations. Therefore, this document is rather a kind of moral obligation imposed on companies, than a strict regulation. The first three months of enforcement of this new regulation showed that most companies at least verbally declared their willingness to play "the best practices game": only 18 out of 205 listed companies declared that they hadn't introduced the best practices and did not intend to do so in future. At the same time, among the rest of the companies, none declared compliance to every provision of the Code. The most common problem was lack of independent members on the supervisory boards.

3.3. External Aspects of Corporate Governance

3.3.1. Capital Market

In Poland, there are several quite different segments of capital market.

Institutionalised market is strictly regulated by the Act on Public Securities Trading and represented by the Warsaw Stock Exchange (WSE). There is popular opinion, that in terms of organization and enforcement, the WSE is the best stock exchange in post-Communist countries. Act on Public Securities Trading imposes very strict disclosure and transparency regulations on entries on organized securities market and on listed companies. Companies have to

provide information on ownership structure, names of shareholders which have voting rights, shareholders which possess at least 5 per cent of votes; all information which can influence the price of shares; quarterly, semi-annual and annual reports with financial statement etc. All these data are to be published. Violation of the law can be punished by a fine up to 1 million zlotys or by withdrawing the company from the WSE. The organized securities market and behaviour of its players is supervised by the Securities and Exchange Commission.

However, the list of flaws in Polish organized securities market is rather long.

This market is highly concentrated: at the end of 2001, 14 per cent of companies listed represented 85 per cent of the whole capitalisation at the WSE[80]. Large enterprises dominate, there very few middle-sizes and small companies. Main players are also big, first of all institutional investors; small individual investors are numerous, but very weak; their share on the stock market is steadily declining (from 50 per cent of total turnover of shares in 2000 to 28 per cent in the first half of 2003). Therefore the concern of small individual investors maybe is not abused, but simply ignored.

The WSE was established mainly to serve initial public offerings in the course of indirect privatisation. It is still dominated by privatised sector: 61 per cent companies listed are former state-owned enterprises. The largest ones are those which have been privatised by indirect method through initial public offering (77 per cent of total capitalisation of the WSE). Domination of privatised enterprises becomes a barrier for further development of the WSE, because the main task of indirect privatisation is to find strategic investors for SOEe, and such investors are not interested in keeping the companies public. In many cases, they are forced to do it by the provisions of privatisation contracts; very often only small part of shares is on the market. Slowing pace of privatisation contributes to further fall on the supply side.

The situation additionally complicates, because new players are entering the market which produce additional demand (e.g., pension funds). The WSE never gained equilibrium of demand and supply. During the first years of its existence, there was huge supply of shares of larges privatised companies. Now, the situation is the other way round.

As a result, the WSE represents very small market which has a tendency to shrink. Overall capitalisation of the WSE is rather low (15 per cent GDP) and shows falling trend. Now the turnover of the WSE on the cash market is shrinking at a pace of over 20 per cent a year and by the end of 2002 amounted to 71.7 billion zlotys. There are virtually no new entries, and some companies are exiting the market. The total number of companies listed is falling (from 230 by the end of 2001 to 216 by the end of 2002).

The WSE does not properly perform two basic functions of a stock exchange: valuation and a source of capital for private sector. The irony is that the Treasury is the largest beneficiary of capital inflow through the WSE.

The securities issued by companies which do not meet tough regulations of the WSE, do not want to be listed or cannot be listed (e.g., shares of LLCs) are bought and sold on "unregulated" segment of securities market, which is still regulated by the law, although not so strict as in the case of publicly listed companies. Banks and brokerage houses made an attempt to organize somewhat this segment of market by introducing the over-the counter market (known by its Polish abbreviation CTO), but this initiative proved to be incapable to gain support from companies which participate in the securities market.

3.3.2. Investment Funds

According to Polish law (Act of August 28, 1997 on Investment Funds and other acts), there are 5 main types of investment funds: general open-end and close-end funds, specialised open-end and close-end funds, and mixed funds. Capital of the funds is accumulated as a result of emission of vouchers or investment certificates.

[80] In this section, the WSE official data has been used (www.gpw.pl).

The investment funds are under strict control of the law and the Securities and Exchange Commission. Functioning of open funds which buy shares of companies is restricted most. Shares of one company cannot constitute more than 5 per cent of the fund's portfolio (the limit can be increased up to 10 per cent if such investments amount to less than 40 per cent of the whole portfolio). Funds cannot buy more than 10 per cent of voting shares in a company. In fact, Polish law prevents institutional investors from becoming active core investors, limiting their role to passive players on securities markets.

In mid-2002, there were about 130 investments funds. Their net assets amounted to 14.9 billion zlotys.

Two specific groups of investment funds are of special interest from the point of view of privatisation and post-privatisation processes.

The first group are National Investment Funds (NIF). They are a part of mass privatisation program (Law of April 30, 1994 on National Investment Funds and their Privatisation). NIFs have restructured their portfolios and sold a lot of companies. 36 companies from the NIF program entered the WSE. Some NIFs changed the character of activity and are engaging themselves in venture capital and private equity investments. By the end of 2001, NIFs possessed more than 5 per cent shares in 15 listed companies.

The second group are pension funds which emerged in the course of pension reform that started in 1999. There are strict regulations of the pension funds investment activities (Act of August 28, 1997 on Set-up and Functioning of Pension Funds and other acts). They can invest only in "safe" securities, i.e. they can buy shares of only publicly listed companies (no more than 40 per cent of pension funds' portfolio); a fund cannot have more than 5 per cent of shares of one company, ant shares of one company cannot amount to more than 5 per cent of the fund's portfolio. Functioning of pension funds is supervised by the Insurance and Pension Funds Supervision Commission.

Despite the restrictions, a strong group of 17 funds have formed whose investments on the WSE amount to 6 per cent of its capitalization. Pension funds have a steady inflow of mandatory pension payments. Therefore, they will strengthen their position on securities markets, including the WSE. On the other hand, the shallow organized market is not able to satisfy the growing demand on securities created by the pension funds.

3.3.3. Banks

Given the fact that the stock market in Poland is very weak in supplying companies with capital, bank credit is still the most important source of external financial resources. However, despite lack of legal restrictions, as a rule banks limit their engagement in companies to lending them money and rather are not interested in participation in companies' equity. Only one bank tried to actively acquire property (BRE Bank).

Banks are not interested in debt-to-equity swaps, which can be performed under provisions of the Act on Commercialisation and Privatisation (as a separate track of commercialisation of SOEs — there were only 14 such chases) and the Act of March 4, 1993 on Financial Restructuring of Enterprises and Banks. One of the goals of the latter act (apart from the main goal of overcoming the bad enterprises' debts crisis and saving the Polish banking system), was to encourage banks' involvement in restructuring and privatisation of state-owned enterprises. While the goal of saving the banking system has been achieved, in most cases banks proved to be incapable and/or not interested in more active involvement in governance of enterprises.

The role of banks in corporate governance structures and organization is very weak. Banks do not perform a role of a proxy in execution of corporate rights (except bank brokerage houses which perform asset management services; however, they are formally independent from the banks). The quality of the corporate governance control of the banks over the

companies is often questionable, the spectacular bankruptcy of the Szczecin Shipyard being a good example.

Another reason of small role of banks in corporate control is underdeveloped bank credit market, especially in the SME sector. As a rule, banks are very cautious in lending money to enterprises, especially small and medium-sized, regarding such activity as more risky than other available investment instruments (e.g., Treasury bonds). On the other hand, enterprises use retained earnings and trade credit as their basic sources of financing, often trying to avoid bank credit because of the high costs of this type of financing.

3.3.4. Insurance Companies

On Polish insurance market, tens of companies are operating. They can invest in publicly traded securities and investment certificates. Their value must not exceed 40 per cent of reserve funds of an insurance company. In practice, most insurance companies do not actively invest at securities market. On average, in 2001 shares and investment certificates amounted to 12 per cent of companies' portfolio (4.6 bln zlotys). However, there are companies that actively play on the securities market, i.e., state-owned PZU and PZU Życie. The latter often uses investment funds as intermediaries.

3.3.5. Bankruptcies

There are two methods of property redistribution of insolvent enterprises. One is liquidation under provisions of art. 19 of the Act on State-owned Enterprises. It is an administrative procedure which can be applied to state-owned enterprises. By the end of the first quarter 2003, out of 1802 such cases started, 918 have been completed (Ministry of the Treasury 2003).

Judicial bankruptcy procedures are regulated by the pre-war Act of October 24, 1934 on Bankruptcy (several times heavily amended). There are about 3000 bankruptcy cases started every year; however, their role in property redistribution could be more significant if the concern of creditors is properly protected. Very often companies proclaim bankruptcy too late, when assets have already been withdrawn; courts often dismiss bankruptcy cases, because the value of assets is not enough even to cover the costs of court examination.

3.4.Outcomes in Practice

It should be noted that the real patterns of corporate governance emerging in Polish companies depend on a number of factors, and not on corporate law alone. Among others, the following factors should also be mentioned:

– the privatization law, especially the two privatization laws (1990 and 1996) and the 1993 Act on National Investment Funds;

– the law on the securities market and development of this market in practice;

– the pace, scope and effects of privatization, all of which proved in practice to be method- and sector-dependent, with indirect (capital) privatization producing deeper changes than direct methods and paths;

– the pace, scope and effects of enterprise restructuring programs, not connected directly to privatization;

– the process of re-configuration of enterprise goals and main actors' interests in the course of transition;

– the type of dominant owner.

The heterogeneous character of Polish privatization, peculiarities of regulation and real processes of enterprise privatization and restructuring resulted in the emergence of heterogeneous patterns of corporate governance in privatized enterprises, although all of them formally stay within the Continental model.

Among those patterns, at least three deserve special attention.

The first pattern is represented by the largest companies which went through capital privatization and have concentrated ownership structures, often dominated by foreign investors. In the sector of former SOEs, they are unquestionable leaders in post-privatization restructuring and creation of highly efficient corporate governance structures and behavior.

The companies with the highest levels of ownership concentration, especially dominated by foreign investors, have more coherent corporate governance structures. In the companies with the lowest levels of ownership concentration, the shareholders' majority is often rather formal and does not ensure full real control over the company.

Within the pattern in question, companies with foreign investor domination deserve special attention. Corporate governance structures in most of these companies are very transparent with clear division of powers among the executive board, supervisory board, and general assembly of shareholders. At the same time, the foreign investor keeps tight and efficient control over the firm. An interesting feature of corporate governance policy in foreign dominated companies is the introduction of incentives for insiders (primarily managers), in the form of small blocks of shares and/or seats on the supervisory board.

It should be pointed out that in spite of all the mistrust and reluctance accompanying the entry of foreign investors into privatized enterprises, in the vast majority of the cases, the consequences of that entry should be assessed positively. It was hoped that foreign capital would save these firms from collapse and their employees from mass layoffs by bringing to these companies not only new capital, but also new corporate culture and by introducing deep restructuring and modernization. The results of numerous studies show that these objectives have largely been met. More importantly, negative expectations ascribing to foreign investors intentions to take control of enterprises in order to later close them down or cripple them to get rid of the competition have not been realized. We are by no means observing a speculative attack of foreigners seeking profit by destroying the foundations of enterprises. It must be clearly stressed that the analysis of company behavior, and in particular of the investment-oriented policy of their owners, proves that foreign investors treat the companies they control very seriously and that they make decisions calculated to improve prospects for long-term development.

The second pattern is found in companies privatized by management-employee buyouts (MEBO). Most of them used the leasing path of direct privatization, although a significant number of such companies emerged as a result of direct sale and even indirect privatization.

Compared with enterprises that have been privatized through indirect methods, corporate governance structures in MEBO companies seem to be to a great extent dysfunctional. A problematic division of powers and functions can be seen in many companies, the exact type of dysfunction depending mainly on the specific ownership structure pattern. The most common problems are:

Combination of the ownership function with the owner control function. This is usually manifested in the personal participation of owners on the supervisory board instead of delegation of that function to outside experts. Another dimension of this combination is the assumption of some of the functions of the general assembly of shareholders by the supervisory board.

Combination of the control function with the management function. This fault manifests itself in the supervisory board's interference in direct management of economic and financial processes, as well as in combining executive posts with seats on the supervisory board.

Combination of the hired employee function with the function of supervisory board member. This creates a complicated system of subordination. There is a conflict of interests in such a combination, while legal protection of the employee involved in this conflict can only be formally effective.

MEBO companies are characterized by a very high inertia of the authority and influence structures which emerged already during the communist period. Reproduction of the managerial elites in these companies (especially with respect to SOE directors and the executive boards of the privatized companies) as a rule takes the form of internal "straight reproduction," i.e., one that does not entail shifts of individuals within the hierarchy of authority. The majority of present executive board members performed managerial functions in the past (i.e., in the former SOE) and, in the majority of cases, the company's executive board president is the former director of that enterprise. A high level staff inertia prevails even in many firms in which ownership concentration in the hands of outsiders has taken place.

As to the ideological underpinnings of this path of privatization, it turned out that claims regarding workers' aspirations for employee participation had been exaggerated. As a rule, they did not express a desire to participate in management of their firms, and shares with no dividends were of no use for them. The main motivation for workers to retain shares was the fear of unwelcome changes that an external investor might cause (lay-offs, worsening labor conditions, etc). The popular idea of capitalism based on employee participation collapsed, but this collapse gave room for the development of corporate governance mechanisms based on clearly defined property rights and a strict distinction between ownership, supervisory and managerial functions.

The third pattern is represented by the JSSPs, companies wholly owned by the state. In fact, these are SOEs that have initiated indirect (capital) privatization but not gotten beyond the stage of commercialization. Initially, JSSPs were intended to be a transition entity between the SOE and a private company (with this stage lasting no longer than one year). However, in practice, as we mentioned above, for every third enterprise which entered capital privatization, ownership transformation stopped at this stage indefinitely. At the beginning, the main cause for this delay was problems with entering the next stage of privatization: technical problems with restructuring and preparing a privatization deal, lack of appropriate buyers, etc. Later on, however, strong lobbies emerged which were interested in keeping enterprises in such an intermediate state. At the enterprise and branch levels, these included trade unions and other organized groups of employees who were not interested in privatization because it would lead to deep restructuring followed by shutdowns of loss-making enterprises, lay-offs, and liquidation of branch privileges. A separate category of insiders not interested in future privatization consisted of the Treasury representatives on the supervisory boards. For them, privatization meant the loss of their positions. Simultaneously, after a significant reform slowdown beginning in 1992, and increase in clientelist behavior of the political elite, JSSPs began to be regarded as a significant asset in the hands of politicians and governmental bureaucracy. The Ministry of Ownership Transformations (later renamed the Ministry of the Treasury) suffered a growing conflict between its owner's and seller's functions: the fewer assets under control of the ministry, the less its political weight. This attitude was strengthened by winning political parties, which started to treat state assets as a kind of a "loot" that belongs to the winners. One of the most attractive parts of this "loot" were the seats on the supervisory boards of the JSSPs, and for a long period of time the Ministry used them as an instrument of preserving its political importance and stability regardless of the changes of governments. (The situation began to change in recent years, when the Ministry of Treasury itself and its policy became an object of political clientelist games.

Although JSSPs are regarded as a highly valuable asset in political struggles, at the enterprise level the role of the Treasury Ministry as an owner is in most cases extremely weak: the real priority is to keep and to use this property, and not to manage it in a microeconomically efficient way. It is therefore not surprising that in terms of corporate governance and enterprise performance JSSPs have become the most dysfunctional group of companies included in the privatization process. Most JSSPs were for a long period of time left in an intermediate

state being neither a "regular" SOE nor a private company, without any concrete prospects or priorities for further ownership transformation, restructuring, etc. Therefore, in practice, existing corporate governance structures are characterized by a high degree of influence of managers and trade unions and the very weak role of the representatives of the Treasury. Additionally, in many JSSPs the spheres of influence of the main actors have not stabilized, which gives ground for perpetual conflicts.

3.5. Conclusions

Polish privatization and corporate governance legislation is very extensive and covers all important spheres of ownership transformation, as well as companies' and capital market's functioning. At the same time, the real corporate governance mechanisms are often inefficient. Minority shareholders abuse is quite common, but at the same time legal provisions aimed at minority protection are sometimes used for "majority abuse" by minorities that represent powerful industrial interests. There are also numerous cases of managers' opportunism, asset stripping and tunneling. External corporate governance mechanisms are often weak and do not always ensure effective regulation of companies' behavior. First of all, the weak and shallow capital market must be mentioned.

It seems that there are the following causes of dysfunction in secondary privatization and corporate governance spheres:

– lack of coherent concept of ownership transformation and development of private property relations. Some very important issues of interrelations between privatization and desired corporate governance models and mechanisms are still unresolved;

– contradictions in the policy of the state (especially concerning securities market, external institutional investors, and the role of insiders), clientelism;

– not fully adequate legislation: at the same time, overregulated, underregulated and misregulated; lack of integrity which hampers meeting the goals of transformation. Some provisions of the law have political character and are intended to gain support of various actors. Sometimes, provisions of law are too general and are not instructive enough;

– poor enforcement of the law and other regulations.

4. The Legal Framework for Effective Corporate Governance: Comparative Analysis of Provisions in Selected Transition Economies

4.1. Introduction[81]

We define "corporate governance" as the set of rules and mechanisms governing the behaviour of a firm which ensures that shareholders, investors and creditors are protected from abuse by managers and large stakeholders and have sufficient incentive to supply the firm with finance and credit. The development of market economies in Central and Eastern Europe, and the imminent accession of some of these countries to EU membership, has only strengthened the view that "corporate governance" is of fundamental importance to the process of transition and to the economic regeneration and growth of former socialist countries. Indeed, fourteen years of "post-socialist development has shown that as the institutions of the new market system develop, more advanced, complex and intricate mechanisms of corporate

[81] The author is grateful to colleagues and friends in many transition economies who helped with the preparation of questionnaires, to Mrs. Jenny Herbert who provided assistance with collection and compilation of the data and sifting through the legal matters, and to Ms. Zorica Kalezic for her help as a research assistant.

governance are needed to ensure the protection of shareholders, investors and creditors who are the vital agents of a dynamic economy. The "needed mechanisms of corporate governance", initially highlighted by Frydman, et al. (1993) are even more important now that these countries have established a market system and, at least some of them, are nearing the end of the transition phase.

Shleifer and Vishny (1997) argued that effective corporate governance is established either through a well developed legal framework and an active capital market, or through concentrated ownership. In an extension of this argument, La Porta, et al. (1997 and 1998) argued that in countries with better legal protection of shareholders, financial markets are more developed and firms have greater access to external finance and better opportunities for growth.[82] This analysis was extended to transition economies by Pistor, et al. (2000) by highlighting the effectiveness and impact of legal institutions on external finance**.** While La Porta et al.'s work was concerned with the analysis of 'anti-director' rights of shareholders, Pistor's work focused on additional dimensions such as the legal provisions for voice and exit, and the ability of shareholders to resist block-holders.

Furthermore, the interpretation of the traditional agency problem (i.e., the conflict between owners and managers) was extended by the work of La Porta et al. (1999), Berglof and von Thadden (1999) and Pistor et al. (2000) to cover other conflicts of interest in firms (e.g., the conflicts between minority shareholders and controlling shareholders, between shareholders and workers, or between managers and creditors). La Porta, et al. (1999), e.g., showed that large companies around the world are generally dominated by concentrated ownership (families or governments) and that the protection of minority shareholders from (potentially) expropriating dominant shareholders lies at the heart of the corporate governance problem.

The ownership transformation process embarked on in many transition economies, especially those undergoing mass privatisation, gave rise to an initially dispersed ownership structure in mass privatised firms. However, since the mid-1990s, these firms have been undergoing a rapid increase in ownership concentration. The process of ownership concentration in mass privatised companies in Poland, Hungary and Slovenia has been demonstrated in detail by Blaszczyk, et al. (2003) - in the Czech Republic, e.g., nearly half of the Czech firms privatised in the mass privatisation scheme now have a dominant owner controlling over 50% of shares (Grosfeld and Hashi, 2003). A similar conclusion was arrived at by Berglof and Pajuste (2003) who focussed on the concentration of both ownership rights and control rights in large listed companies in twelve transition countries (including all accession countries). This increased concentration of ownership and control, and the emergence of dominant owners for firms in transition economies have highlighted the importance of corporate governance mechanisms, particularly those relating to the protection of minority shareholders and the disclosure and transparency requirements expected of the management – in short, the "voice" and "exit" mechanisms.[83]

In developed market economies the discussion of corporate governance and the need for improvements in the regulatory framework has continued. The OECD and EU member

[82] Similarly, in a comparison of the regulations governing the Polish and Czech stock exchanges, Gleaser, et al. (2001) showed that because of the regulations protecting the interests of investors and minority shareholders, it was possible to raise over a billion dollars of finance for new and existing firms in Poland and launch 138 IPOs (until 1998) while none of this was possible on the Prague Stock Exchange.

[83] For a discussion of voice and exit mechanisms, see Roe (1993) and Hashi (1998). The only exception to the generally accepted increased importance of corporate governance is Mihalyi (2002) who argued that with the growth of multinational companies' activities in Central and Eastern Europe and the accession to EU membership, corporate governance becomes rather 'irrelevant'. However, the limited influence of foreign firms in transition economies on the one hand and the continued interest in corporate governance codes and regulations in Western market economies on the other, particularly in the light of the Enron and Worldcom scandals, contradict Mihaly's view.

states, as well as multinational professional organisations, have all produced codes of obligatory and voluntary behaviour for improvements in the corporate governance system.[84] The legal framework and voluntary arrangements developed in these countries provide a bench mark from which transition economies can learn.

This paper aims at comparing the legal framework for corporate governance in selected transition economies in order to highlight the progress made so far as well as the shortcomings of the existing framework. In the light of the present workshop, the paper identifies the differences between the Polish and Russian system of corporate governance and that existing in other transition countries. Each of the next three sections considers a particular aspect of the corporate governance framework as practiced in the selected countries. These are: shareholders' rights; equitable treatment of all shareholders; and the responsibilities of company boards. These sections broadly correspond to the first three headings of the OECD Principles as well as other interested organisations (see footnote 83 for details).

The data for the analysis of each section was collected through a questionnaire on various aspects of corporate governance completed separately for each country. The respondents were lawyers, economists, academics, researchers and stock market participants, i.e., professionals involved in the study and/or practice of corporate governance (see Appendix 1 for Questionnaire).

2.2. Shareholders' Rights

Shareholders' rights are the subject of Principle I of the OECD code of good practice and are fundamental to any corporate governance system. The separation of ownership and control and the potential principal-agent conflict in joint stock companies underline the importance of emphasising shareholders' rights, especially the right to participate in the company's important decisions made at general or extraordinary meetings of shareholders. In order for this right to be exercised, the legal framework must establish procedures by which shareholders are duly informed of such meetings, in good time, so they can take part in the decisions of the company without any inconvenience or cost.[85] Furthermore, it is crucial that their geographic proximity to the company does not affect their ability to participate in the decision-making process.

The implementation of these provisions require, firstly, a secure register of shareholders and, secondly, the availability of postal voting and proxy voting options. While most of these requirements are common practice in OECD countries, they are not legal requirements in transition economies and in practice many of them fall short of meeting these criteria. Table 6 summarises the legal position on some aspects of shareholders' rights[86] in selected countries.[87]

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[84] For a detailed comparative study of the regulatory framework in EU countries, see OECD (2002). Of particular relevance to this discussion are: the OECD Principles of Corporate Governance (OECD, 1999); the International Corporate Governance Network's statement on corporate governance principles (ICGN, 1999); the European Association of Securities Dealers' corporate governance principles and recommendations (EASD, 2000); and the Euroshareholders Corporate Governance Guidelines 2000.

[85] OECD Principle II.A.3 states that companies should not make it unduly difficult or expensive for shareholders to vote at the general meetings.

[86] Another aspect of shareholders' rights is the right to be properly informed of the financial position of the company and material factors which may influence this position. This will be discussed later, under the responsibilities of the boards.

[87] The countries studied include Bosnia-Herzegovina, itself composed of two entities – Federation of Bosnia-Herzegovina (referred to as the Federation) and Republika Srpska (referred to as RS) – with their own specific laws. In this paper, we identify the legal position on different aspects of corporate governance in the two entities, especially when they are different.

Clearly there are diverse arrangements for owners' participation in decision making in different countries although, in most areas, there is a noticeable trend towards conformity with OECD principles. Independent share registers seem to exist in most countries, especially the accession countries. Information on meetings is often communicated via the media rather than by letters sent to individual shareholders. Given the wide use of 'bearer shares', this seems to be a reasonable deviation.[88] The opportunity for postal voting is generally still not available in most countries and proxy voting, though technically possible, in many countries is often subject to the additional condition that the proxy must have an official power of attorney. Furthermore in some countries shares have to be deposited with a third party for a minimum period before the shareholders' meetings. These restrictions clearly weaken the ability of shareholders to participate and influence the company's decisions and provide fertile ground for abuse by controlling shareholders.

Table 6

Aspects of shareholders' rights to participate in decision making

Countries	Independent Share register	Postal voting	Proxy voting	Notice of meetings
Albania	Yes	No	Yes[b]	Media or letters to shareholders
Bosnia-Herzegovina	Yes[g]	Yes[h]	Yes	Notice in national papers[i]
Bulgaria	No	No	Yes	Notice in State Gazette
Czech Republic	Yes	No	Yes (power of attorney necessary)	One national paper or letters to shareholders
Hungary	No[j]	Yes[a]	Yes[k]	Notice in a newspaper
Lithuania		Yes[a]	Yes[a]	Media or letters to shareholders
Macedonia	No	Yes	Yes	Public announcement or invitation letters
Poland	**Yes**	**No**	**Yes[c]**	**Announcement method not specified[d]**
Romania	Yes	No	Yes (power of attorney necessary)	Notice in State Gazette and a newspaper or by letters to shareholders[e]
Russia	**Yes**	**Yes**	**Yes**	**By registered letters to shareholders[f]**
Slovenia	Yes	No	Yes	Notice in national papers or company website

[a] Only if the provision is allowed in the company's articles of incorporation.

[b] Companies with more than 50 employees only

[c] On the regulated segment of the market

[d] Notice of meeting *may* however be by letters to shareholders if shares are named shares.

[e] If shares are named shares.

[f] Or as the company charter determines (e.g., by invitation in the newspapers or television).

[g] While there are independent share registries in both entities, many companies are still not registered.

[h] Only in the 2003 amendments postal voting became possible in both entities of BiH. In the Federation, postal voting (including fax and email) is possible only when there are very large number of small shareholders while in the Republika Srpska (RS) there are no restrictions.

[i] In RS, in addition to the notice in the newspaper, known shareholders have to be invited by a letters.

[j] The share registry is kept by the company.

[k] Either power of attorney or a letter signed by two witnesses are necessary, and the latter is very easy to obtain.

[88] With bearers shares, the possibility of proxy voting or postal voting is significantly limited as the company has no access to the identity of owners. It is generally believed that bearer shares are widely used as a vehicle for corrupt practices and for hiding the identity of real beneficial owners.

4.3. Equitable Treatment of All Shareholders

The OECD code recommends that all shareholders (minority or majority; foreign or domestic) of each type of share be treated equally. An important aspect of "equal treatment" is the concept of "one share-one vote" which is practiced in many, though not all, OECD countries. According to this Anglo-American practice, all shares should have equal voting rights in order to provide owners with proportionate power to influence the decisions of the company. In many countries (including OECD countries), other practices such as non-voting shares, shares with greater voting power, etc. are common. In some countries there is a cap on the voting rights of large shareholders, effectively giving their shares less voting rights than that of minority holders. In these circumstances, minority shareholders exercise undue influence over the decision-making process. The OECD Principles do not choose one practice in preference to another, though in some countries different types of voting shares are either discouraged or being abandoned altogether (e.g., Denmark and Greece). ICGN (1999) also regards any deviation from one share-one vote as undesirable.

Another aspect of equal treatment is the treatment of minority shareholders in particular, who may be the target of opportunistic and sometimes fraudulent behaviour by majority shareholders. Indeed, the question of equitable treatment becomes crucial when large shareholders can exercise greater control rights than warranted by their ownership rights (either because of the dispersion of the shareholding or through the multiple voting right of some shares).[89] For this reason, specific mechanisms are needed to ensure that all shareholders are treated the same. Minority shareholders can be protected in a number of ways: (i) the so-called 'super-majority' requirement for certain important proposals put to the assembly of shareholders which enables minorities to block certain decisions (such as capital increase, liquidation, mergers, etc.); (ii) the imposition of a quorum for shareholder meetings; (iii) the allocation of a seat on the board to the representative of minority shareholders (the cumulative voting procedure); (iv) the entitlement to buy shares in proportion to one's current shareholding when the company's capital is increased and new shares are issued (the so-called "pre-emptive right"); (v) the right to embark on legal action against the management on the basis of "duty of care" (the so-called oppressed minority rule).[90] Table 7 summarises the legal framework for the equal treatment of all shareholders and the protection of the minority. Here, too, most transition economies fall short of OECD recommendations.

Clearly, all countries have made some attempt to devise and improve their legal framework to ensure the equal treatment of shareholders including minority shareholders. The "one share - one vote" principle seems to be the norm in most countries. In terms of minority shareholders' rights, most countries impose a quorum and a super-majority requirement on the meetings of shareholders – though the accession countries seem to have less strict rules than non-accession countries in some areas (lower quorum for assemblies, and lower percentage of votes for decisions requiring super-majority).[91] Pre-emptive rights are observed in almost all countries (with the notable exception of Poland[92]) and the oppressed minority rule is

[89] Interestingly in many EU countries (notably Austria, Belgium, Germany and Italy), a majority of listed companies have controlling shareholders with ownership stakes in excess of 50% of shares (Barca and Brecht, 2001)

[90] This list is not exhaustive but contains some of the more common ways of protecting the minority against abuse by large stakeholders.

[91] In the light of the possibility of abuse by minority, and in the presence of better legal framework, these seemingly less restrictive measures may not be too significant (see next paragraph). It should be added that, in some countries, some decisions of the boards require higher super-majority levels than indicated in Table 7 (for example in Lithuania a resolution aiming to withdraw shareholders' pre-emptive rights require a 75% majority).

[92] It should be noted that the Polish law allows for companies to include 'pre-emptive' rights in their charters (if they so wish) but, unlike other countries, it does not impose this restriction on companies. The same thing applies to the quorum for the assembly of shareholders.

on the statute book in most countries too. Interestingly, only in Poland and Romania are minority shareholders entitled to one seat on company boards (though the provision is not commonly used in practice in Romania). The ability of minority shareholders to sue the management for violation of the "duty of care" principle has occasionally led to the abuse of the litigation process by the minority. Although such abuse is rare (see Blaszczyk, Hoshi and Woodward 2003 for examples), policy makers should be aware of its potential existence and formulate mechanisms to discourage it.[93]

Table 7
Equitable treatment of shareholders (including minority shareholders)

Countries	One share - one vote is the norm[a]	Quorum for AGM (% of voting rights to be present)	Supermajority for important decisions (% of shares present)	Automatic right to buy shares in new issues	Oppressed minority rule	Right of minority shareholders to elect a board member
Albania	Yes	51%	75%	No	No	No
Bosnia-Herzegovina	Yes	50%[c]	67%	Yes	Yes	No[h]
Bulgaria	Yes	None	67%	Yes	No	No
Czech Republic	Yes[b]	30%	67%[d]	Yes	Yes	No
Hungary	Yes	50%	75%	Yes	Yes	No
Lithuania	Yes	50%	66%	Yes[f]	Yes	No
Macedonia	No	50%	75%	Yes	No	No
Poland	**Yes**[j]	**None**	**67%**[e]	**No**[k]	**Yes**	**Yes**
Romania	Yes	50%	75%	Yes[g]	Yes	Yes[i]
Russia	**Yes**	**50%**	**75%**	**Yes**	**Yes**	**No**
Slovenia	Yes	None	75%	Yes	Yes	No

[a] In the course of privatisation in some countries, the so-called 'golden shares' were created, giving the government (as the holder of the golden share) additional powers. These are excluded from the table.
[b] But it is possible to impose a cap on the voting rights of individual shareholders.
[c] In RS, the quorum is 30%.
[d] For delisting, a supermajority of 75% is required.
[e] Other important decisions require 75%, 80% and 90% of votes.
[f] Unless the AGM decides otherwise (a super-majority of 75% is required)
[g] Not a legal requirement but may be included in the Company charter.
[h] In RS, the election of Board of Directors was changed to require the 75% super-majority in 2002, but under pressure from the international community this amendment was dropped in 2003.
[i] This is possible in law but has not been practiced yet.
[j] Although for this is the norm for quoted companies, deviations do exist.
[k] In the actual practice, however, the shareholders are always offered the first refusal for new shares, but there is no legal provision for it.

4.4. Disclosure, Transparency and Responsibilities of Company Boards

Company boards are where the interests of shareholders, block-holders and managers are articulated. They are also the place where different types of conflict of interest manifest themselves. For this reason, and following a number of inquiries and reports on the subject, many OECD countries have opted for provisions requiring a certain proportion of companies' board members (either on boards of directors or supervisory boards) to be "*independent*" of the company and its shareholders. These board members can claim genuine independence

[93] In Bosnia-Herzegovina, the 75% super-majority requirement of the Enterprise Law of Republika Srpska, has resulted in the inability of majority shareholders to change the inefficient managers and board members. The same law also allows for minority stakeholders to have a seat on the supervisory board.

from managers and large shareholders (who usually elect their own nominees to company boards) so that they can make impartial judgements when conflicts of interest arise. Various codes of good practice strongly advocate the presence of a reasonable number of "independent" or "non-executive" directors on boards, numerous enough to maintain the boards' independence on crucial issues and conflicts of interest. Almost all transition economies have employed the so-called German model of the two-tier board system (a supervisory board and a management board).[94] Although, technically, there is a separation of functions within the two boards so that members of the former are almost by definition not involved in the day to day management of the company (i.e., they are non-executive), nevertheless they remain the representative of the owners – actually, large block-holding owners rather than all owners. The concept of "independent" members is very new and has still not found its way into the normal practice of even large companies in most transition countries.

Investment decision making by prospective investors as well as the effective operation of the market for corporate control and managerial labour market require accurate and timely information on various aspects of performance and ownership of companies. The responsibility for providing such information lies ultimately with company boards. Precisely for this reason, companies are required to publish accounts certified by independent auditors on a regular basis, while companies listed on the stock exchange are required to publish more detailed accounts more frequently.

Additionally, members of the boards and management are bound by various 'insider dealing' laws aimed at preventing those privy to confidential and price sensitive information from using such information for their own gains. Also in order to minimise the abuse of power by board members, audit committees, remuneration committees and nomination committees, largely or wholly made up of independent members of the boards, are given the responsibility for overseeing the preparation of financial statements of companies and preparing proposals on the remuneration of board members and managers and nominations to the boards.

Financial markets and prospective investors are also concerned by the provision of information on the ownership structure of the company and the ownership interests of board members. Therefore legal requirements exist not only to declare the ownership stakes of board members but also to identity the firm's large shareholders and any owner reaching a threshold ownership level (3% in the UK and 5% in most OECD countries).

Finally, OECD Principle III recognises the rights of other 'stakeholders' in a company and encourages cooperation between companies and their stakeholders. The main stakeholders of companies are identified as employees, customers, creditors, suppliers and governments. Of these groups, employees have been selected for special treatment and offered various rights ranging from consultation to representation at supervisory board level. In transition economies, the situation is rather mixed. Although in countries with a history of employee participation (such as former Yugoslavia and Poland) it would have been natural for employees to be represented at board level, in practice this has not always been the case.

[94] Needless to say, the two boards may be called differently in different countries (e.g., Board of Administration in Romania and Board of Directors in Russia, instead of supervisory board) though their essential features remain the same. Moreover, although the two-tier board system is the norm in transition economies, there are notable exceptions to the rule. In Bulgaria, the single tier model was commonly used in the early stages of transition but, following the end of the mass privatisation scheme, many companies opted for the two-tier model. According to the Commercial Act, companies can choose between one-tier or two-tier boards – a decision usually taken by the general shareholders meeting. In practice, larger companies have opted for the two-tier system while smaller companies have chosen the single tier model. In Macedonia too, companies can decide whether they wish to have a single or a two-tiered board structure. In Kosovo, however, the Regulation on Business Organisations (UNMIK 2001) establishes an Anglo-American style unitary board of directors for joint stock companies as the general rule while allowing the shareholders' meeting to decide on other board models.

Some countries without that background (e.g. Czech Republic and Hungary) have adopted the practice while others (e.g. Poland) have not. The presence of employees on company boards can play an important role in not only involving this important group of stakeholders in the decision making process, but also using their inside knowledge of the company to improve the monitoring of the management. This is particularly important in transition countries where there are no independent shareholders on boards and the danger of opportunistic behaviour by dominant shareholders and their appointed managers is real.

Table 8 summarises some of the characteristics of company boards as well as some aspects of transparency and disclosure requirements in selected transition economies.

Table 8
Boards, disclosure and transparency

Countries	Independent members on boards	Representatives of employees on boards	Independent auditors	Financial reporting requirement for quoted companies	Threshold for disclosure of ownership stakes	Obligation to make a purchase offer to other share holders (threshold)[e]	Disclosure of managerial ownership and Remuneration	Tenure of general director (years)
Albania	No	No	Yes	N/A	None	None	No	3
Bosnia-Herzegovina	No	No	Yes	Half yearly	None	None	No	4
Bulgaria	No[a]	No	Yes	Quarterly	5%	50%	No	3
Czech Republic	No	Yes	Yes	Half yearly	5%[d]	40 and 50%	Partial[g]	5
Hungary	No	Yes[h] 200+	Yes	Half yearly	25%	33%	No	5
Lithuania			Yes					4
Macedonia	No	No	Yes	Quarterly	10%	45%	No	6
Poland	**No[b]**	**No**	**Yes**	**Quarterly**	**5%**	**50%**	**Yes**	**5**
Romania	No	No	Yes	Half yearly	5%	50.1 and 75%	No	4
Russia	**No[c]**	**No**	**Yes**	**Quarterly**	**5%**	**30%+[f]**	**Yes**	**5**
Slovenia	No	Yes	Yes	Annually	5%		Partial[g]	8

[a] Except for public companies where 1/3 of the supervisory board must be independent.

[b] The Code of Good Corporate Governance, however, *recommends* that 50% of board members should be independent (for Treasury owned companies, however, the law requires that 3/5 of the board members should be independent).

[c] Recommended by the Code of Corporate Conduct but the practice is limited to some of the biggest companies only.

[d] Any outsider can find out the identity of shareholders once they reach the 10% threshold.

[e] A shareholder reaching this threshold must make an offer to buy out other shareholders.

[f] This obligation may be withdrawn by Company charter or AGM.

[g] Only total salary bill is disclosed.

[h] In companies with more than 200 employees, 1/3 of the supervisory board is elected by employees.

As mentioned earlier, the concept of independent board members is at its infancy in transition economies (even accession countries) with only Poland and Russia having a *recommendation* to engage independent members on boards on a voluntary basis. Similarly the representation of employees on the supervisory board is also rare, with Slovenia and Czech Republic (and large companies in Hungary) the only countries with statutory representation of employees at board level. On the other hand, the need for independent auditors and regular

financial reporting is well established in all countries under consideration, with some countries even having obligatory quarterly reporting.

The disclosure of information about beneficial owners of a company is recognised in all countries, with most of them now having a threshold of 5% (and other higher levels). In a majority of cases, the mandatory bid rule (the obligation to make an offer to buy out other shareholders once an owner reaches a certain threshold, between 30 and 50%) is also place to ensure that minority shareholders can exit without financial penalties if a controlling shareholder enters the scene. However, in some countries such as Russia, the effectiveness of this provision is reduced by the fact that some beneficial owners are simply 'off shore' companies and the true identity of their owners remains unknown. Furthermore, there is anecdotal evidence about the existence of cross ownership and pyramid holdings which also hide the true identity of beneficial owners (see Berglof and Pajuste, 2003 for examples).

Table 9
Rule of law and the effectiveness of financial regulations

Countries	Rule of law		Financial regulations effectiveness		
	1997/98	2000/01	1998	2001	2002
Albania	n.a.	n.a.	2-	2-	3
Bosnia-Herzegovina	n.a.	n.a.	1	1	1
Bulgaria	-0.15	0.02	3	3	4
Czech Republic	0.54	0.64	3-	3	4-
Hungary	0.71	0.76	4	4-	4-
Lithuania	0.18	0.29	2	4-	4-
Macedonia	n.a.	n.a.	2	2	4-
Poland	**0.54**	**0.55**	**3**	**3**	**4-**
Romania	-0.09	-0.02	3-	3	4
Russia	**-0.72**	**-0.87**	**2**	**2+**	**4-**
Slovenia	0.83	0.89	3-	4-	4-

Source: Kaufman et al., 2002; EBRD, 1999 and 2002.

The chief executives of companies in transition economies still enjoy a great deal of power. Their term of office is usually very long, between 3 to 8 years (mostly 5). In comparison with EU countries, this is rather long – the Cadbury Committee recommended contracts of 1 to 2 years for chief executives in the U.K. (Cadbury, 2002). Similarly, as far as the ownership stake and remuneration of managers and boards are concerned, most countries still maintain a veil of secrecy and, at best, provide partial information (such as the aggregate value of managerial remuneration and shareholding) for shareholders investors and markets.

In all countries there are legal provisions against the abuse of power by managers. Almost everywhere they are forbidden by law to engage in actions, in collusion with others, to artificially manipulate share prices for personal gain. It is also explicitly against the law to engage in insider trading (the use of price sensitive information for personal gain). In both cases penalties ranging from fines, prison terms and the loss of the right to be a company director are available to courts. The implementation and enforcement of legal remedies is, of course, weak and successful prosecution of a significant number of company managers has not taken place in the transition countries investigated, despite the numerous financial scandals and cases of abuse of power –e.g., *tunnelling* which resulted in financial crisis in the Czech Republic or the pyramid schemes whose collapse led to civil unrest in Albania.

Finally, it is important to note that although the legal framework for corporate governance in the countries under consideration is fairly well developed and comprehensive, it does not mean that their implementation and enforcement are equally well developed. Indeed, as many observers have noted, law enforcement and implementation is a general problem in transition countries. Many authors and institutions have reported on the development of the

legal framework and its enforcement in transition economies in the last few years (La Porta et al., 1997; Pistor et al., 2000; Kaufman et al., 2002; and the EBRD 's *Transition Reports*, among others). These studies provide a ranking of the legal framework especially the 'rule of law' and the effectiveness of legal provisions in the financial sector in these countries. Table 9 summarises two of the recent studies on law enforcement in the countries under consideration.

Clearly, despite much improvement in the legal framework, the general state of 'rule of law' is still far from satisfactory in most countries. Russia, in particular comes out quite poor (indeed with some deterioration of its score) in the Kaufman et al.'s study while Poland and Czech Republic seem to be in much better position. In terms of the effectiveness of financial regulations, most countries have improved and reached a satisfactory situation though, in the light of our investigations, the improvement in 2002 seems rather surprising. Even then, all countries have still some way to go to reach the position of developed market economies (which would attract a score of 4+).

4.5. Conclusions

Effective corporate governance is fundamental to the process of economic regeneration in transition economies. It improves the performance of enterprises by aligning conflicts of interest, and by reducing fraudulent and opportunistic behaviour. It enhances the quality of information available to participants in the capital market and facilitates access to external finance. All transition economies have made significant progress in developing a corporate governance framework and are moving towards adopting the OECD Principles on voluntary or statutory basis. Poland and Russia are amongst the group of countries with more developed corporate governance practices.

The board system in almost all transition countries (with minor exceptions) is similar to the German two-tier model with a supervisory board (responsible for the strategic direction of the company and the supervision and monitoring of the management) and a management board (dealing with the operational and day-to-day management of the company). The shareholders' ability to influence the boards by exercising their voting rights and participating in the decision making process is, however, somewhat restricted in many countries. The opportunity for postal voting is generally non-existent and proxy voting is subject to additional time consuming requirements such as the power of attorney. Both Poland and Russia need to make improvements in these areas to encourage and facilitate a wider exercise of shareholder rights. Another important area of improvement is the appointment of independent members on supervisory boards, something which none of the countries under consideration have achieved so far. The codes of good corporate governance practice in both Russia and Poland, however, recommend that independent members should constitute one-third to one-half of board membership.

In terms of the protection of minority shareholders, most countries have adopted measures such as the quorum requirement for shareholder assemblies and the super-majority requirement for important decisions. Other measures such as pre-emptive rights, the mandatory bid rule and the oppressed minority rule are only available in some countries. Poland is the only country where the minority shareholders are able to pool their votes and elect a member to the supervisory board of companies, but at the same time, it is also the only accession country without the automatic pre-emptive right. This is an area of improvement which should be considered at the time of the review of the legal framework. The protection of minority, of course, has to be weighed against the ability of majority owners to engage in entrepreneurial activities. The abuse of minority rights is a potential problem that countries have to be aware of and make legal provisions to avoid without restricting the rights of minority owners.

As far as the rights of other stakeholders are concerned, there are no explicit references in the corporate governance framework of any of the countries studied – the only exception being the recognition of employees' right of representation at supervisory board level in some countries (Czech Republic and Slovenia, e.g.). There are no provisions for consultation and the involvement of, or the supply of targeted information to, creditors, suppliers or governments. The participation of employee representatives on supervisory boards is of course recommended by the OECD Principles and is practiced in a number of EU countries. Interestingly in Russia, the practice is common especially in larger companies though it is not legally required. This is another area where companies can improve their corporate governance procedures without any adverse effect on the work of their management bodies.

Finally, in all countries, there are legal remedies for breaches of rules, ranging from fines to imprisonment and restrictions on the future employment of the managerial personnel involved. This is very important and necessary, though not sufficient, for discouraging fraud and misuse of position of influence. However, while legal provisions are fairly good in most countries, the implementation of the legal framework or 'law in practice' is far from satisfactory. In many countries, basic rules such as the registration of shareholders, information for assemblies and various rules designed to protect minority owners are not observed fully or implemented in a lax manner. In Poland, where rules applying to companies on the Warsaw Stock Exchange are quite strict, the same is not true for other companies. In Russia too, the level of implementation, apart from larger companies with public presence is fairly low. The identity of the beneficiary owners of many companies are hidden behind the 'off shore' company formula which reduces the confidence of investors in the laws governing financial market. It is in this area that authorities need to make further visible progress to reassure investors and creditors. The EBRD index of legal effectiveness shows a surprising improvement in all countries in 2002 over previous years. This improvement does not match other researchers' and the Bank's earlier investigations and has to be treated cautiously.

V. Empirical Evidence

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1. Impact of the Institutional Structure of an Enterprise on the Efficiency of its Operation: An Empirical Study (Russia)

This section presents the results of an empirical study of the impact of the parameters characterizing the ownership structure and the Board of Directors of a joint stock company, as well as other indicators of the institutional structure on the efficiency indicators relating to the operations of Russia's enterprises in a three year panel consisting of 100 enterprises. The study is designed basing on the methods proposed in the paper by Radygin, Entov (2001), however, it was significantly modified. Firstly, we have changed the method pertaining to calculation of the corporate conflict intensity index, which is used as an explanatory variable in the course of regression analysis. Secondly, we used new (not previously used) data, what allowed us to form a data panel and apply methods of evaluation of panel regressions.

1.1. Database: A Description

The present study has been carried out basing on the results of two surveys conducted by IET in 1999 and 2001. In the course of the first stage of the survey conducted at the end of 1999, there were surveyed 872 enterprises, 201 of which were used to form a sample. An additional survey carried out at the end of 2001 embraced only the enterprises included in the sample (201 joint stock companies) and concerned such issues as the number of employees at an enterprise, amounts of sales proceeds in 1999 and 2000, profits in 1999 and 2000, and fixed assets value in 1999 and 2000, as well as issues relating to changes in the indicators of outstanding creditor and debtor indebtedness in 2000. Therefore, by combining the results of these two surveys the authors were able to form a three-year panel of data on 100 enterprises.

A specific feature of the sample under observation is that the absence of answers to certain questions frequently means a negative answer or zero. In order to obtain more adequate results, at the preliminary stage of data processing there was carried out a certain adjustment of the results of the survey.

Such an adjustment concerned the issues pertaining to the structure of capital stock and the Board of Directors. The respective reports contained omissions, many of which might be interpreted as a negative answer to a question (i.e. as an answer "representatives of this group of owners do not own shares in our enterprise" or as "representatives of this interest group are not included in the membership of the Board of Directors") depending on the sum of answers concerning the share (%) of stocks owned by other groups of shareholders, or about the share of representatives of this interest group in the Board of Directors. In the case the sum of answers relating to the questions about the structure of stock capital or the share of representatives of all interest groups in the Board of Directors made more than 100 per cent (or more), the authors assumed that the respondents indicated the representation of only those groups of owners or Board of Directors members, who owned stocks or were members of the Board of Directors, and replaced omissions in answers with zeros. In other words, the authors assumed

that representatives of a certain group did not own shares in an enterprise, or were not members of the Board of Directors.

Besides, in the case the sum of answers concerning the structure of stock capital exceeded 100 per cent, the answers were proportionally adjusted in a way making their sum equal to 100 per cent. Of course, such an adjustment of data may be not absolutely correct, since only the answers to one question might have been significantly biased, while such an adjustment results in a bias of all data towards a decrease in the share of a concrete owner of capital stock. However, on the whole such an adjustment shall not significantly bias the results of the survey, since the share of such enterprises is rather small.

At the same time, in the case the sum of the answers to questions concerning the structure of stock capital or the Board of Directors were below 100 per cent, the authors did not conduct any adjustment, since it was assumed that replace omissions with zeros in this situation would have been incorrect.

Below, there are presented sample statistical characteristics of base indicators used in this study. Table 1 presents sample statistics of the shares of stock capital.

Table 1

Mean share of an owner in stock capital as based on the whole sample

Mean % of shares owned by:	Number of enterprises having answered the question (out of 100)	mean % (among those having responded)	Median (among those having responded) (%)
Rank and file employees and the management (insiders)	93	44	41
Share of rank and file employees in insiders[a]	90	74	81
Share of management in insiders[a]	90	29	19
Russia's enterprises and holdings	72	30	23
Commercial banks, investment funds, pension funds, insurance companies	47	13	7
Outside shareholders – individuals	69	23	19
Foreign shareholders	32	4	0
State and local authorities	36	0.05	0

[a] In these lines there are presented the mean values and medians of indicators of shares in stock capital owned by rank and file employees of enterprises and management in the structure of insiders.

As Table 1 demonstrates, in the mean across the whole sample the largest number of stocks (44 per cent) is owned by insiders (rank and file employees and management), while at a half of enterprises the share of insiders makes less than 40 per cent of stocks. At the same time, in the mean rank and file employees own almost three fourths of all stocks owned by insiders. Groups of Russian enterprises and holdings and outside shareholders – individuals in the ownership structure is rather significant: in the mean across the whole sample these groups of shareholders own 30 per cent and 23 per cent of stocks respectively. Various financial institutions (commercial banks, investment funds, pension funds, insurance companies) own 13 per cent of stocks in the mean. Groups of foreign shareholders and the state in the structure of stock capital are less significant – they own 4 per cent and 0.05 per cent of stocks respectively.

Table 2 presents mean values of shares the representatives of insiders, large private shareholders, and the state have in the composition of the Board of Directors.

Table 2
Mean values of shares (%) the representatives of various interest groups have in the composition of the Board of Directors (across the whole sample)

"Average" Board of Directors consists of representatives of interest groups (%)	Number of those having responded	Mean value (among those having responded)	Median (among those having responded)
Insiders	99	62	60
Large private shareholders	91	19	13
State	94	7	0

Therefore, in the average Board of Directors (across the whole sample) representatives of insiders (management and rank and file employees) make 60 per cent, representatives of large private shareholders – 19 per cent, and representatives of the state – 7 per cent. At the same time, at about half of the enterprises included in the sample (out of the number of those having responded to this question) there are no representatives of the state in the Board of Directors.

Table 3 demonstrates that the structure of employment (distribution of enterprises across size groups) has not changed significantly over the three years under observation. The majority of enterprises included in the sample had from 101 to 500 employees, although there was detected a certain decline in the share of such enterprises in 2000 in comparison with the figures registered in the preceding years.

Table 3
Distribution of enterprises by the indicator of the total number of employees across size groups

	1998			1999			2000		
	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded
No response	6	6		6	6		6	6	
Below 100	4	4	4.26	4	4	4.26	7	7	7.45
101-500	37	37	39.36	40	40	42.55	33	33	35.11
501-1000	28	28	29.79	23	23	24.47	30	30	31.91
1001-1500	17	17	18.09	18	18	19.15	13	13	13.83
1501-2000	3	3	3.19	3	3	3.19	6	6	6.38
over 2000	5	5	5.32	6	6	6.38	5	5	5.32

Similarly, the share of enterprises having from 1001 to 1500 employees declined from 18 per cent (in 1998) to 14 per cent (in 2000). On the contrary, the number of enterprises having from 501 to 1000 employees increased to 32 per cent in 2000 as compared with 24.5 per cent registered in 1999.

As Tables A2.1 – A2.3 of Appendix 2 demonstrate, the distribution of the enterprises included in the sample as broken down by size groups in accordance with the indicator of employed in industrial production is practically similar to the distribution in accordance with the indicator of the total number of employees at an enterprise.

Tables 4 and 5 present the results of the survey concerning changes (increase or decrease) in the size of outstanding creditor indebtedness to suppliers and outstanding creditor indebtedness to banks. Table 4 demonstrates that the nature of behavior of the outstanding creditor indebtedness to suppliers in 1999 is different from the behavior of this indicator in

1998 and 2000: while in 1998 and 2000 about one third of respondents having answered the respective question declared that their outstanding creditor indebtedness to suppliers increased and about two thirds of respondents pointed out that it declined, in 1999 the nature of behavior of this indicator was opposite – only about one third of the respondents having answered the respective question declared that this indebtedness declined, while two thirds of respondents indicated that the respective indicator increased.

Table 4

Changes in outstanding creditor indebtedness to suppliers in 1998 through 2000

	1998			1999			2000		
	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded
No response	18	18		15	15		16	16	
Increased	31	31	37.8	53	53	62.35	30	30	35.71
Decreased	51	51	62.2	32	32	37.65	54	54	64.29

The results presented in Table 5 demonstrate that the nature of behavior of outstanding creditor indebtedness to banks also differs across years. It shall be mentioned that in contradistinction to the preceding indicator the share of respondents having answered this question makes approximately 20 to 30 per cent of the total number of respondents, therefore, no unambiguous conclusions can be made as concerns the behavior of this indicator.

Table 5

Changes in outstanding creditor indebtedness to banks in 1998 through 2000

	1998			1999			2000		
	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded	Number of answers	%	% among those having responded
No response	73	73		72	72		69	69	
Increased	20	20	74.07	23	23	82.14	10	10	32.26
Decreased	7	7	25.93	5	5	17.86	21	21	67.74

Therefore, in 1998 and 1999, the share of enterprises where the increase in the amount of outstanding creditor indebtedness made about 75 to 80 per cent of the number of those having responded to the question, while less than one fourth of the respondents declared that this indicator decreased. In 2000, the behavior of this indicator changed: only about one third of enterprises indicated that their outstanding creditor indebtedness to banks increased, while two thirds declared a decline in this indicator.

The authors used the following five indicators[95] as characteristics of the efficiency of enterprises' operations (hereinafter referred to as indicators of the efficiency of enterprises' (economic) operations):

– Ratio between proceeds and the total number of employees at an enterprise in prices of 1998;

[95] This study uses the same indicators of the efficiency of enterprises' operations as in the paper by Radygin, Entov (2001), where the authors have thoroughly justified the choice of exactly these characteristics of economic operations of enterprises as explained variables.

– Ratio between proceeds and the number of employed in industrial production in prices of 1998;

– Ratio between profits and fixed assets;

– Ratio between profits and proceeds;

– Ratio between proceeds and fixed assets.

– It shall be mentioned that in the course of regression analysis all aforementioned indicators were adjusted in the following way: 5 per cent of maximum and minimum values were replaced with respective maximum and minimum values from the sub-sample consisting of 95 per cent of the remaining values.

Table 6 presents descriptive statistics of the indicators of proceeds, profits, and fixed assets in prices of 1998: the maximum and minimum values, mean and 25 per cent value, 50 per cent value (median), and 75 per cent value. As it is demonstrated by the table, no less than 50 per cent of the enterprises included in the sample (among those having answered the question) show real financial indicators below respective sample mean values notwithstanding the year. Only for 25 per cent of the most successful enterprises (in terms of the characteristics under observation) certain real financial indicators are commensurable with the respective mean sample values. The only exception is the amounts of profits of enterprises among 25 per cent of the most profitable ones: notwithstanding the year, all values are below the mean sample value.

Table 6

Real amounts of profits, proceeds, and fixed assets (in prices of 1998, Rub. thous.)

Indicator	# of answers	Minimum value	Maximum value	Mean value	Quartiles		
					25 %	50 %	75 %
Profit, 1998	65	-38140	104000	2055	-5.32	23.78	4152
Profit, 1999	84	-64459	188688	5333	90.54	1802	4646
profit, 2000	83	-16562	457237	9729	207.60	1609	5775
Sales proceeds, 1998	86	1.68	527000	44066	1045	14114	48750
Sales proceeds, 1999	99	3.55	718133	65805	11287	25441	72582
Sales proceeds, 2000	99	2.87	1333608	76533	12073	30124	77701
Cost of fixed assets, 1998	79	12.14	5747000	151270	3834	31854	79132
Cost of fixed assets, 1999	91	16.67	555795	64922	12510	32600	68008
Cost of fixed assets, 2000	89	13.74	320824	46355	8945	23778	53902

Similar behavior is demonstrated by the indicator of the cost of fixed assets in 1998 – the values of this variable are almost two times below the mean sample value for 75 per cent of enterprises.

1.2. Methodology of the Study

Taking into account the specifics of the data (a sample of 100 enterprises over three years from 1998 to 2000), in the course of evaluation of regression models the authors used the methods of panel data analysis. Since there were available only the data for three years and the enterprises included in the sample differed by their industrial, size, etc. structures, regressions were evaluated using the iterated feasible (estimated) generalized least squares (IFGLS) method as adjusted for heteroskedasticity of random errors. All models were evaluated using the econometric package STATA 8,0.

At the first stage, the authors estimated bivariate panel regressions, firstly, because it was considered necessary to check if there exist pair correlations between institutional characteristics of enterprises and efficiency of their operations, and, secondly, because it was assumed that the estimation of multiple regressions pertaining to the dependence of certain indicators of enterprises' efficiency on their institutional characteristics would be too difficult due to the specifics of the database.

At the second stage of the study, the authors estimated models of multiple panel regressions allowing to detect more significant institutional characteristics of enterprises affecting the efficiency of their operations.

It shall be noted that the data on the ownership structure, composition of the Board of Directors, etc. were available only for the first year of the sample. Due to this fact, the authors could test the hypotheses about the impact of the institutional characteristics of enterprises on the efficiency of their operations only assuming that the variables characterizing the institutional specifics of an enterprise remain unchanged over the period under observation. No doubt that this assumption sets certain limitations on the interpretation of obtained results, however, generally speaking, it is rather realistic taking into account that a rather short time interval is under observation. Besides, even the assumption that large owners of stocks will change due to the continuing process of redistribution of ownership rights after privatization may rather make amendments concerning titles of ownership rights than the structure of ownership, what apparently does not contradict the initial assumption. This is in particular related to the persistent system of indirect corporate control on the part of the largest (concentrated) owners.

1.3. Corporate Conflict Intensity Index (CCII): The Methods of Construction

Before starting to present main hypotheses tested in the course of the study, the method of construction of the corporate conflict intensity index, which is used in this paper as an institutional characteristic of an enterprise, shall be described in more detail. In this study, the methods of construction of the CCII were modified as compared with those offered in papers by Radygin and Entov (2001), Radygin and Arkhipov (2000, 2001). In order to compute the CCII the authors used the methods borrowed from papers concerning the study of poverty levels in different countries[96].

In order to construct the corporate conflict intensity index there were used the results of the survey across the following six questions somehow signaling that a corporate conflict exists at an enterprise:

Question No. 19. Did the joint stock company pay the preferred dividend in 1997 and 1998?

Question No. 21. Did the joint stock company redeem its shares?

Question No. 22. Did the joint stock company sell (transfer) shares to employees in 1996 through 1999?

Question No. 23. Did the joint stock company carry out new issues not related to revaluation of fixed assets in 1996 through 1999?

Question No. 27. Is there a shareholder owning more than 50 per cent of stocks?

Question No. 31. How many general meetings of shareholders were held over the last two years?

In general form, the formula for computation of the corporate conflict intensity index looks as following:

[96] See, for instance, Cheli, Lemmi (1995), or Korchagina, Ovcharova, Turuntsev (1998).

$$CCI_i = \frac{\sum_{k=1}^{6} d_k w_k}{\sum_{k=1}^{6} w_k},$$

where CCI_i is the corporate conflict intensity index at the *i*-th enterprise, d_k is the dummy characterizing the presence or absence of the *k*-th indicator of corporate conflict at the *i*-th enterprise, w_k is the weight given to the *k*-th indicator of corporate conflict at which it is included in the constructed index. The weight of each parameter indicating a corporate conflict at an enterprise in the aggregate index depends on the degree of its prevalence, i.e.: the more frequently this indicator of corporate conflict is detected among the enterprises included in the sample, the less is its impact on the corporate conflict intensity index[97]. Such an opposite impact is taken into account by the use of the following weight coefficients:

$$w_k = \log \frac{1}{m_k},$$

where m_k characterizes the degree of prevalence[98] of the *k*-th indicator of corporate conflict. Since in this case all parameters characterizing the existence or absence of a corporate conflict are binary, this indicator coincides with the mean value of the *k*-th indicator of corporate conflict. For the information on values assigned to the parameters characterizing the existence of corporate conflict at an enterprise, see Table 7. It shall be noted that the indicator was assigned the value equal to one in the case the respondent gave an answer indicated in column "1", otherwise the value was equal to zero.

Table 7

Numerical values assigned to the parameters used for the computation of CCII

Question #	Question	"1"	"0"
19	Did the joint stock company pay the preferred dividend in 1997 and 1998?	Yes	No
21	Did the joint stock company redeem its shares?	Yes	No
22	Did the joint stock company sell (transfer) shares to employees in 1996 through 1999?	Yes	No
23	Did the joint stock company carry out new issues not related to revaluation of fixed assets in 1996 through 1999?	Yes	No
27	Is there a shareholder owning more than 50 per cent of stocks?	Yes	No
31	How many general meetings of shareholders were held over the last two years?	More than two	Two or less

[97] The problem of weight assignment in the course of construction of composite indicators is rather nontrivial. The method of selection of weights used in this paper is only one from many relevant ones. The major factor behind this choice is that it was assumed that there are present certain "traditional" or "rather frequently encountered," and, respectively, "less frequently encountered" and "more refined" methods of struggle for control over enterprises. I.e., the more frequently there is encountered this or that indicator of a corporate conflict, the more traditional and, therefore, less significant it is. In this case it seems more logical to give a less weight to such an indicator. On the contrary, in the case a "rare" indicator of corporate conflict is detected at an enterprise, it may be interpreted as an indication that all traditional methods of struggle have been exhausted and the parties of the conflict try to use less frequently encountered and more costly methods of struggle for the enterprise. In this connection, in the course of construction of the corporate conflict intensity index it seems more logical to give a greater weight to such an indicator.

[98] For binary variables, the degree of prevalence of an indicator coincides with the percentage of ones among the answers to the respective question.

It shall be noted that the mean value of the corporate conflict intensity index is equal to 0.22, the minimum value equals zero, and the maximum value equals 0.81.

1.4. Basic Hypotheses Tested in the Course of the Study

In certain papers focusing on the problems of empirical study of the impact of the parameters of the ownership structure, corporate governance, and characteristics of external environment on the indicators of privatized enterprises' economic operations (see, for instance, Radygin, Entov (2001), Radygin, Entov, Turuntseva, Gontmakher (2002)), it is indicated that the results of an empirical analysis frequently either contradict the traditional theoretical principles, or do not detect significant relationships between the parameters of efficiency of enterprises' operations and any institutional characteristics of firms[99]. In the framework of this study, there is tested a number of traditional hypotheses about the impact of the parameters of the institutional structure of enterprises on the efficiency of their operations, at the same time, it is assumed that obtained empirical results can be at variance with the introduced hypotheses. Below there are presented the basic hypotheses selected for testing in the framework of this study.

– The following five characteristics were chosen as indicators of the efficiency of enterprises' operations:

– Ratio between proceeds and the total number of employees at an enterprise in prices of 1998;

– Ratio between proceeds and the number of employed in industrial production in prices of 1998;

– Ratio between profits and fixed assets;

– Ratio between profits and proceeds;

– Ratio between proceeds and fixed assets.

The list of all variables used in the study is presented in Appendix 3. It shall be noted that there were reviewed the following explanatory variables: shares (or per cent)[100] of different groups of owners in the structure of stock capital, shares (or per cent) of different interest groups in the Board of Directors, the indicators characterizing the effect of early privatization (dummies with values equal to 1 in the case the enterprise was privatized in 1993 (1992) or earlier, otherwise the respective values equal to zero), the characteristics of the concentration of property (shares or per cent), indicators showing changes (increase or decrease) in outstanding creditor indebtedness to suppliers or banks, the corporate conflict intensity index (shares or per cent).

Hypotheses on the impact of different parameters of enterprises' ownership structure on the efficiency of their operations

- Enterprises where the share of managers in the stock capital is high, while the share of employees is respectively lower, demonstrate higher indicators of efficiency of economic operations as compared with enterprises where the share of employees in stock capital is high and the share of managers is low;

[99] As concerns the factors behind the possible deviations, for more details see: Radygin, Entov (2001).

[100] Depending on the measurement units of the endogenous variable, there were used certain explanatory variables either in shares (an indicator changing within the interval from 0 to 1), or in per cent (changing from 0 to 100 per cent). In the case the indicators of ratios between real proceeds and the total number of employees at the enterprise, or the ratio between real proceeds and the number of employed in industrial production were used as the dependable variables, there were used respective explanatory variables measured in per cent, in other cases there were used variables measured in shares.

- The higher is the share of the state in the structure of stock capital, the less efficient such firms are;
- A higher share of outsiders (without the state) in the composition of stockholders causes better efficiency of an enterprise's operations. This hypothesis will be tested both for the group of outsiders on the whole, and its different subgroups. For instance, it is assumed that enterprises, where a lower share of stocks is owned by Russian enterprises and a higher share of stocks is owned by foreign firms, are more efficient.

Hypotheses on the impact of the composition of the Board of Directors on efficiency of enterprises' operations

- An enterprise where the share of the state in the Board of Directors is high is less efficient;
- A large share of insiders in the composition of the Board of Directors presupposes that the economic operations of such a firm are less efficient;
- Enterprises where the share of large private stockholders in the composition of the Board of Directors is high demonstrate higher indicators of efficiency of their operations.

Hypotheses on the impact of the privatization effect and the level of property concentration on the efficiency of firms' operations

- There exists a positive relationship between the early privatization effect and the efficiency of enterprises' operations;
- The higher is the level of property concentration, the more efficiently operates the enterprise.

Relationship between the existence of intense corporate conflicts and characteristics of efficiency of enterprises' operations and parameters of ownership structure and corporate governance

This hypothesis can be formulated in the most abstract terms, since in the situation of still forming ownership structure and other corporate characteristics of an enterprise it is rather difficult to discuss any concrete relationships among these indicators. Therefore, in the course of the study of the impact the intensity of corporate conflict has on the efficiency of an enterprise's operations the authors attempted to find out the existence or absence of such an impact and its nature (positive or negative) over the time period under observation.

1.5. Empirical Testing of the Hypotheses: The Results

Before starting to describe the concrete results obtained in the course of the econometric study of the relationships between the five financial indicators listed above and different characteristics of distribution of stock capital, the composition of the Board of Directors, privatization effect, etc., it shall be noted that no significant multiple relationships between the indicators of the ratios between profits and fixed assets and proceeds and fixed assets and characteristics of the institutional structure of enterprises could be detected. As concerns these indicators, there could be detected only significant pair relationships, which are discussed below. It shall be noted that simple regressions estimated for all five endogenous variables are presented in Appendix 4.

1.5.1. Impact of different parameters of ownership structure and corporate governance on the indicator of real proceeds per an employee

As it was noted above, the results of an empirical analysis often do not coincide with the traditional theoretical principles, and this study was not an exception from many of such papers: many of hypotheses formulated in paragraph 2 could not be substantiated in the course of this study or obtained results contradicted to theoretical principles selected for testing.

Table 8 presents the results of the regression analysis of relations between real proceeds per an employee and different characteristics of the ownership structure and corporate governance. As it was expected, there was detected a positive relationship between the indicator of the share (per cent) of stocks owned by the management in the block of stocks owned by insiders at large, and the ratio between the enterprise's proceeds and the total number of employees at this enterprise[101]. On the contrary, despite the generally accepted hypotheses, there was detected a negative impact of the early privatization effect (variable *Priv_92*) on the indicator of the efficiency of enterprises' economic operations.

Table 8

Relation between the indicator of real proceeds per an employee and the institutional characteristics of an enterprise

Number of obs =	233	
Number of groups =	86	
Obs per group: min =	1	
avg =	2.709302	
max =	3	
	Wald chi2(4)= 789.84	
Log likelihood= -1090.027	Prob > chi2= 0	
	Coef.	**P-value (z-stat)**
cci_50	.0405353	0.042
own_5	-.3597308	0.000
priv_92	-6.779514	0.000
m_ins	.2952439	0.000
Constant	60.72544	0.000

Note: cci_50 is the index (%) of corporate conflict intensity, own_5 is the percentage of stocks owned by 5 largest shareholders, priv_92 is the dummy with value 1 in the case the enterprise was privatized in 1992 or earlier, otherwise it is equal to zero, m_ins is the share (%) of stocks owned by the management of the enterprise in the block of stocks owned by insiders at large.

Besides, this relationship indicates a positive influence of an intense corporate conflict at the enterprise on the efficiency of its operations. At the same time, a high concentration of property (variable own_5) negatively affects the indicator of proceeds per an employee.

1.5.2. Impact of different parameters of the ownership structure and corporate governance on real proceeds per an employed in industrial production

The following financial characteristic selected for the empirical testing of the formulated hypotheses was the indicator of real proceeds per an employed in industrial production. As it is seen from Table 9, there was detected a negative impact of variables, characterizing the fact of early privatization (variable Priv_93), property concentration (variable Own_5), and the share (per cent) of stocks owned by rank and file employees in the structure of insid-

[101] There was also detected a negative dependence of the indicator of the efficiency of enterprises' operations on the indicator of the share (%) of the rank and file employees in the structure of the insider stock capital (see Table A4.1, Appendix 4). At the same time, other variables included in the regression practically do not change their numerical values.

ers' block of stocks. Besides, it is following from the regression relationship that the existence of corporate conflict positively affects the indicator of real proceeds per an employed in industrial production.

Table 9
Relation between the indicator of real proceeds per an employed in industrial production and the institutional characteristics of an enterprise

Number of obs =	220	
Number of groups =	81	
Obs per group: min =	1	
avg =	2.716049	
max =	3	
	Wald chi2(6)=	1485.24
Log likelihood = -1043.295	Prob > chi2=	0
	Coef.	**P-value (z-stat)**
cci_50	.4124786	0.000
priv_93	-15.79784	0.000
own_5	-.241677	0.000
w_ins	-.2202076	0.000
sd_fis	.176716	0.000
sd_state	-.4549612	0.000
Constant	75.67326	0.000

Note: cci_50 is the index (%) of corporate conflict intensity, own_5 is the percentage of stocks owned by 5 largest shareholders, priv_93 is the dummy with value 1 in the case the enterprise was privatized in 1993 or earlier, otherwise it is equal to zero, w_ins is the share (%) of stocks owned by the rank and file employees of the enterprise in the block of stocks owned by insiders at large, sd_state is the per cent of state representatives in the Board of Directors of the enterprise, sd_fis is the share (per cent) of representatives of large private stockholders in the Board of Directors of the enterprise.

Alongside with the relationships mentioned above, there was detected a positive relation between the indicator of the share (per cent) of large private stockholders in the composition of the Board of Directors and the indicator of real proceeds per an employed in industrial production, as well as there was noted a negative influence of the variable characterizing the share (per cent) of the state representatives in the Board of Directors on the indicator of the efficiency of enterprises' operations under observation.

1.5.3. Impact of different parameters of the ownership structure and corporate governance on the ratio between profits and proceeds

Table 10 presents the results of the empirical estimate of the impact the characteristics of the institutional structure of enterprises have on the ratio between profits and proceeds. Similarly to the preceding cases, it may be indicated that an intense corporate conflict at an enterprise has a positive impact on the efficiency of its operations.

There was detected a negative impact of the indicator characterizing the early privatization effect on the ratio between profits and proceeds. In contradistinction to the preceding cases, the indicator of property concentration (variable own_10) positively influences the effectiveness of enterprises' operations.

Basing on the obtained results, it may be indicated that the impact of the structure of the Board of Directors on the indicator of efficiency of enterprises' operations is as follows: high shares of insiders and large private stockholders positively influence the ratio between profits and proceeds, while the existence of high share of the state, on the contrary, negatively affects this ratio.

Table 10
Relation between the "profits – proceeds" indicator and the institutional characteristics of an enterprise

Number of obs =	208	
Number of groups =	84	
Obs per group: min =	1	
avg =	2.47619	
max =	3	
	Wald chi2(6)=	1344.62
Log likelihood = 287.1473	Prob > chi2=	0
	Coef.	**P-value (z-stat)**
cci_50	.0581388	0.000
priv_93	-.037617	0.000
own_10	.0657871	0.000
sd_ins	.0883432	0.000
sd_fis	.0191249	0.097
sd_state	-.065475	0.000
constant	-.0062129	0.141

Note: cci_50 is the index (%) of corporate conflict intensity, own_5 is the percentage of stocks owned by 5 largest shareholders, priv_93 is the dummy with value 1 in the case the enterprise was privatized in 1993 or earlier, otherwise it is equal to zero, sd_state is the per cent of state representatives in the Board of Directors of the enterprise, sd_fis is the share (per cent) of representatives of large private stockholders in the Board of Directors of the enterprise, sd_ins is the share of representatives of insiders in the Board of Directors.

1.5.4. Impact of different parameters of the ownership structure and corporate governance on the ratio between proceeds and fixed assets and between profits and fixed assets

As it has been noted above, in the case of relations between proceeds, fixed assets, and profits, no significant multiple relations could be detected as concerns these indicators of effectiveness of enterprises' economic operations and their institutional structure. Table 11 presents the signs of coefficients of detected significant relations[102] obtained in the result of estimation of simple panel regressions for the given characteristics of efficiency of enterprises' operations and their institutional characteristics.

Table 11
Relation between ratios "proceeds – fixed assets" and "profits – fixed assets" and the institutional characteristics of an enterprise

	Ratio between proceeds and fixed assets	Ratio between profits and fixed assets
cr_p	-	-
w_ins	-	
m_ins	+	
nonfin	+	
fis	+	
for_outs	-	

Note: cr_p is the indicator of changes in outstanding creditor indebtedness to suppliers, w_ins and m_ins are shares in stocks owned by the rank and file employees of the enterprise and the management respectively in the block of stocks owned by insiders at large, nonfin is the share of Russian enterprises and holdings in the stock capital of the enterprise, fin is the share of financial institutions in the stock capital of the enterprise, fis is the share of outsiders – individuals in the stock capital of the enterprise, for is the share of foreign stockholders in the stock capital of the enterprise.

[102] The respective regression equations are presented in Appendix 4.

Thus, with certain reservations, it may be indicated that an increase in the outstanding creditor indebtedness to suppliers negatively affects the characteristics of efficiency of enterprises' operations under observation. The obtained results indicate that enterprises where the share of rank and file employees in the stock capital is low and the share of management is high demonstrate higher values of the indicator "proceeds – fixed assets." This relation is also positively affected by the indicators of shares of Russian enterprises and holdings in the stock capital of an enterprise and outsiders - individuals in the stock capital of an enterprise.

1.6. Conclusions

The obtained results of the study are not always unambiguous. For instance, a number of proposed hypotheses failed in the course of the conducted empirical study. For instance, there were detected no assumed positive relation between the indicator characterizing the early privatization effect and the parameters of effectiveness of enterprises' operations. On the contrary, the detected relation turned out to be negative. This fact primarily indicates that the theoretical assumptions about positive influence of early privatization on the efficiency of economic operations formed in the 1990s not always are true in the case of real interrelations. However, the authors are fully aware of possible distortions and inaccuracies of the study caused by the quality of the available sample.

At the same time, the results obtained in the course of the study present a rather wide picture of interrelations between dominating owners, representation in Boards of Directors, concentration levels, corporate conflicts and the efficiency of enterprises' economic operations, which originates from the analysis. For principal outcomes of the study, see below.

1. It may be indicated that the early privatization effect has rather a negative impact on the efficiency of enterprises economic operations. However, this circumstance may be more likely related to the objectively earlier "entry" of an enterprise to the stage of post-privatization development bearing all respective costs (in this case there are compared not state and private enterprises, but only private enterprises, which started privatization at different points in time). More generally, it may be assumed that their "life cycles," the starting point of which is the moment of privatization (i.e. initial privatization, first fixation of property rights, consolidation or interception of corporate control, new fixation of property rights, etc.) did not coincide;

2. Enterprises, where corporate conflicts are intense, demonstrate higher values of the indicators of efficiency of operations in comparison with enterprises, where corporate conflicts are less intense;

3. The higher is the share of management in the stock capital of an enterprise and lower the share of rank and file employees, the more efficient is such an enterprise;

4. Enterprises, where the share of large private stockholders in the structure of the Board of Directors is high, or the share of the state is low, are more efficient;

5. The process of concentration of stock capital has a rather ambiguous impact on the enterprises' operations: high concentration of property negatively affects some of the efficiency parameters, at the same time positively affecting other parameters. This conclusion is important primarily because it assumes a more balanced evaluation of possible practical measures of public regulation.

2. Enterprise Performance and Ownership Changes in Polish Firms

2.1. Introduction

Much has been written about privatization in the transition economies. However, little has been written about post-privatization ownership changes in privatized companies and what relation such changes might have to corporate performance. In this paper we examine the question of post-privatization ownership changes, or "secondary privatization" – to use a term coined by Barbara Blaszczyk – in two groups of Polish companies. The first group consists of over 84 companies from the subset of Poland's 500 largest companies which have been privatized.

The second group consists of companies privatized by what are often called, for simplicity's sake, employee (or management-employee) buyouts.[103] This is a privatization method by which a state enterprise is liquidated and its assets leased to a company which by law is to include at least half of the employees of the liquidated enterprise. By 31 December, 1998, about one thousand state enterprises had been privatized by this method, most of them small- to medium-sized firms, usually with less than 500 employees (CSO, 1999; Kozarzewski et al., 2000).

In this paper we will refer to the two groups of companies as the 84 large companies and employee-leased companies, respectively.

We proceed as follows. First, we briefly summarize the results of previous analyses presented in the paper entitled "Corporate Governance and Secondary Privatization in Poland," where we discussed such issues of relevance as the ownership structure of privatized companies and how it changed over the course of the 1990s, what factors seemed to have influenced those changes, the economic performance of these companies, and the composition of corporate governance organs such as supervisory and executive boards (that is, what sorts of organizations are represented on supervisory boards, and what the previous occupations of executive board members were). In the following section, we present the results of econometric analysis of the relationship between performance and ownership structure evolution, focusing on concentration and the respective roles of three types of owners – managers, non-managerial employees, and strategic outside investors. In reference to the debate about whether ownership variables are exogenous or endogenous for performance, we test both hypotheses concerning the effect of ownership on performance and concerning the effect of performance on ownership change. Finally, we conclude with a summary of our results.

The data used in the analysis presented here is described in the Appendix 5. An explanation of these labels and the variables is also found in the Appendix 5.

2.2. Brief Overview of Ownership, Performance and Corporate Governance

2.2.1. Eighty-four Large Companies

The ownership structure of these companies is highly outsider-dominated: on the average,[104] insiders possessed only 12.7% of shares at the beginning of 1998, and this fell to 11.4% two years later. In two thirds of the companies, managers held no shares at all, and other employees held no shares in almost half of the companies in the sample. Managers and

[103] We would like to thank Maria Jarosz of the Polish Academy of Sciences for kindly allowing us to utilize the data base for the employee-leased companies, which was created in a research project conducted under her direction. Richard Woodward would also like to thank Iraj Hoshi for his advice concerning the ownership endogeneity analysis, and Katarzyna Pietka and Agnieszka Sowa for technical help with that analysis. The usual disclaimers apply.

[104] The averages referred to here are not weighted.

other employees had majority stakes in only 5% of the firms. Foreign investors were the largest shareholders, and they were the only shareholder type that gained significantly in 1998-2000 (their average share rose from 19.8% at the beginning of 1998 to 26.1% at the beginning of 2000). The second largest type of dominant shareholders were domestic private individuals; however, their shares were slowly decreasing. The average share of domestic industrial companies grew from 9.2% at the beginning of 1998 to 10.5% at the beginning of 2000, while that of financial institutions (banks and investment funds) fell from 14.6% at the beginning of 1998 to 11.1% at the beginning of 2000. Finally, the state continued to hold an average share of about 8%.

Ownership concentration was very high and growing. On average, the single largest shareholder held a majority stake, and the five larger shareholders held over 80% of shares. The number of companies in which the single largest shareholder held a majority stake was slowly growing during the whole period under review. The concentration level was highest in companies in which the largest shareholder was a foreign investor. The lowest ownership concentration was observed in insider-dominated firms.

In 2000, companies controlled by foreign investors had the largest revenues, assets and employment, as well as the highest gross and net profits and investments. Their exports and research and development (R&D) expenditures were twice as high as the average for the whole sample. Companies held by domestic institutional shareholders were also among the largest in terms of employment, but their revenues were relatively small, and on the whole they were unprofitable. However, they were not too far behind foreign companies in investment and R&D spending. Companies controlled by domestic outside individuals were smaller than the previous group, but basically they were in the same condition. Insider companies were the smallest in terms of employment, and had the most consumption-oriented policies, with the largest wage funds, the highest dividends, and the lowest level of investments, R&D expenditures and exports. A preliminary analysis suggested the hypothesis that performance is more closely related to dominant owner type than to the level of concentration (a similar result, based on rigorous econometric analysis, was found in a study of a sample of Czech firms; see Kocenda, Valachy, 2003).

The average supervisory board composition roughly corresponds to the average ownership structure of the companies, with some divergences. If we compare the supervisory board representation of insiders to their ownership shares, top managers seem to be underrepresented (understandable given the nature of the supervisory board as an organ monitoring top management), while other employees are overrepresented. Foreign investors are underrepresented in companies they control, while in other groups of companies they are rather overrepresented. Banks are overrepresented, especially in companies controlled by domestic outsiders – both individual and institutional. Thus, in general, the two most powerful groups – top managers and foreign investors – tend to be underrepresented, while employees and outsiders are overrepresented. This could be interpreted as evidence that the supervisory board fulfills a function of representation of stakeholders as well as shareholders.

Finally, we look at whether top management (executive board members) were recruited from within the companies or from outside. One would expect insider elites to be firmly entrenched in insider-owned companies, with foreign owners more frequently bringing new expertise to executive boards by appointing outsiders. However, the results observed in this sample were very surprising. The relatively small number of insider managers in insider-owned companies is astonishing – company presidents in insider-owned companies were as a rule outsiders, and in one third of these companies there were no insiders in the executives boards at all. By contrast, in more than half of the foreign-owned companies, company presidents were of insider origin.

2.2.2. Employee-leased Companies

Immediately following privatization, insiders possessed, on the average, 92% of the shares in the sample of employee-leased companies, and in 95% of those companies, insiders owned over 50% of the shares. The share of non-managerial employees in ownership has steadily decreased, from 58.7% immediately after privatization to 31.5% in 1999. It is worth noting, however, that despite widespread selling of their shares by non-managerial employees, by 1999 only in 6% of firms had this group of owners vanished completely. In most companies, non-managerial employees retained at least minor blocks of shares. While non-managerial employees were losing their shares, the number of shares in the hands of outsiders increased fivefold (from 7.6% to 38.5%). Almost all of them are domestic investors; only three firms have foreign investors (in two cases, strategic investors). A large portion of the outsider shares represent concentrated holdings: 44.4% of the outsider shares were held by owners whom respondents referred to as strategic investors. There is also a large group of private firms and entrepreneurs (18.7%).

Strategic owners were generally involved in the privatization of smaller than average companies, while the percentage of shares belonging to non-managerial employees at the time of privatization was generally higher in larger firms. By 1999 the situation had changed: while strategic investor presence tended to be noted in smaller firms at the time of privatization, in 1999 they tended to be present in larger firms. It is interesting to note that in companies that found strategic investors after privatization, top management owned much fewer shares at the time of privatization than in the case of those that did not find strategic investors later.

Earlier studies show that in the first half of the 1990s managers were actively buying shares from non-managerial employees and increasing their holdings.[105] More recently, the position of managerial staff has stabilized, and in fact they have even begun to lose ground.

In the average company, the single largest shareholder held over one quarter of all the company's shares by 1998. This indicates a fairly large degree of concentration on the average. As in the sample of 84 large companies, concentration is growing.

A number of factors influence the direction and the dynamics of ownership changes, among others sector affiliation, company size, initial ownership structure, etc., but on the basis of a preliminary analysis we concluded that the most powerful factor determining the dynamics of ownership changes in the companies is their economic condition. When a company is doing well, the internal relations in the company are stable, and none of the main actors has an incentive to undermine this stability. When a company encounters severe economic problems, the actors begin to look around for solutions. The most obvious one is to find an external investor who brings an injection of fresh capital. When major inside shareholders have to choose between survival of the company and preservation of their shares, they tend to choose survival, at the same time trying to keep some shares for themselves. When the future prospects of the company are threatened, however, non-managerial employees lose every possible motivation to hold on to their shares. In earlier studies, a strong positive correlation was discovered between lack of dividends and selling of shares by non-managerial employees (Kozarzewski, 1999). In other words, there is preliminary evidence for what we refer to as the endogeneity of ownership (see Section 2.3.2 below). Moreover, given the evidence of certain well-known cases of highly successful industrial employee-owned companies which were sold to foreign investors or whose shares were quoted on the Warsaw Stock Exchange, one might hypothesize the non-linear nature of this endogenous relationship, with very good and very poor performance stimulating ownership changes.

[105] For more, see Gardawski (1996) and Kozarzewski (1999).

Management ownership on the average appears in relatively small companies, while strategic investors appear in companies whose average employment is above the sample average. This is probably due to the fact that, given low levels of personal savings at the beginning of the transformation, it was more difficult for an individual or small group of individuals to buy a large block of shares in a large company than in a small firm.

The financial results of employee-owned companies seem to be generally fairly sound. Profitability indices for the average Polish employee-leased company have been close to – and sometimes even better than – the average indices for firms privatized by commercial methods, and are much higher than those of state enterprises and firms participating in the NIF program. It is, however, worth noting that this profitability index has been consistently falling from year to year.

A rather surprising result is the complete absence of any correlation between various measures of strategic investor shares and their growth on the one hand and investment variables or paying off the lease on the other. In other words, there is no statistical evidence that the presence of a strategic investor actually leads to more investment! In contrast, for 1999 (but not for 1997), there is a positive correlation between concentration in the hands of management and investment spending.

There is consistently a positive correlation between the value of investment projects and the use of credit as a means of financing them, which would tend to support the claims that lack of access to credit is one of the main explanatory factors for the low rate of investment in employee-owned companies in Poland. Interestingly, use of credit is not correlated with size. However, investment spending was positively correlated with the size of the firm (measured in terms of employment).

The membership of the executive boards is dominated by persons who had managed the companies before privatization, when they were still state enterprises. Contrary to what one might expect in view of the process of ownership "outsiderization," the position of insiders on supervisory boards (measured by numerical dominance in the composition of the boards) remains generally strong. At the same time, we do observe a kind of polarization into purely "insider" and purely "outsider" boards.

The supervisory boards tend not to use all the powers given to them by the law and provisions of company by-laws. Extension of the supervisory boards' activities is observed most frequently in companies in economic distress. Generally speaking, the small role of owners in the decision-making process is striking. The owners most frequently act as decision makers where ownership is concentrated in the hands of a strategic outside investor. The role of owners in decision-making also grows in loss-making companies (at the expense of the powers of the executive and supervisory boards). Thus, we see that on the whole, the authority of top management is usually very strong in these companies, with no other actors challenging them.

2.3. Performance and Ownership: Econometric Analysis

2.3.1. Productivity and Ownership Structure

We analyze productivity here using an augmented production function framework that has been used in several earlier studies analyzing the relation between employee participation and productivity. Ideally, the logarithmized production function estimated is a Cobb-Douglas function:

$$\ln V_{it} = \alpha_0 + \alpha_1 \ln K_{it} + \alpha_2 \ln L_{it} + \alpha_3 Z_{it} + \alpha_4 X_{it} + \mu_{it}$$

where V denotes value added, K and L represent capital and labor inputs, respectively, X is a vector of industry and enterprise-specific variables such as dummies for the year of produc-

tion, Z is a vector of ownership variables, firms are denoted by the subscript i, the time period in years by t, and the residual by μ. However, because of difficulties in constructing a measure for value added based on the data available, and because in a number of studies of labor productivity in transforming economies, researchers have found sales revenues to yield better results than value added in econometric analyses of productivity[106], we use revenues instead of value added. (We use total revenues rather than sales revenues because sales revenues were not available for the 84 large companies.)

We estimate the models using Ordinary Least Squares (OLS) techniques. Table 12 contains the results for the entire panel, the 84 large companies separately, and the employee-leased companies separately. The dependent variable is the natural logarithm of total revenues (LNREV).

As one would expect, the coefficients of labor (LNLAB) and capital (LNAS) are positive and significant. The coefficient for CON1 (i.e., the percentage of a company's shares held by the single largest shareholder) is positive everywhere but significant only in the case of employee-leased companies. The coefficient for presence of a strategic investor (SI) is negative except in the case of the 84 large companies; however, this coefficient is nowhere significant. We see mixed signs for top management ownership (EB) and employee ownership (EMP); here again, however, the coefficients are not statistically significant. For the employee-leased companies, we have dynamic ownership variables showing shifts to states of concentrated ownership, management ownership, and ownership by strategic investors. However, none of these coefficients are significant. Similarly, none of the coefficients for corporate governance variables (measuring the relative dominance of insiders and outsiders on supervisory and executive boards) are significant. Therefore, the only reasonably strong result seems to be the positive relationship between revenues and ownership concentration in employee-leased companies.

2.3.2. The Endogeneity of Ownership: The Effect of Performance on Ownership Change

In previous section we examined the evidence for effects of ownership structure and changes in that structure on performance (productivity). However, it is just as likely that performance should be on the right-had side of the equation and ownership changes on the left-hand side – that is, that new owners emerging or consolidating their shares in the process of "secondary privatization" are motivated to do so by the performance of the enterprises in which they acquire control. In this section, we attempt to test for the endogeneity of ownership – that is, the hypothesis that economic performance determines the ownership structure – by regressing ownership concentration on a number of enterprise variables as well as testing a probit model in which the probability of the emergence of various types of dominant ownership (dominant ownership by a strategic investor, by top management, or by employees) in a given firm is estimated.

What are the factors which we hypothesize to affect changes in ownership structures? Based on previous research on this subject (Demsetz, Lehn, 1985; Himmelberg et al., 1999; Grosfeld, Hoshi, 2003), we hypothesize that the following factors affect ownership changes in the following ways:

Size. We have observed that the larger the firm, the less likely it is to have a concentrated ownership structure. On the other hand, certain measures of size – in particular, revenues – can provide an indication of the size of the firm's market, and we hypothesize that the larger that market is, the more likely it will be able to attract a strategic (particularly foreign) investor. We use total revenues as our measure of size.

[106] See, for example, Brada, Singh (1995), Grosfeld, Nivet (1998), Woodward (1999).

Table 12
OLS estimates of productivity effects (using revenues instead of value added)

Variable	Whole panel		84 large		Employee-leased (1)		Employee-leased (2)	
	Beta	t-statistic	Beta	t-statistic	Beta	t-statistic	Beta	t-statistic
YEAR	.026	.954	.022	.277	.021	.964	-.020	-.694
YP	.016	.724	.084	.910	.021	.803	.065	1.858
E15	-.010	-.424	.200*	2.553	-.059*	-2.301	-.081*	-2.642
E17	-.061*	-2.685	-.137	-1.868	-.053*	-2.140	-.056*	-2.011
E18	-.004	-.194	-.014	-.187	.000	.005	-.012	-.515
E20	.002	.109	-.011	-.153	-.002	-.079	-.017	-.660
E21			.070	1.052				
E22			.060	.975				
E24			.141*	2.022				
E25	-.089*	-4.604	.002	.026	-.160*	-7.577	-.087*	-3.383
E26	-.040*	-2.009	-.011	-.158	-.036	-1.736	-.057*	-2.283
E27			-.006	-.098				
E28	-.033	-1.453	.047	.617	-.034	-1.421	-.011	-.368
E29	-.023	-1.128	.036	.558	-.009	-.421	-.022	-.878
E31	-.020	-1.001			-.029	-1.381	-.047	-1.788
E32	-.036	-1.775	-.091	-1.386	-.036	-1.681	-.011	-.426
E33							-.008	-.351
E34	.055*	2.605	.116	1.671	-.006	-.244	-.078*	-2.750
E35	.014	.702	-.044	-.671			-.011	-.458
E36			.010	.164				
E37			-.027	-.419				
E45	.026	.934			.009	.306	-.043	-1.161
E50	.086*	3.909	.268*	3.538	.114*	4.854	.067*	2.329
E51	.133*	5.473	.186*	2.994	.182*	6.775	.131*	4.253
E74	-.003	-.109	.010	.164	-.012	-.406	-.055	-1.555
LNLAB	.044	.958	.101	1.000	.148*	3.279	.164*	3.021
LNAS	.925*	17.994	.666*	7.114	.802*	17.766	.772*	15.211
CON1	.025	.946	.063	.787	.132*	3.688	.141*	3.360
SI	-.014	-.460	.094	1.011	-.057	-1.610	-.078	-1.875
EB	-.002	-.076	.005	.088	.013	.473	-.005	-.139
EMP	.028	.891	.130	1.081	.019	.633	.004	.125
SBINS	.036	.472			.028	.381	-.090	-.924
SBOUT	.093	1.309	.068	.508	.057	.814	-.052	-.564
TRCON					.088	1.075	.081	.751
TRSI					-.082	-1.377	-.104	-1.306
TRM					-.028	-.437	-.014	-.170
CHAIR	.030	1.097			.037	1.309	.049	1.422
PRES	.020	.675					.016	.583
EBINS	-.100	-1.541			-.090	-1.659		
EBOUT	-.102	-1.510			-.067	-1.183		
	N=193		N=129		N=160		N=219	
	adjusted R^2 = .936		adjusted R^2 = .665		adjusted R^2=.945		adjusted R^2=.889	

Asterisks indicate coefficients which are statistically significant at the 95% confidence level.

Risk and uncertainty. Demsetz and Lehn (1985) argue that in a risky market environment, monitoring of managers is more difficult, and therefore owners are more highly motivated to acquire controlling stakes in order to have greater control over managers. On the other hand, it can be argued that in a riskier environment, investors are more likely to take a portfolio approach, investing only in small stakes and thereby minimizing their risk. We use the standard deviation of total revenues as the measure of uncertainty.

Performance. Stated in a simple way, the hypothesis is that the better the performance of an enterprise, the more attractive it is for potential investors. However, this statement needs to be qualified. Thus, for example, an enterprise experiencing financial difficulties but with a

large market may be an attractive investment. We have used profitability (the ratio of gross profit to revenues) as the measure of performance. Of course, if in analyzing employee-owned companies, we use concentration as our measure of ownership transformation, then the positive relationship between performance and the attraction of outside investors may appear ambiguous, as these investors may appear in the form of strategic investors, increasing concentration, but may also enter the company via its quotation on the stock exchange, which may actually decrease the level of ownership concentration.

Type of shareholder. Certain types of shareholders are more likely to become strategic investors than others; for example, a company in the same industry as the company whose shares are being acquired is much more likely to acquire a majority share than a financial institution. For this reason, we include a dummy variable for each of the following types of dominant shareholders at the time of privatization: top management, strategic investors, and employees.

Length of time since privatization. Obviously, the more time has elapsed since privatization, the greater the chance that a new investor has appeared or incumbent owners have consolidated their holdings. We therefore include the number of years since privatization in the analysis.

Finally, we include industry dummies (based on two-digit NACE classification), as well as the level of indebtedness (measured by leverage, i.e., the ratio of debts – short- and long-term – to assets) and the ratio of investment spending to assets as well.

For each of the variables, the average values for the period 1993-1996 are calculated. Each of the financial variables is expressed in constant prices, using CPI deflators for final goods industries and PPI indicators for intermediate goods industries.

In a study of endogeneity of ownership changes in privatized Czech companies, Grosfeld and Hoshi (2003) found that one of the key determinants of concentration is the riskiness of the firm's activity; the proxy they used to measure this was the ratio of tangible assets to total assets (based on the assumption that the lower the share of intangibles in total assets, the more stable the firm's performance can be expected to be). They found a significant positive relationship between this ratio and concentration; in other words, the greater the riskiness, the lower the concentration. They also found that larger firms were less likely to have concentrated ownership structures, and that corporate investors were more likely to have larger stakes.

Unfortunately, lack of data prior to 1998 does not allow us to carry out this analysis for the 84 large companies. We therefore restrict our analysis to the employee-leased companies.

We estimate two sets of models. In the first the dependent variable is a measure of concentration, in the second it is a set of dummy variables indicating transitions from a lack of dominant shareholdings by particular types of shareholders at the time of privatization to their dominance in the years covered by the analysis (1997-1999). The first model is specified as follows. In an OLS regression, the dependent variable is the natural logarithm of the share of the single largest shareholder (CON1/100). The independent variables are:

– industry dummies (NACE classification);

– the natural logarithm of revenues, in constant 1993 prices;

– the standard deviation of revenues, in constant 1993 prices;

– the number of years since privatization;

– the averages of the following over the previous period since 1993: the investment-to-assets ratio, leverage (total obligations over total assets), and a measure of enterprise performance based on profitability (different measures were used in two different models; see below), and

– shares of following types of owners at time of privatization: strategic investor, Executive Board member(s), and other employees.

In Table 13, we present the estimates of the regressions of the natural logarithm of CON1 on enterprise characteristics and performance. In Model 1, for our measure of enterprise performance, we use the simple ratio of gross profits to total revenues. In Model 2, in an attempt to identify possible non-linear effects of performance about which we speculated in Section 2.2.2, we use the square of the ratio of gross profits to total revenues. On the basis of the results presented here, it seems reasonable to conclude that the effects of the initial ownership structures are much stronger determinants of subsequent ownership changes than are financial performance and other economic characteristics of the firms in the sample. Looking at coefficients which are significant at the 95% confidence level, we observe positive and significant effects on the concentration measure CON1 for the number of years since privatization and the initial shares of strategic investors and executive board members. The only economic characteristic which has a significant effect at this confidence level is leverage in model 2 (interestingly, the sign is positive!). If we extend the analysis to include variables whose coefficients are significant at 90% confidence level, we can add leverage in Model 1 and the riskiness indicator, SDREV, for both models to the list. The signs are also positive here. It is worth noting that the implied conclusion concerning the effect of riskiness on concentration contradicts the aforementioned finding of Grosfeld and Hoshi (2003), though we must remember that the measures – both imperfect proxies – used in the two analyses were different.

Models in the second group (probit models) are specified as follows. The dependent variables are dummy variables representing the following transitions:

– there was no strategic investor with at least 20% share at the time of privatization, but there was one at the time of the observation;

– there was no Executive Board member with at least 20% share at the time of privatization, but there was one at the time of the observation, and

– there was neither a strategic investor nor an Executive Board member with at least 20% share at the time of privatization, but there was at least one at the time of the observation.

The independent variables are the same as those reported above for the OLS regressions.

Tables with the results of the regressions are contained in Appendix 6. As in the case of the OLS regressions, for each of the three dependent variables we test two models, one with the simple ratio of gross profits to total revenues, and one with the square of that ratio. We will discuss the results which are statistically significant.

Transition to dominance by a strategic investor (TRSI) is positively affected by the amount of time elapsed since privatization (YP) in both models, but only at the 90% confidence level in model 1. It is also positively affected by the share of employees at the time of privatization (PEMP),[107] and by leverage (LEV) in model 2, and is negatively affected by gross profitability in model 1. The last two results (for leverage and gross profitability) may be indications of a tendency for poor performance to stimulate sales of shares by non-managerial employees, as discussed in Section 2.2.2.

Transition to dominance by Executive Board members (TRM) is positively affected by the amount of time elapsed since privatization (YP) and by investment intensity (INV).

TRCON is a sort of combined measure of TRM and TRSI, reflecting transitions to dominance by either one of these groups, and therefore the results here reflect those for the previous two variables. This variable is positively affected by the amount of time elapsed since privatization (YP), the share of employees at the time of privatization (PEMP) – albeit

[107] As we noted in Section 2.2.2, strategic investors tended to appear in companies in which managers held small stakes (and consequently in those companies in which non-managerial employees strongly dominated the ownership structure).

only at the 90% level of confidence, by leverage (LEV) in model 2, by investment intensity (INV), and by size, as measured by LNREV (but only at the 90% confidence level in model 2), and negatively by gross profitability (GP) in model 1.

Table 2
OLS estimates of effects of enterprise performance and characteristics on ownership concentration

Model 1			Model 2		
Variable	Beta	t-statistic	Variable	Beta	t-statistic
YP	.188*	2.589	YP	.186*	2.640
E14	.018	.317	E14	.017	.299
E15	.105	1.640	E15	.101	1.575
E17	.038	.491	E17	.040	.527
E18	-.121*	-2.092	E18	-.121*	-2.081
E20	-.101	-1.673	E20	-.102	-1.713
E22	-.016	-.154	E22	-.183	-.777
E25	-.218*	-3.643	E25	-.229*	-3.768
E26	.073	1.249	E26	.072	1.238
E28	-.053	-.797	E28	-.056	-.840
E29	.050	.702	E29	.048	.684
E31	-.026	-.375	E31	-.048	-.677
E32	-.009	-.138	E32	-.013	-.210
E33	.036	.597	E33	.038	.637
E34	.048	.680	E34	.050	.715
E35	-.122*	-2.104	E35	-.122*	-2.112
E50	-.006	-.082	E50	-.002	-.027
E51	-.132	-1.846	E51	-.125	-1.758
E52	.015	.231	E52	.021	.321
E55	.004	.067	E55	.008	.130
E60	.038	.612	E60	.041	.672
E72	.035	.576	E72	.037	.616
E73	.121	1.705	E73	.124	1.751
E74	-.118	-1.534	E74	-.116	-1.560
E80	-.087	-1.142	E80	-.148	-1.406
PSI	.222*	2.568	PSI	.216*	2.499
PEB	.196*	2.139	PEB	.189*	2.071
PEMP	-.098	-.971	PEMP	-.104	-1.037
LEV	.153	1.663	LEV	.139*	1.991
GP	.027	.180	GPSQ	.201	.801
INV	.089	1.105	INV	.085	1.054
LNREV	.093	1.013	LNREV	.098	1.074
SDREV	.127	1.865	SDREV	.121	1.781
N=246 Adjusted R^2 = .250			N=246 Adjusted R^2 = .252		

Asterisks indicate coefficients which are statistically significant at the 95% confidence level.

Finally, if we compare the R^2 statistics for the tests of ownership endogeneity with those for productivity, we note that the estimations based on production functions are much better predictors of performance than the endogeneity models are of changes in ownership structures. While there would seem to be some substance underlying the endogeneity hypothesis, we clearly need to refine our theory about the determinants of ownership changes (as well as our measures of different kinds of ownership transformations, given the possibilities for non-linear and seemingly ambiguous relationships discussed above).

2.4. Conclusions

The ownership structure of Polish employee-leased companies, especially immediately after privatization, was characterized by large holdings of dispersed insider owners. Subsequently, the shares of non-managerial employees gradually decline, while those of outsiders grow. Concentration of shares in the hands of managers can be seen from the very moment of privatization. Later, however, managerial holdings stabilize and even decrease somewhat in favor of outsiders.

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

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

– consolidation of ownership in the hands of insider elites;

– concentration of ownership in the hands of outside investors.

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

We found little evidence of an effect of ownership structure on performance (measured by total revenues). The only statistically significant result is the positive relationship between concentrated ownership and revenue performance in employee-leased companies.

We found little evidence for the effects of economic characteristics of companies on changes in the concentration of their ownership structures. The initial ownership structures and the amount of time elapsed since privatization seem to have much stronger effects on changes in the level of concentration. As for the emergence of strategic owners or dominance of the ownership structure by top management, again, the time elapsed since privatization is an important factor positively affecting such changes, as is a large non-managerial employee stake for the appearance of strategic investors. The negative relationship between gross profitability and the appearance of strategic investors may be an indication of a tendency for poor performance to stimulate sales of shares by non-managerial employees. Interestingly, leverage and investment intensity seem to positively affect the emergence of strategic investors and managerial dominance, respectively. The level of riskiness does not seem to be a factor behind these types of ownership changes.

In short, with respect to ownership endogeneity hypotheses and the hypotheses concerning the effects of ownership structure and its changes on performance, the results here tend to point to the following conclusion: that productivity is affected most strongly by the standard components of the production function (capital and labor), while ownership structure is most strongly determined by ... ownership structure.

VI. Conclusions and Policy Recommendations

One cannot analyze corporate governance mechanisms separately from the ownership changes which took place during and following privatization. The crystallizing ownership and corporate governance structure is important both for the post-privatization development of enterprises and for the economy in general due to a whole range of considerations:

- because the proper configuration of ownership structure in a corporation (as well as the delegation of those rights) provides an incentive for the restructuring and upgrading the efficiency;

- the initially formed structure of ownership distribution in a corporation influences the national specificity of a corporate governance model and, respectively, concrete legislation and government regulation;

- a “transparent” (clearly defined) model of corporate governance where the rights of all types of investors (shareholders, creditors) are protected is a key condition to attract investment at the micro-level;

- the model of the corporate governance and the structure of the capital market stipulate the differences in the forms of organization and financing of corporations, the industrial structure and the relationship between employers and employees;

- the corporate governance model is one of the major institutional components of economic growth.

Within this context we can draw broad practical conclusions for a transitional economy.

1. The most general conclusion which can be drawn from this study is that Russia and Poland are not unique or exempt from the rules which are valid for the majority of the transition economies. There is no unique trajectory in this sphere. All more or less typical trends accompanying the emergence of the corporate control and governance model, including the problems of the fight for control in privatized enterprises, are in one way or another characteristic for Russia and Poland as well.

2. The (corporate) ownership structure currently emerging in Russia (as well as in some other transitional economies) still appears intermediary, which makes it premature to draw any conclusions concerning its gravitation towards a certain classical model.

At the moment, we observe the presence of certain components of all the traditional models in this country. However, none of the models is present in its complete form. Thus, we observe the relatively dispersed ownership typical of the “Anglo-Saxon” model (but without the liquid market and strong institutional investors that characterize that model). We also observe a clear and steady trend to concentration of ownership and control (but without the adequate financing and efficient monitoring that characterize economies like those of Japan and Germany for which such ownership structures are typical). There are also elements of cross-ownership and the emergence of complex corporate structures of different types (though not gravitating toward a certain one). Such amorphous structures also create visible challenges to decision-making processes in such areas as legal and economic policies.

It should be noted that the existing uncertainty (instability) in the sphere of property rights leads to conservation (at least in the medium run) of unstable and transient forms of corporate governance in Russia. In this context there is no current alternative for development

of the legal mechanisms of corporate governance and for enforcement in the medium-run period.

Unlike the situation in Russia, where the currently emerging ownership and corporate governance structures still appear transient, in Poland the structures seem to have stabilized. All major changes occur mainly within existing shareholder categories. However, the peculiarity of the situation in Poland is that the heterogeneous character of Polish privatization and coexistence of a number of interests groups involved in the privatization process led to heterogeneity of emerging types of ownership structure and patterns of further property redistribution, as well as different corporate governance patterns. The latter remain, however, within the so-called Continental model.

Nevertheless, the Polish enterprise sector still has substantial capacities for ownership structure changes in future, due to a large number of cases of suspended privatization (a large number of commercialized enterprises that have not been sold yet) and still large SOE sector.

3. Conflicts between managers and outside shareholders (both large and small) within the framework of the "principal-agent" relationship are becoming very sharp. Problems related to the monitoring of managers by shareholders and consequences thereof are aggravated by the fact that managers, either directly, or through proxy, are acting both as insiders and outsiders of the corporation. The problem of an issuer's transparency becomes a crucial one not only for potential investors but also for de facto outside shareholders of the corporation.

In Russia, the principle importance of the problem of affiliation relationships should be noted. As far as the real organization of ownership (control) structure and financial flows of many large national companies are concerned, practically all the original data for empiric research in such areas as ownership (with respect to both managers and outsiders) and enterprises' financial operations can be viewed as dubious. Here, the problem of managers' ownership should be singled out: it is clear that the shares of directors cited in polls are far from real. Their actual power in the company can be based on a relatively small stock package (according to some estimates, a 15% stake often suffices), though there is a clear rend to maximization of formal control through stakes in the share capital. However, since the latter often occurs through affiliates and therefore cannot easily be traced, it is extremely hard to test various hypotheses about the role played by managers as formulated in classical papers.

In Poland, the above-mentioned problems are of much smaller scale, and the ownership structure of privatized companies is much more transparent, due, among other things, to the higher average level of corporate culture of most Polish companies and much tougher transparency and disclosure requirements and enforcement in practice. This makes it possible to test hypotheses on the managers' and other stakeholders' role in specific corporate governance configurations with a high degree of plausibility and accuracy.

4. The corporate governance problem is no less important from the standpoint of the financial system, which is understood as certain institutional arrangements providing for the transformation of savings into investments and allocating resources among alternative users within the industrial sector. Under the conditions of the transition economy, the development of an efficient system of financial institutions (especially banks) becomes especially important for the shaping of a national model of the corporate governance and financing of industrial corporations.

Their weakness in Russia became especially apparent during the financial crisis of 1998, which made theoretical discussions about the principal character of the national model of corporate governance (the American model versus the German one) useless. Correspondingly, the potential role of banks as an alternative mechanism of corporate control – in a situa-

tion in which other mechanisms that might have forced managers to act not only in their own interests are of limited use – also turned out to be of little relevance.

Poland has very tough and well-defined bank and investment fund supervision and prudential regulations, which in most cases ensures their proper behavior on financial markets. At the same time, the role of banks in privatisation of Polish companies and their involvement in corporate governance seem to be very modest. Banks regard the companies mostly as actual and potential debtors rather than a source of property (assets). Nevertheless, banks have important channels of monitoring the situation in many of the largest enterprises, so there is a potential for the growth of the banks' influence on companies' management.

5. From the standpoint of the applied analysis of corporate control issues, the situation in the transitional economy is ambiguous. On the one hand, with respect to the separation of ownership and control discussed in the literature since the days of Berle and Means, it is clear that large groups of formal owners were excluded from real authority involving control and management in Russian joint stock companies. This was especially typical for the first post-privatization years, before the law on joint-stock companies was enacted. On the other hand, the link between ownership, corporate control, and corporate governance is certainly real. This is clear in cases in which it is possible to identify different types of the "hard core" shareholders exercising control either directly or by means of affiliated entities ("coalitions" in terms of organization theory). Here, the key problem is to identify the hubs of real control in corporations with formally dispersed ownership structure.

Strictly speaking, refinements of corporate law are not sufficient to counter permanent mass theft (through trust schemes, transfer prices, agreements on sale for reduced prices, etc.), at least in the contemporary Russian situation. This means that at least conceptually (taking into account the economic content of the newly adopted norms of corporate legislation) our attention should be focused on improving enforcement and expanding the scope of monitoring of the activity of insiders (managers and major shareholders) by, or on behalf of, small outside shareholders. The point here is not absolute and unconditional support of the small shareholders. Maintaining a balance between the interests of various groups of shareholders is important, since the general principle of protection of rights of private property must prevail.

6. In some countries the role of "external" and "internal" mechanisms of corporate governance may essentially differ. In spite of the existing differences between their structures of corporate governance, all developed countries generated checks and balances in order to both protect interests of the investors and to provide for the sufficient independence and initiative of the managers. In countries in transition, the rather weak development of "external" mechanisms of corporate governance means that "internal" mechanisms are of particular importance. This is typical both for the countries with concentrated ownership and for those with an amorphous (non-transparent) structure of corporate control.

In Russia and in Poland, given low market liquidity, the problem of choice between the mechanism of "vote" and the mechanism of "exit" loses its dichotomous nature, since in essence there is no alternative: if it is impossible to sell one's shares, then it is necessary to upgrade the role of the "vote" mechanism. This means that active control by shareholders (voting) should become the predominant form (as compared to the passive control through the sale of shares). This also creates a special burden for the "external" legislative and "internal" (supervisory boards) mechanisms of corporate control; the problems of enforcement become especially relevant.

7. All transition countries have the two-tier system (i.e., executive board and supervisory board [or board of directors, as it is called in Russia]) of governance. The requirement to

institute a supervisory board is often linked to a company's size (Russia, Latvia, Poland) or is left to the discretion of shareholders (Bulgaria, Romania). In some countries the two-tier system is mandatory for all companies (Czech Republic, Hungary).

The supervisory board is usually considered as the main internal (or direct) mechanism of control. On the whole, however, the problem of the board's (managers, executive directors) loyalty in relation to joint-stock companies and their shareholders is rather acute in all countries. For this reason, representation of external shareholders in different bodies of joint-stock companies is of particular importance.

In many joint-stock companies in all countries there is a significant stratum of shareholders, who, while participating in the capital, do not participate in any corporate governance body or current management. These are usually individual shareholders – employees and external shareholders – while commercial banks and industrial enterprises (suppliers and buyers) tend to be more active. The latter is not surprising, because both indicated groups have more possibilities to ensure their shareholder rights by using financial and trade mechanisms of pressure.

In Poland, supervisory boards more frequently extend their activity beyond mere rubber-stamping of company financial statements. In most small and medium sized companies (SMEs), the widespread weak role of this body in the corporate governance system is reported in the surveys. However, in large firms, especially those with high ownership concentration, supervisory boards play a very important role not only in supervision of managers, but also as a forum for representation of interests of different shareholder and stakeholder groups and as a source of knowledge and advice for running the company. In this context, including so-called independent supervisory board members becomes crucial. This practice is not yet common in Polish companies, although it is recommended by the Best Practices Code.

8. For the top management of joint-stock companies in transition economies, one of the biggest problems lies in the attitudes of the majority of managers. These attitudes lead to fierce struggles for control (in "amorphous" or "insider" models) and resistance to the entry of new owners.

It is also important to take notice of another trend. The second half of the 1990s and the first years of the new millenium were characterized by a combination of the functions of managers and outsiders in many Russian and some Polish corporations. The managers gradually became major stockholders in corporations, while outsiders consolidating their control began to function as managers. This is a conflict-ridden process; however, there is a potential for the outcome of this process to yield the resolution of very bitter corporate conflicts and aid in the further stabilization of property rights in corporations. (In Poland, such trends have been observed mainly in SMEs with insider and/or dispersed outsider ownership, whereas large companies with concentrated outsider ownership are as a rule characterized by strict separation between ownership and management functions.)

9. The key specifics of the corporate governance models of Russia and Poland which have developed to date include the following:

- the permanent process of ownership redistribution in corporations (in Poland mostly within already existing ownership patterns);
- specific motivations of many insiders (managers and large stockholders alike) related to control over financial flows and stripping of corporate assets;
- the weak role played by traditional external corporate governance mechanisms (the securities market, bankruptcy mechanisms, and the market for corporate control);
- continuing considerable government shares in share capital and problems in the management and control areas related to these shares;

- inefficient and/or selective (politicized) government enforcement (in spite of relatively developed regulations in the area of protection of shareholders' rights).

Additionally, in the Russian Federation, regional governments play an active role as independent agents in corporate relationships (more specifically, as agents that operate in the framework of the conflict of interests as owners, while exercising their administrative powers as regulators at the same time).

10. Based on current trends, we can expect the following developments in the evolution of Russian and Polish corporate governance models:

- the concentration of share capital, leading to the consolidation of control (proposed in the mid-1990s for the transitional economies in the enforcement context);
- given the economic conditions, innovations in corporate law (protection of shareholder rights) have to a significant extent reached their limits;
- without adequate general measures in the enforcement area, further development of effective methods of shareholder rights protection may not be expected;
- in the absence of a developed system of competitive product markets, markets for capital and labor, and bankruptcy mechanisms, the methods of monitoring of management will remain inefficient.

In Russia, the following country-specific aspects should be noted:

- the prevalent separation of ownership from management cannot be expected in the medium term;
- there is a very low probability of a significant expansion of outside shareholder financing over the upcoming years;
- the current uncertain state of the national financial system does not allow for any reasonable predictions concerning the evolution of the Russian corporate governance system in the direction of any classical examples (the only reasonable assumption for the near future is that self-financing and appropriate types of control will continue to be widespread).

11. A whole series of empirical and legal data testified to the co-existence of two conflicting approaches in the emerging corporate governance system. One the one hand, concentration of share capital has reached levels that would suggest keeping shareholder protection to a necessary minimum. On the other hand, regulatory systems have tended to adopt the Anglo-Saxon maximization of legal protection of minority shareholders (although this adoption has, in at least some cases, been rather piecemeal, due to rather strong resistance of various industrial lobbies).

This combination created a unique situation of mutual neutralization. The gradual reduction in the number of small shareholders decreases the significance of broad means of protection of minority shareholders from the perspective of the corporate sector as a whole; indeed, the instruments of protection of small shareholders have been transformed into corporate greenmail instruments. At the same time, the creation of a developed system of shareholder protection, in turn, constrains the process of concentration of ownership. We should remember that it is the prerogative of large shareholders to protect their interests through further concentration.

On the other hand, recent signs of stabilization of the system give grounds for some optimism. In such an optimistic interpretation of events in the first years of the new millenium, one could see the development of a balance between the level of concentration (adjusted for affiliated relationship and alliances) and regulations protecting small shareholders.

12. Does all of the above mean that Russia lacks the economic and institutional prerequisites for solving the classical corporate governance problem? The model implying the

dominance of small shareholders' interests (or a strong emphasis in the law on absolute protection of them) is perhaps possible (at least theoretically). However, in practice, there are no conditions for it. Nonetheless, the role played by small shareholders is critical to ensure company "transparency." Some mixed model is probably optimal. The latter should take into consideration the aforementioned economic principles and trends to create a balance of interests of all shareholders (and, more broadly, stakeholders). At this point, the basis for such a model could be found in the principles developed by OECD.

Poland is much more advanced in building its corporate governance regime, which is, due to the heterogeneous character of Polish privatization methods and ownership structure patterns, rather a mixed model. While staying basically within the framework of the Continental model, it differs substantially from company to company, with different ownership structure patterns and combinations of main stakeholders' interests.

13. In the long-term perspective, one should take into account the global trend to unification of corporate governance models. In some sense, there is evidence that national legal designs of corporate governance models are of secondary importance, with the main driving factor behind developments being based upon economic rather than regulatory processes (particularly globalization).

In terms of applied approaches, this means the inexpedience (impossibility) of a legal design of a "national" corporate governance model that would match a certain classical example (as such examples in real life become increasingly amorphous). From the governmental perspective, the fundamental task is to consider corporate governance in the context of protection and guarantees of property rights (rights of investors, shareholders) and ensuring the balance of interests (rights) for all the participants in the corporate relationship.

From the perspective of coping with such challenges as regulation and ensuring equity among shareholders, it would be appropriate to identify as priorities such areas as: mergers and takeovers (especially anti-trust control over big deals); the role of affiliated structures, capital groups and beneficiary ownership; owners' responsibility, and bankruptcy regulation and practice. In the absence of efficiently functioning enforcement infrastructure and the political will to ensure such enforcement, any attempts to advance in these areas would clearly be senseless.

14. Not a single transition country has a corporate governance regime (in the broad sense, encompassing both regulation and enforcement) which can be evaluated as highly developed. This does not mean that there has not been significant progress in the field of new legislation and institutions. According to the EBRD, Russia and Poland have actually joined the group of leaders in the area of coverage of commercial laws. However, there is still a lag as regards the "efficiency" of commercial laws, or enforcement.

At the current stage the major country-specific objectives of regulations can be singled out. For Russia the priorities are:

- to fill in the legal gaps characteristic of the Russian corporate legislation (such as regulation of insider trading, affiliated persons and relationships, corporate reorganizations etc.);
- to institute more rigid regulation of relations between legally independent but economically connected companies (for example, the definition of a "group" in French law could be applied);
- to address procedural issues of the corporate relationships (authority and procedure of shareholders' meetings, boards of directors, new securities issues, etc.);
- to institute requirements concerning the issuers' transparency (although at present the quantitative approach to the disclosure of information prevails, the qualitative aspects requiring the reliability of the information are no less important);

- to strengthen the system of sanctions for violations of the corporate law provisions;
- to enhance the authority and coordination of the governmental regulatory bodies, and
- to enhance the scope and quality of judicial control over the companies' activity.

For Poland, they are:

- to liquidate differences in corporate governance regimes for different groups of companies originating mainly from their "privatization history" (e.g., different requirements concerning the representation of employees on supervisory boards, depending on whether the company was once in the state sector or not);
- to channel stakeholders' interests in such a way as to harmonize them to a greater extent with the interests of the company;
- to reduce legal possibilities for abuse of different shareholders' groups, both majority and minority (for example, quorum requirements for shareholders' meetings must be introduced and requirements for notification concerning shareholders' meetings strengthened);
- to resolve the problem of the capital market liquidity (among others by harmonizing privatization policy with regulations dealing with corporate governance issues);
- to strengthen insolvency procedures;
- to strengthen the instructive character of legal acts that regulate corporate governance issues;
- to strengthen corporate law enforcement (including strengthening of relevant capacities of courts and prosecutors' offices), and
- to complete privatization (both of remaining state-owned enterprises and commercialized companies that remain in the hands of the state).

15. It is obvious that any single law on companies simply cannot cover the whole spectrum of corporate problems. Correspondingly, the sole governmental regulatory body which would be able to efficiently and legally intervene in case of disputes arising in connection with relationships between the subjects of the corporate governance and control should become the most important element of the law enforcement system. Of course the role of political will is also quite obvious.

Moreover, at the present stage a new, systemic approach to the development and updating of legislation is needed, as well as harmonization between the provisions belonging to different branches of law (administrative, civil, civil procedural, criminal and criminal procedural) regulating the activity of corporations. Another crucial factor now is the general legal environment in which companies function, as well as systematization of the related regulatory documents (on the securities market, bankruptcy, rules on mergers and acquisitions, protection of investors, investment institutions, banks, etc.).

16. The fact that during the last ten years Russia and Poland have moved toward market economy institutions is undeniable. Nevertheless, Russia has been plagued by: the chronic incompleteness of institutional reforms; the system of soft budgetary constraints and hierarchical bargaining between the state and large corporations; insecurity of property rights; noncompliance with contracted terms; inefficiency and corruption of public administration; state enforcement as a measure of selective influence, and private enforcement often taking criminal forms. The progress achieved in certain important areas (progressive corporate legislation of 1996-2002, introduction of a new bankruptcy mechanism in 2003, corporate securities market regulation, anti-trust legislation) was constrained as a result of these problems, and therefore these mechanisms could not function as they were supposed to. This became absolutely apparent by early 2000. The majority of programs of institutional reforms adopted in the second half of the 1990s in fact remained on paper. It is necessary either to accept this legacy of 1990s, or to prepare for a new stage of tough institutional reforms.

Poland has achieved much more substantial success in building the market economy than Russia. Polish privatization and corporate governance legislation is very extensive and covers all important spheres of ownership transformation, as well as company and capital market operation. At the same time, the legislation seems to be not fully adequate. In some spheres there is overregulation, in others underregulation and misregulation. Some provisions of the law have a political character and are intended to gain support of various actors, which has prepared fertile ground for the growth of clientelism. A coherent concept of ownership transformation and development of private property relations still does not exist. Some very important issues of interrelations between privatization and desired corporate governance models and mechanisms are still unresolved. One should also mention contradictions in the policy of the state (especially concerning the securities market, external institutional investors, and the role of insiders).

The progress in overcoming of many of these problems to a considerable degree depends on the volume, efficiency and intensity of the institutional regulation. Sharp stepping up of the activities directed toward the protection of investors' rights (including infrastructural measures) is necessary under the current conditions as a crucial factor in restoring the investment attractiveness of the country. It is obvious that real effects can be achieved only in conjunction with other measures of the macroeconomic and institutional character.

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Appendices

Appendix 1. Questionnaire on Mechanisms of Corporate Governance

Participation in Decision Making at the Annual General Meetings of the Company

1. Is the voting right of all shares equal, i.e., one share one vote? Or, are there some categories of shares which have a higher voting right than other categories?
2. Is postal voting for the Annual General Meetings possible?
3. Is proxy voting for the Annual General Meeting possible?
4. What is the quorum required for AGM meetings?
5. What is the majority needed for AGM decisions? Is a "supermajority" (e.g. 66% or 75%) needed for some important decisions? Examples?
6. How is the AGM announced to shareholders? In newspapers (what kind of papers – national, regional, etc?) or by sending letters to shareholders?
7. Supervisory Board (or Board of Directors in Russia) and Management Board (or Executive Board)
8. Are there "independent" directors on the Supervisory Board? Is the practice common?
9. Are employees represented on the Supervisory Board or the Management Board? What proportion of Board members are employees? Is this representation required by law?
10. What is the usual tenure (length of office) of the General Manager of the Co.?
11. Can the Supervisory Board, or the Management Board or employees stop a hostile takeover)?

Minority shareholders' rights

12. Can owners of substantial minority stakes elect a board member? Or is 51% of votes sufficient to elect a Supervisory Board member?
13. Does the ownership of 33% of shares entitle the owner to any specific rights (e.g., vetoing certain decisions of the Board, or electing a member to the Board)?
14. Can minority owners take legal action against directors for some of their decisions (oppressed minority rule)?
15. In case of capital increase, do existing shareholders have automatic right to buy new shares – and only if they refuse to do so, these shares can be sold to others?

Transparency and Monitoring Issues

16. What is the threshold for the legal requirement to disclose the identity of shareholders? (5%, 10%, 33%, 50%?)
17. Is it possible to have "nominee shareholders" and is it required by law to disclose the identity of the real owner or the nominee?
18. Is there a requirement to make an offer to all shareholders once important ownership thresholds are passed (33% or 50%)?

19. How frequently is the reporting requirement (annual, quarterly, monthly?) for companies quoted on the stock market and those not quoted? Is the requirement of the Stock Exchange more stringent than that required by law for companies not quoted on the Exchange..
20. Are salaries, bonuses, and shareholding of top managers and Supervisory Board members reported in the annual accounts of the company – or elsewhere?
21. Is there a legal requirement for Joint Stock Companies to be audited by independent auditors?

Others

22. Are share prices on the stock exchange different from trading off the exchange? Are a significant amount of shares traded off the exchange?
23. Is it explicitly against the law for the managers to engage in collusion with other parties to artificially change the share prices? If so, what is the penalty for infringement? Fines, suspension from managerial posts for a period of time, or jail?
24. Is it explicitly against the law for those involved in share trading to use confidential information (insider trading)? If so, what is the penalty for infringement?
25. Is there an independent share registry in operation? What is it called? Is it the responsibility of a joint stock company or its shareholders to keep the share registry informed of any changes in ownership (above a certain level)?
26. How seriously are the laws on above issues enforced?
27. Is there a law requiring companies to pay shareholders a % of their profits as dividends.

Appendix 2. Descriptive Statistics of 2001 Questionnaire (Russia)

Table A2.1

Q43_98. The Number of Employed in Industrial Production. 1998. range			
	Frequency	Percent	Valid Percent
No Answer	5	5	
Less Than 100	6	6	6.32
101-500	40	40	42.11
501-1000	26	26	27.37
1001-1500	16	16	16.84
1501-2000	2	2	2.11
More Than 2000	5	5	5.26
Total	100	100	100

Table A2.2

Q43_99. The Number of Employed in Industrial Production. 1999. range			
	Frequency	Percent	Valid Percent
No Answer	6	6	
Less Than 100	6	6	6.38
101-500	43	43	45.74
501-1000	23	23	24.47
1001-1500	15	15	15.96
1501-2000	2	2	2.13
More Than 2000	5	5	5.32
Total	100	100	100

Table A2.3

Q43_00. The Number of Employed in Industrial Production. 2000. range			
	Frequency	Percent	Valid Percent
No Answer	7	7	
Less Than 100	8	8	8.60
101-500	37	37	39.78
501-1000	25	25	26.88
1001-1500	17	17	18.28
1501-2000	2	2	2.15
More Than 2000	4	4	4.30
Total	100	100	100

Table A2.4

Q1. Year of Privatization			
	Frequency	Percent	Valid Percent
1990	4	4	4
1991	2	2	2
1992	45	45	45
1993	33	33	33
1994	11	11	11
1995	3	3	3
1996	2	2	2
Total	100	100	100

Table A2.5

Q2. The Type of Privilege			
	Frequency	Percent	Valid Percent
No answer	12	12	
The First	29	29	32.95
The Second	55	55	62.50
The third	4	4	4.55
Total	100	100	100

Table A2.6

Q3. Share of Workers in the Share Capital			
	Frequency	Percent	Valid Percent
No answer	10	10	
0-5%	11	11	12.22
5-10%	5	5	5.56
10-15%	6	6	6.67
15-20%	11	11	12.22
20-25%	12	12	13.33
25-30%	6	6	6.67
30-35%	5	5	5.56
35-40%	11	11	12.22
40-45%	4	4	4.44
45-50%	3	3	3.33
50-55%	4	4	4.44
55-60%	2	2	2.22
60-65%	1	1	1.11
65-70%	1	1	1.11
70-75%	3	3	3.33
85-90%	5	5	5.56
Total	100	100	100

Table A2.7

Q4. Including Collective Trust			
	Frequency	Percent	Valid Percent
No Answer	80	80	
0%	14	14	70.00
0-5%	1	1	5.00
5-10%	1	1	5.00
15-20%	1	1	5.00
30-35%	1	1	5.00
35-40%	1	1	5.00
65-70%	1	1	5.00
Total	100	100	100

Table A2.8

Q5. Share of Managers in Share Holders			
	Frequency	Percent	Valid Percent
No answer	14	14	
0%	3	3	3.49
0-5%	31	31	36.05
5-10%	21	21	24.42
10-15%	14	14	16.28
15-20%	7	7	8.14
20-25%	2	2	2.33
25-30%	2	2	2.33
30-35%	2	2	2.33
35-40%	1	1	1.16
40-45%	2	2	2.33
45-50%	1	1	1.16
Total	100	100	100

Table A2.9

Q6. Including General Director			
	Frequency	Percent	Valid Percent
No answer	14	14	
0%	5	5	5.81
0-5%	58	58	67.44
5-10%	13	13	15.12
10-15%	6	6	6.98
15-20%	3	3	3.49
25-30%	1	1	1.16
Total	100	100	100

Table A2.10

Q7. At the Firm's Balance			
	Frequency	Percent	Valid Percent
No answer	53	53	
0%	33	33	70.21
0-5%	6	6	12.77
5-10%	2	2	4.26
10-15%	3	3	6.38
45-50%	1	1	2.13
50-55%	1	1	2.13
65-70%	1	1	2.13
Total	100	100	100

Table A2.11

Q8. Supplier's and Consumer's Share in SC			
	Frequency	Percent	Valid Percent
No answer	56	56	
0%	22	22	50.00
0-5%	5	5	11.36
5-10%	3	3	6.82
10-15%	1	1	2.27
15-20%	2	2	4.55
20-25%	1	1	2.27
25-30%	2	2	4.55
30-35%	1	1	2.27
35-40%	1	1	2.27
40-45%	2	2	4.55
45-50%	2	2	4.55
50-55%	1	1	2.27
55-60%	1	1	2.27
Total	100	100	100

Table A2.12

Q9. Share of Other Enterprises in Share Capital			
	Frequency	Percent	Valid Percent
No answer	45	45	
0%	13	13	23.64
0-5%	5	5	9.09
5-10%	6	6	10.91
10-15%	4	4	7.27
15-20%	4	4	7.27
20-25%	6	6	10.91
25-30%	1	1	1.82
30-35%	2	2	3.64
35-40%	2	2	3.64
40-45%	2	2	3.64
45-50%	1	1	1.82
50-55%	5	5	9.09
55-60%	2	2	3.64
70-75%	1	1	1.82
85-90%	1	1	1.82
Total	100	100	100

Table A2.13

Q10. Share of Holding Companies and FIG in Share Capital			
	Frequency	Percent	Valid Percent
No answer	66	66	
0%	25	25	73.53
0-5%	1	1	2.94
10-15%	1	1	2.94
15-20%	3	3	8.82
25-30%	1	1	2.94
75-80%	1	1	2.94
80-85%	1	1	2.94
85-90%	1	1	2.94
Total	100	100	100

Table A2.14

Q11. Share of Commercial Banks in Share Capital			
	Frequency	Percent	Valid Percent
No answer	67	67	
0%	24	24	72.73
0-5%	3	3	9.09
5-10%	2	2	6.06
10-15%	3	3	9.09
60-65%	1	1	3.03
Total	100	100	100

Table A2.15

Q12. Share of Investments Banks in Share Capital			
	Frequency	Percent	Valid Percent
No answer	57	57	
0%	19	19	44.19
0-5%	5	5	11.63
5-10%	7	7	16.28
10-15%	3	3	6.98
15-20%	2	2	4.65
20-25%	2	2	4.65
25-30%	1	1	2.33
30-35%	2	2	4.65
40-45%	2	2	4.65
Total	100	100	100

Table A2.16

Q13. Share of Pension Fund in Share Capital			
	Frequency	Percent	Valid Percent
No answer	70	70	
0%	29	29	96.67
0-5%	1	1	3.33
Total	100	100	100

Table A2.17

Q14. Share of Insurance Company in Share Capital			
	Frequency	Percent	Valid Percent
No answer	71	71	
0%	27	27	93.10
0-5%	2	2	6.90
Total	100	100	100

Table A2.18

Q15. Share of Exterior Natural Person in Share Capital			
	Frequency	Percent	Valid Percent
No answer	31	31	
0%	5	5	7.25
0-5%	13	13	18.84
5-10%	9	9	13.04
10-15%	4	4	5.80
15-20%	4	4	5.80
20-25%	9	9	13.04
25-30%	8	8	11.59
30-35%	3	3	4.35
40-45%	3	3	4.35
45-50%	2	2	2.90
50-55%	3	3	4.35
55-60%	1	1	1.45
60-65%	1	1	1.45
65-70%	2	2	2.90
70-75%	1	1	1.45
80-85%	1	1	1.45
Total	100	100	100

Table A2.19

Q16. Share of Foreign Holders in Share Capital			
	Frequency	Percent	Valid Percent
No answer	68	68	
0%	26	26	81.25
0-5%	1	1	3.13
5-10%	1	1	3.13
15-20%	2	2	6.25
35-40%	2	2	6.25
Total	100	100	100

Table A2.20

Q17. Share of State in Share Capital			
	Frequency	Percent	Valid Percent
No answer	45	45	
0%	17	17	30.91
0-5%	5	5	9.09
5-10%	7	7	12.73
10-15%	1	1	1.82
15-20%	7	7	12.73
20-25%	5	5	9.09
25-30%	5	5	9.09
35-40%	2	2	3.64
40-45%	2	2	3.64
50-55%	3	3	5.45
60-65%	1	1	1.82
Total	100	100	100

Table A2.21

Q18. Including RF			
	Frequency	Percent	Valid Percent
No answer	63	63	
0%	16	16	43.24
0-5%	2	2	5.41
5-10%	3	3	8.11
10-15%	1	1	2.70
15-20%	2	2	5.41
20-25%	4	4	10.81
25-30%	4	4	10.81
35-40%	2	2	5.41
40-45%	1	1	2.70
50-55%	2	2	5.41
Total	100	100	100

Table A2.22

Q19. Did Joint-Stock Company Pay off Dividends in 1998-99?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
Yes	19	19	19.39
No	79	79	80.61
Total	100	100	100

Table A2.23

Q20. Has JSC an Independent Registrar?			
	Frequency	Percent	Valid Percent
No Answer	1	1	
Yes	70	70	70.71
No	29	29	29.29
Total	100	100	100

Table A2.24

Q21. Has JSC Arranged Their Redemption of Stock			
	Frequency	Percent	Valid Percent
No Answer	2	2	
Yes	37	37	37.76
No	61	61	62.24
Total	100	100	100

Table A2.25

Q22. Did JSC Sell (Transfer) Their Stock to Workers?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
yes	25	25	25.51
No	73	73	74.49
Total	100	100	100

Table A2.26

Q23. Did JSC Arrange New Issue in 1996-1999?			
	Frequency	Percent	Valid Percent
Yes	12	12	12
No	88	88	88
Total	100	100	100

Table A2.27

Q24. Did JSC Arrange Open Selling Their Stock in 1996-1999?			
	Frequency	Percent	Valid Percent
Yes	9	9	9
No	91	91	91
Total	100	100	100

Table A2.28

Q25. Has JSC Arranged Corporate Bonds?			
	Frequency	Percent	Valid Percent
No answer	2	2	
No	98	98	100.00
Total	100	100	100

Table A2.29

Q26. How Many Shareholders Having More Than 25% of Stock Capital Exists?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
1	27	27	27.55
2	1	1	1.02
No	70	70	71.43
Total	100	100	100

Table A2.30

Q27. Has a Shareholder Having More Than 50% of Share Capital?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
Yes	7	7	7.14
No	91	91	92.86
Total	100	100	100

Table A2.31

Q28. Has JSC a Shareholder Having More Than 75% of Share Capital?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
Yes	4	4	4.08
No	94	94	95.92
Total	100	100	100

Table A2.32

Q29. Increasing of Regional Administration's Share - is Good for JSC?			
	Frequency	Percent	Valid Percent
No Answer	7	7	
Yes	20	20	21.51
No	73	73	78.49
Total	100	100	100

Table A2.33

Q30. Since what Year General Director Worked as a GD?			
	Frequency	Percent	Valid Percent
No Answer	3	3	
Ealier Than 1990	28	28	28.87
1990	4	4	4.12
1992	11	11	11.34
1993	6	6	6.19
1994	5	5	5.15
1995	5	5	5.15
1996	11	11	11.34
1997	12	12	12.37
1998	9	9	9.28
1999	6	6	6.19
Total	100	100	100

Table A2.34

Q31. How Many General Stockholders' Meeting did During Last 2 Years?			
	Frequency	Percent	Valid Percent
No Answer	1	1	
0	2	2	2.02
1	1	1	1.01
2	73	73	73.74
3	17	17	17.17
4	6	6	6.06
Total	100	100	100

Table A2.35

Q32. How Many Members Committee of Directors (CD) Consist of?			
	Frequency	Percent	Valid Percent
0	1	1	1
3	2	2	2
4	1	1	1
5	16	16	16
6	3	3	3
7	45	45	45
8	1	1	1
9	23	23	23
10	1	1	1
11	5	5	5
15	1	1	1
17	1	1	1
Total	100	100	100

Table A2.36

Q33. Number of Employees of JSC in CD			
	Frequency	Percent	Valid Percent
0	3	3	3
1	6	6	6
2	15	15	15
3	14	14	14
4	15	15	15
5	16	16	16
6	12	12	12
7	16	16	16
8	1	1	1
9	1	1	1
10	1	1	1
Total	100	100	100

Table A2.37

Q34. Number of Employees of Subsidiary in CD			
	Frequency	Percent	Valid Percent
No Answer	12	12	
0	77	77	87.50
1	4	4	4.55
2	4	4	4.55
3	2	2	2.27
5	1	1	1.14
Total	100	100	100

Table A2.38

Q35. Number off Big Private Shareholders in CD			
	Frequency	Percent	Valid Percent
No Answer	10	10	
0	41	41	45.56
1	13	13	14.44
2	17	17	18.89
3	8	8	8.89
4	6	6	6.67
5	2	2	2.22
6	2	2	2.22
7	1	1	1.11
Total	100	100	100

Table A2.39

Q36. Number of State In CD			
	Frequency	Percent	Valid Percent
No Answer	9	9	
0	53	53	58.24
1	23	23	25.27
2	14	14	15.38
3	1	1	1.10
Total	100	100	100

Table A2.40

Q37. How Many Members of Committee of Directors Have Working at JSC More than 5 Years?			
	Frequency	Percent	Valid Percent
No Answer	2	2	
0	7	7	7.14
1	6	6	6.12
2	14	14	14.29
3	13	13	13.27
4	13	13	13.27
5	15	15	15.31
6	14	14	14.29
7	13	13	13.27
8	2	2	2.04
9	1	1	1.02
Total	100	100	100

Table A2.41

Q38. How Many Stock (% of Authorized Capital Stock) Have 5 Biggest Shareholders?			
	Frequency	Percent	Valid Percent
No Answer	8	8	
0%	8	8	8.70
0-5%	3	3	3.26
5-10%	6	6	6.52
10-15%	4	4	4.35
15-20%	6	6	6.52
20-25%	5	5	5.43
25-30%	5	5	5.43
30-35%	4	4	4.35
35-40%	8	8	8.70
40-45%	3	3	3.26
45-50%	5	5	5.43
50-55%	3	3	3.26
55-60%	5	5	5.43
60-65%	7	7	7.61
65-70%	6	6	6.52
70-75%	8	8	8.70
75-80%	2	2	2.17
80-85%	1	1	1.09
>85%	3	3	3.26
Total	100	100	100

Table A2.42

Q39. How Many Stock (% of Authorized Capital Stock) Have 10 Biggest Shareholders?			
	Frequency	Percent	Valid Percent
No Answer	12	12	
0%	13	13	14.77
0-5%	1	1	1.14
5-10%	2	2	2.27
10-15%	6	6	6.82
20-25%	4	4	4.55
25-30%	4	4	4.55
30-35%	4	4	4.55
35-40%	4	4	4.55
40-45%	4	4	4.55
45-50%	7	7	7.95
50-55%	5	5	5.68
55-60%	2	2	2.27
60-65%	8	8	9.09
65-70%	6	6	6.82
70-75%	9	9	10.23
75-80%	4	4	4.55
80-85%	2	2	2.27
>85%	5	5	5.68
Total	100	100	100

Table A2.43

Q40. How Many Shareholders Have More Than 5% of Share Capital?			
	Frequency	Percent	Valid Percent
No Answer	6	6	
0	20	20	21.28
1	16	16	17.02
2	18	18	19.15
3	13	13	13.83
4	13	13	13.83
5	6	6	6.38
6	5	5	5.32
7	2	2	2.13
30	1	1	1.06
Total	100	100	100

Table A2.44

Q41. How Many Stock (% of Authorized Capital Stock) Have Shareholders Having More Than 5% of Share Capital?			
	Frequency	Percent	Valid Percent
No Answer	12	12	
0%	21	21	23.86
0-5%	1	1	1.14
5-10%	4	4	4.55
10-15%	2	2	2.27
15-20%	5	5	5.68
20-25%	4	4	4.55
25-30%	4	4	4.55
30-35%	4	4	4.55
35-40%	6	6	6.82
40-45%	3	3	3.41
45-50%	4	4	4.55
50-55%	3	3	3.41
55-60%	3	3	3.41
60-65%	8	8	9.09
65-70%	4	4	4.55
70-75%	7	7	7.95
75-80%	1	1	1.14
80-85%	1	1	1.14
>85%	3	3	3.41
Total	100	100	100

Appendix 3: List of Variables (Russia)

Ins – Share of insiders at shareholders structure;
w_ins – Share of workers within insiders at shareholders structure;
m_ins – Share of managers within insiders at shareholders structure;
nonfin – Share Russian enterprises and holdings at shareholders structure;
fin – Share of financial institutions at shareholders structure;
fis – Share of exterior natural persons at shareholders structure;
for – Share of foreign shareholders at shareholders structure;
outs – Share of outsiders at shareholders structure;
for_outs – Share of foreign shareholders within outsiders at shareholders structure;
rus_outs – Share of Russian juridical person within outsiders at shareholders structure;
fin_outs – Share of financial institutions within outsiders at shareholders structure;
nf_outs – Share of non-financial organizations within outsiders at shareholders structure;
state – Share of State at shareholders structure;
st_rf – Share of Federal State at shareholders structure;
sd_ins – Share of insiders at Committee of Directors;
sd_fis – Share of representatives of big private shareholders at Committee of Directors;
sd_state – Share of State at Committee of Directors;
cr_p – Change of account payable to supplier;
cr_b – Change of account payable to banks;
pa – Ratio between profits and fixed assets;
pg – Ratio between profits and proceeds;
ga – Ratio between proceeds and fixed assets;
own_5 – % of shares that 5 biggest shareholders own;
own_10 – % of shares that 10 biggest shareholders own;

own_5_b – % of shares that shareholders own more than 5% of shares have
ge_r – Ratio between proceeds and the total number of employees at an enterprise in prices of 1998;
ge2_r – Ratio between proceeds and the number of employed in industrial production in prices of 1998;
Priv_92 – Dummy variable equals 1 if firm had been privatized before 1992 or in 1992 and equals 0 otherwise;
Priv_93 – Dummy variable equals 1 if firm had been privatized before 1993 or in 1993 and equals 0 otherwise;
CCI_50 – corporate conflicts intensity index.

Appendix 4: The Results of Empirical Analysis Firm's Efficiency Dependence on Their Institutional Characteristics (Russia)

Table A4.1

Estimated covariances = 88				Number of obs =		236
Estimated autocorrelations = 0				Number of groups =		88
Estimated coefficients = 5				Obs per group: min =		1
				avg =		2.681818
				max =		3
				Wald chi2(4) =		824.89
Log likelihood = -1092.455				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
cci_50_pr	.0415848	.0201013	2.07	0.039	.002187	0.080983
own_5_pr	-.3585954	.0214746	-16.70	0.000	-.4006848	-0.31651
priv_92	-7.520229	1.441754	-5.22	0.000	-10.34601	-4.69444
w_ins_pr	-.307303	.0366976	-8.37	0.000	-.3792289	-0.23538
_cons	91.09517	2.875949	31.67	0.000	85.45841	96.73192

Table A4.2

Estimated covariances = 98				Number of obs = 262		
Estimated autocorrelations = 0				Number of groups = 98		
Estimated coefficients = 2				Obs per group: min = 1		
				avg = 2.673469		
				max = 3		
				Wald chi2(1) = 151.49		
Log likelihood = -1251.205				Prob > chi2 = 0.0000		
ge_r	**Coef.**	**Std. Err.**	**z**	**P>|z|**	**[95% Conf. Interval]**	
own_10	-23.76285	1.930637	-12.31	0.000	-27.54683	-19.97887
_cons	59.43395	1.266555	46.93	0.000	56.95154	61.91635

Table A4.4

Estimated covariances = 98				Number of obs =		261
Estimated autocorrelations = 0				Number of groups =		98
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.663265
				max =		3
				Wald chi2(1) =		106.82
Log likelihood = -1228.088				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
priv_92	-13.05727	1.263343	-10.34	0.000	-15.53337	-10.5812
_cons	46.45276	.7951867	58.42	0.000	44.89422	48.01129

Table A4.5

Estimated covariances =	92	Number of obs =	226
Estimated autocorrelations =	0	Number of groups =	92
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.456522
		max =	3
		Wald chi2(1) =	8.67E+17
Log likelihood	= -1029.886	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
cr_p	-1.156467	1.24e-09	.	0.000	-1.156467	-1.15647
_cons	40.54335	1.24e-09	.	0.000	40.54335	40.54335

Table A4.6

Estimated covariances =	88	Number of obs =	236
Estimated autocorrelations =	0	Number of groups =	88
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.681818
		max =	3
		Wald chi2(1) =	31.5
Log likelihood	= -1101.766	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
w_ins	-0.20457	0.03645	-5.61	0.000	-0.2714	-0.1331
_cons	58.6414	2.9773	19.70	0.000	52.806	64.4768

Table A4.7

Estimated covariances =	46	Number of obs =	123
Estimated autocorrelations =	0	Number of groups =	46
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.673913
		max =	3
		Wald chi2(1) =	21.2
Log likelihood	= -588.7265	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
fin	.3624963	.0787278	4.60	0.000	.2081926	0.5168
_cons	36.81058	1.301729	28.28	0.000	34.25924	39.36193

Table A4.8

Estimated covariances =	67	Number of obs =	179
Estimated autocorrelations =	0	Number of groups =	67
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.671642
		max =	3
		Wald chi2(1) =	86.22
Log likelihood	= -833.2324	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
fis	-.3085606	.0332306	-9.29	0.000	-.3736914	-0.24343
_cons	46.94168	1.016925	46.16	0.000	44.94855	48.93482

Table A4.9

Estimated covariances =	32	Number of obs =	84
Estimated autocorrelations =	0	Number of groups =	32
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.625
		max =	3
		Wald chi2(1) =	36.72
Log likelihood =	-401.553	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
for	.6660759	.109918	6.06	0.000	.4506406	0.881511
_cons	40.41526	.7705232	52.45	0.000	38.90507	41.92546

Table A4.10

Estimated covariances =	36	Number of obs =	95
Estimated autocorrelations =	0	Number of groups =	36
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.638889
		max =	3
		Wald chi2(1) =	36.62
Log likelihood =	-453.4851	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
for_outs	0.43363	0.071655	6.05	0.000	0.29319	0.5741
_cons	40.5372	.7613263	53.25	0.000	39.04503	42.02937

Table A4.11

Estimated covariances =	72	Number of obs =	187
Estimated autocorrelations =	0	Number of groups =	72
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.597222
		max =	3
		Wald chi2(1) =	175.78
Log likelihood =	-885.7676	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
nf_outs	0.25811	0.019468	13.26	0.000	0.21995	0.29627
_cons	34.154	.9698911	35.21	0.000	32.25304	36.05495

Table A4.12

Estimated covariances =	54	Number of obs =	143
Estimated autocorrelations =	0	Number of groups =	54
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.648148
		max =	3
		Wald chi2(1) =	17.59
Log likelihood =	-670.3335	Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
state	-.2860316	.0682039	-4.19	0.000	-.4197089	-0.15235
_cons	48.7421	1.14514	42.56	0.000	46.49766	50.98653

Table A4.13

Estimated covariances =	54			Number of obs =		143
Estimated autocorrelations =	0			Number of groups =		54
Estimated coefficients =	2			Obs per group: min =		1
				avg =		2.648148
				max =		3
				Wald chi2(1) =		22.27
Log likelihood	= -668.956			Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
st_rf	-.3191922	.0676317	-4.72	0.000	-.4517479	-0.18664
_cons	49.12574	1.040103	47.23	0.000	47.08717	51.1643

Table A4.14

Estimated covariances =	98			Number of obs =		261
Estimated autocorrelations =	0			Number of groups =		98
Estimated coefficients =	2			Obs per group: min =		1
				avg =		2.663265
				max =		3
				Wald chi2(1) =		150.58
Log likelihood	= -1238.27			Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
own_10	-.2375317	.0193573	-12.27	0.000	-.2754713	-0.19959
_cons	59.31105	1.276233	46.47	0.000	56.80968	61.81242

Table A4.15

Estimated covariances =	98			Number of obs =		261
Estimated autocorrelations =	0			Number of groups =		98
Estimated coefficients =	2			Obs per group: min =		1
				avg =		2.663265
				max =		3
				Wald chi2(1) =		106.82
Log likelihood	= -1228.088			Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
priv_92	-13.05727	1.263343	-10.34	0.000	-15.53337	-10.5812
_cons	46.45276	.7951867	58.42	0.000	44.89422	48.01129

Table A4.16

Estimated covariances =	92			Number of obs =		226
Estimated autocorrelations =	0			Number of groups =		92
Estimated coefficients =	2			Obs per group: min =		1
				avg =		2.456522
				max =		3
				Wald chi2(1) =		8.67E+17
Log likelihood	= -1029.886			Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
cr_p	-1.156467	1.24e-09	.	0.000	-1.156467	-1.15647
_cons	40.54335	1.24e-09	.	0.000	40.54335	40.54335

Table A4.17

Estimated covariances = 88			Number of obs =	236
Estimated autocorrelations = 0			Number of groups =	88
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.681818
			max =	3
			Wald chi2(1) =	31.5
Log likelihood = -1101.766			Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
w_ins	-.2045726	.0364503	-5.61	0.000	-.2760139	-0.13313
_cons	58.64139	2.977299	19.70	0.000	52.806	64.47679

Table A4.18

Estimated covariances = 86			Number of obs =	233
Estimated autocorrelations = 0			Number of groups =	86
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.709302
			max =	3
			Wald chi2(1) =	29.05
Log likelihood = -1101.462			Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
m_ins	.1985946	.036849	5.39	0.000	.1263718	0.270817
_cons	38.44795	.9681658	39.71	0.000	36.55038	40.34552

Table A4.19

Estimated covariances = 46			Number of obs =	123
Estimated autocorrelations = 0			Number of groups =	46
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.673913
			max =	3
			Wald chi2(1) =	21.2
Log likelihood = -588.7265			Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
fin	.3624963	.0787278	4.60	0.000	.2081926	0.5168
_cons	36.81058	1.301729	28.28	0.000	34.25924	39.36193

Table A4.20

Estimated covariances = 67			Number of obs =	179
Estimated autocorrelations = 0			Number of groups =	67
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.671642
			max =	3
			Wald chi2(1) =	86.22
Log likelihood = -833.2324			Prob > chi2 =	0

ge_r	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
fis	-.3085606	.0332306	-9.29	0.000	-.3736914	-0.24343
_cons	46.94168	1.016925	46.16	0.000	44.94855	48.93482

Table A4.21

Estimated covariances = 32				Number of obs =		84
Estimated autocorrelations = 0				Number of groups =		32
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.625
				max =		3
				Wald chi2(1) =		36.72
Log likelihood = -401.553				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
for	.6660759	.109918	6.06	0.000	.4506406	0.881511
_cons	40.41526	.7705232	52.45	0.000	38.90507	41.92546

Table A4.22

Estimated covariances = 36				Number of obs =		95
Estimated autocorrelations = 0				Number of groups =		36
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.638889
				max =		3
				Wald chi2(1) =		36.62
Log likelihood = -453.4851				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
for_outs	.4336346	.0716551	6.05	0.000	.2931932	0.574076
_cons	40.5372	.7613263	53.25	0.000	39.04503	42.02937

Table A4.23

Estimated covariances = 77				Number of obs =		201
Estimated autocorrelations = 0				Number of groups =		77
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.61039
				max =		3
				Wald chi2(1) =		362.2
Log likelihood = -948.5792				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
rus_outs	.2458408	.0129175	19.03	0.000	.2205231	0.271159
_cons	24.7703	.5960724	41.56	0.000	23.60202	25.93858

Table A4.24

Estimated covariances = 72				Number of obs =		187
Estimated autocorrelations = 0				Number of groups =		72
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.597222
				max =		3
				Wald chi2(1) =		175.78
Log likelihood = -885.7676				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
nf_outs	.2581134	.0194684	13.26	0.000	.2199561	0.296271
_cons	34.154	.9698904	35.21	0.000	32.25305	36.05495

Table A4.25

Estimated covariances = 54				Number of obs =		143
Estimated autocorrelations = 0				Number of groups =		54
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.648148
				max =		3
				Wald chi2(1) =		17.59
Log likelihood = -670.3335				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
state	-.2860316	.0682039	-4.19	0.000	-.4197089	-0.15235
_cons	48.7421	1.14514	42.56	0.000	46.49766	50.986

Table A4.26

Estimated covariances = 54				Number of obs =		143
Estimated autocorrelations = 0				Number of groups =		54
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.648148
				max =		3
				Wald chi2(1) =		22.27
Log likelihood = -668.956				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
st_rf	-.3191922	.0676317	-4.72	0.000	-.4517479	-0.18664
_cons	49.12574	1.040103	47.23	0.000	47.08717	51.1643

Table A4.27

Estimated covariances = 89				Number of obs =		239
Estimated autocorrelations = 0				Number of groups =		89
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.685393
				max =		3
				Wald chi2(1) =		1990.52
Log likelihood = -1181.213				Prob > chi2 =		0
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
sd_fis	.6710026	.0150398	44.62	0.000	.6415252	0.70048
_cons	2.512579	.4372766	5.75	0.000	1.655532	3.369625

Table A4.28

Estimated covariances = 92				Number of obs =		247
Estimated autocorrelations = 0				Number of groups =		92
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.684783
				max =		3
				Wald chi2(1) =		0.65
Log likelihood = -1163.111				Prob > chi2 =		0.4193
ge_r	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
sd_state	.050647	.0627125	0.81	0.419	-.0722674	0.173561
_cons	44.89616	1.101815	40.75	0.000	42.73664	47.05568

Table A4.29

Estimated covariances = 92			Number of obs =	230
Estimated autocorrelations = 0			Number of groups =	92
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.5
			max =	3
			Wald chi2(1) =	3.33
Log likelihood = 267.2141			Prob > chi2 =	0.0679

pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
own_5	.0141962	.007776	1.83	0.068	-.0010445	0.029437
_cons	.0403666	.003422	11.80	0.000	.0336596	0.047074

Table A4.30

Estimated covariances = 82			Number of obs =	203
Estimated autocorrelations = 0			Number of groups =	82
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.47561
			max =	3
			Wald chi2(1) =	59.83
Log likelihood = 243.984			Prob > chi2 =	0

pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
w_ins	-.0447325	.005783	-7.74	0.000	-.0560669	-0.0334
_cons	.0741927	.0054179	13.69	0.000	.0635738	0.084812

Table A4.31

Estimated covariances = 79			Number of obs =	199
Estimated autocorrelations = 0			Number of groups =	79
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.518987
			max =	3
			Wald chi2(1) =	52.91
Log likelihood = 234.7494			Prob > chi2 =	0

pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
m_ins	.0423612	.0058239	7.27	0.000	.0309465	0.053776
_cons	.0327197	.0034304	9.54	0.000	.0259962	0.039443

Table A4.32

Estimated covariances = 66			Number of obs =	164
Estimated autocorrelations = 0			Number of groups =	66
Estimated coefficients = 2			Obs per group: min =	1
			avg =	2.484848
			max =	3
			Wald chi2(1) =	4.99
Log likelihood = 203.1352			Prob > chi2 =	0.0255

pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
nonfin	.0001679	.0000752	2.23	0.025	.0000206	0.000315
_cons	.0699689	.0031307	22.35	0.000	.0638328	0.076105

Table A4.33

Estimated covariances = 63				Number of obs =		160
Estimated autocorrelations = 0				Number of groups =		63
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.539683
				max =		3
				Wald chi2(1) =		11.31
Log likelihood = 192.0962				Prob > chi2 =		0.0008
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
fis	.0003196	.000095	3.36	0.001	.0001333	0.000506
_cons	.0550356	.0037502	14.68	0.000	.0476854	0.062386

Table A4.34

Estimated covariances = 82				Number of obs =		203
Estimated autocorrelations = 0				Number of groups =		82
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.47561
				max =		3
				Wald chi2(1) =		359
Log likelihood = 245.6087				Prob > chi2 =		0
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
outs	.0008592	.0000453	18.95	0.000	.0007703	0.000948
_cons	.0020658	.0018836	1.10	0.273	-.001626	0.005758

Table A4.35

Estimated covariances = 73				Number of obs =		179
Estimated autocorrelations = 0				Number of groups =		73
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.452055
				max =		3
				Wald chi2(1) =		35.45
Log likelihood = 196.3085				Prob > chi2 =		0
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
rus_outs	-.0414109	.0069549	-5.95	0.000	-.0550421	-0.02778
_cons	.0788429	.0052006	15.16	0.000	.06865	0.089036

Table A4.36

Estimated covariances = 48				Number of obs =		121
Estimated autocorrelations = 0				Number of groups =		48
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.520833
				max =		3
				Wald chi2(1) =		37.79
Log likelihood = 137.4333				Prob > chi2 =		0
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
fin_outs	-.050765	.0082582	-6.15	0.000	-.0669508	-0.03458
_cons	.0846659	.0031559	26.83	0.000	.0784804	0.090851

Table A4.37

Estimated covariances = 67				Number of obs =		163
Estimated autocorrelations = 0				Number of groups =		67
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.432836
				max =		3
				Wald chi2(1) =		64.73
Log likelihood = 190.9731				Prob > chi2 =		0
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
nf_outs	-.04253	.00529	-8.05	0.000	-.0529	-0.032
_cons	.0800172	.0032899	24.32	0.000	.0735692	0.086465

Table A4.38

Estimated covariances = 50				Number of obs =		124
Estimated autocorrelations = 0				Number of groups =		50
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.48
				max =		3
				Wald chi2(1) =		66.23
Log likelihood = 157.4683				Prob > chi2 =		0
pg	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
st_rf	-.0003184	.0000391	-8.14	0.000	-.000395	-0.00024
_cons	.0537605	.0030401	17.68	0.000	.0478021	0.059719

Table A4.39

Estimated covariances = 88				Number of obs =		213
Estimated autocorrelations = 0				Number of groups =		88
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.420455
				max =		3
				Wald chi2(1) =		56.69
Log likelihood = -180.4692				Prob > chi2 =		0
ga	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
cr_p	-.1083843	.014395	-7.53	0.000	-.1365981	-0.08017
_cons	.805381	.014395	55.95	0.000	.7771672	0.833595

Table A4.40

Estimated covariances = 86				Number of obs =		221
Estimated autocorrelations = 0				Number of groups =		86
Estimated coefficients = 2				Obs per group: min =		1
				avg =		2.569767
				max =		3
				Wald chi2(1) =		4.52E+13
Log likelihood = -148.5668				Prob > chi2 =		0
ga	**Coef.**	**Std. Err.**	**z**	**P>z**	**[95% Conf.**	**Interval]**
w_ins	-.0202445	3.01e-09	.	0.000	-.0202445	-0.02024
_cons	.5196822	2.69e-09	.	0.000	.5196822	0.519682

Table A4.41

Estimated covariances =	82	Number of obs =	211		
Estimated autocorrelations =	0	Number of groups =	82		
Estimated coefficients =	2	Obs per group: min =	1		
		avg =	2.573171		
		max =	3		
		Wald chi2(1) =	2.52E+10		
Log likelihood	= -149.4365	Prob > chi2 =	0		

ga	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
m_ins	.0202445	1.27e-07	.	0.000	.0202443	0.020245
_cons	.4994377	3.08e-08	.	0.000	.4994376	0.499438

Table A4.42

Estimated covariances =	68	Number of obs =	174
Estimated autocorrelations =	0	Number of groups =	68
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.558824
		max =	3
		Wald chi2(1) =	1.80E+10
Log likelihood	= -144.0328	Prob > chi2 =	0

ga	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
nonfin	.0066544	4.96e-08	.	0.000	.0066543	0.006655
_cons	.4820152	1.34e-07	.	0.000	.4820149	0.482016

Table A4.43

Estimated covariances =	30	Number of obs =	80
Estimated autocorrelations =	0	Number of groups =	30
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.666667
		max =	3
		Wald chi2(1) =	22.05
Log likelihood	= -87.59639	Prob > chi2 =	0

ga	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
for	-.0137551	.0029292	-4.70	0.000	-.0194963	-0.00801
_cons	.7865868	.038091	20.65	0.000	.7119298	0.861244

Table A4.44

Estimated covariances =	34	Number of obs =	90
Estimated autocorrelations =	0	Number of groups =	34
Estimated coefficients =	2	Obs per group: min =	1
		avg =	2.647059
		max =	3
		Wald chi2(1) =	23.07
Log likelihood	= -89.36898	Prob > chi2 =	0

ga	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
for_outs	-.9619646	.2002742	-4.80	0.000	-1.354495	-0.56943
_cons	.8482819	.0270507	31.36	0.000	.7952636	0.9013

Table A4.45

Estimated covariances =	75	Number of obs =		173
Estimated autocorrelations =	0	Number of groups =		75
Estimated coefficients =	2	Obs per group: min =		1
		avg =		2.306667
		max =		3
		Wald chi2(1) =		2.64E+13
Log likelihood	= -269.6822	Prob > chi2 =		0

pa	Coef.	Std. Err.	P>z	[95% Conf.	Interval]
cr_p	-.2763359	5.38e-08	0.000	-.276336	-0.27634
_cons	.3080025	5.38e-08	0.000	.3080024	0.308003

Appendix 5. Data and Variables (Poland)

Data

The data for the 84 large companies were gathered in a survey conducted in 2001 as part of a project entitled "Corporate Governance, Relational Investors, Strategic Restructuring and Performance in Hungary and Poland" financed by the European Union's Phare ACE Program (contract no. P98-1048-R). The companies were selected from among Poland's 500 largest companies and had been privatized in the years 1990-2001.

The data for employee-leased companies were gathered during research conducted by the interdisciplinary team headed by Professor Maria Jarosz of the Polish Academy of Sciences in a four-year study (1997-2000) devoted to direct privatization (the sample for this study included about 160 employee-leased companies).[108]

The sample was representative with respect to sector (manufacturing, construction, services, trade), size (measured by number of employees) and region, and consisted of 110 firms privatized between 1990 and 1996. This constituted 12.9% of the total number of companies privatized by the leasing method through the end of 1996. Data were collected using two methods: interviews with the main actors in the companies and collection of hard data by questionnaire (these included data from the balance sheets and financial statements, as well as information on ownership and corporate governance issues, employment, restructuring, investments, etc.).

Definitions of Variables

E##	dummy variables for industry (NACE classification, two digit level)
LNREV	natural logarithm of total revenues (in constant 1993 prices for the endogeneity analysis)
SDREV	standard deviation of total revenues (in constant 1993 prices) over the period of 1993-1996 for 1997, 1993-1997 for 1998 and 1993-1998 for 1999
LNLAB	natural logarithm of employment
LNAS	natural logarithm of total assets
LEV	average value of leverage (i.e., the ratio of total debts and other obligations to total assets) over the period of 1993-1996 for 1997 and 1998 and 1993-1998 for 1999 (we were unable to use data for 1997)

[108] For detailed discussions of the results of these studies, see Jarosz (1994, 1995, 1996, 1999, 2000).

GP	average value of the ratio of gross profit to total revenues over the period of 1993-1996 for 1997, 1993-1997 for 1998 and 1993-1998 for 1999
GPSQ	square of GP
INV	average value of the ratio of investment spending to total assets over the period of 1993-1996 (we have no data on investment spending for 1997 and 1998)
CON1	percentage of shares held by the single largest shareholder
LNCON1	natural logarithm of CON1/100
SI	percentage of the company's shares held by the strategic investor
EB	percentage of the company's shares held by members of the Executive Board
EMP	percentage of the company's shares held by employees (not belonging to the Executive Board)
PSI	percentage of the company's shares held by the strategic investor at the time of privatization
PEB	percentage of the company's shares held by members of the Executive Board at the time of privatization
PEMP	percentage of the company's shares held by employees (not belonging to the Executive Board) at the time of privatization
TRCON	dummy indicating whether neither Executive Board members nor a strategic investor had a share of more than 20% at time of privatization and one or both of these types of owners had over 20% in mid-1997
TRSI	dummy indicating whether strategic investor had a share of less than 20% at time of privatization and over 20% in mid-1997
TRM	dummy indicating whether Executive Board members had a share of less than 20% at time of privatization and over 20% in mid-1997
SBINS	the percentage of supervisory board members who are employed by the company
SBOUT	the percentage of supervisory board members who are not employed by the company
CHAIR	a dummy variable with a value of 1 if the chairperson of the supervisory board is employed by the company
EBINS	the percentage of executive board members who are employed by the company
EBOUT	the percentage of executive board members who are not employed by the company
PRES	a dummy variable with a value of 1 if the president of the company was employed by the company prior to becoming an executive board member in the 84 large companies or employed in the liquidated state enterprise before privatization in the case of the employee-leased companies
YEAR	the year for the data (1997, 1998, and 1999 for the employee-leased companies; 1998, 1999, and 2000 for the others)
YP	the number of years elapsed since privatization

Appendix 6. Probit Results (Poland)

Table A6.1
Dependent variable: TRSI

Model 1			Model 2		
Variables	Beta	Standard Error	Variables	Beta	Standard Error
YP	.3717176	.201455	YP	.4684056*	.186662
E45	-.2659213	.6018546	E45	-.3417664	.5599125
E51	-1.582521*	.8024448	E51	-1.672695*	.7813665
E74	-.3455331	.8236787	E74	-1.158343	.7165571
PEB	-.034628	.0383634	PEB	-.0347124	.0344332
PEMP	.0328783*	.0136793	PEMP	.0331589*	.0135857
LEV	.116659	1.900133	LEV	3.243445*	1.391894
GP	-15.47208*	6.472068	GPSQ	-36.59613	27.68459
INV	2.037201	3.008095	INV	1.521701	2.586592
LNREV	.4508864	.3125053	LNREV	.250005	.269997
SDREV	9.31e-06	.0000485	SDREV	.0000175	.0000447
CONSTANT	-9.230995*	3.835046	CONSTANT	-10.33248*	3.710879
N = 157 Log likelihood = -27.293086 Pseudo R^2 =.5442			N = 157 Log likelihood = -30.142578 Pseudo R^2 =.4966		

Asterisks indicate significance at the 95% level of confidence.

Table A6.2
Dependent variable: TRM

Model 1			Model 2		
Variables	Beta	Standard Error	Variables	Beta	Standard Error
YP	.195153*	.107075	YP	.209071*	.1044268
E45	.3226083	.632006	E45	.3458331	.6584329
E51	1.157239*	.6713477	E51	1.202858	.7382229
E52	2.147117*	.6804387	E52	2.166592*	.7395924
E72	1.940535*	1.152297	E72	1.983586	1.185735
E74	.5714299	.6520921	E74	.5426281	.664081
PEB	-.0114917	.0146358	PEB	-.0125818	.0145694
PEMP	.0008641	.0091852	PEMP	.0006461	.0093046
LEV	-.6308196	1.320719	LEV	-.330077	1.09091
GP	-1.920322	4.726457	GPSQ	-.3344572	27.18271
INV	4.884594*	2.020344	INV	4.829957*	2.021605
LNREV	.2573309	.1569174	LNREV	.2502569	.1564342
SDREV	-.0001043	.0000844	SDREV	-.0001088	.000085
CONSTANT	-5.114228*	2.11536	CONSTANT	-5.395114*	2.042708
N = 180 Log likelihood = -59.695586 Pseudo R^2 = 0.2327			N = 180 Log likelihood = -59.778568 Pseudo R^2 =.2316		

Asterisks indicate significance at the 95% level of confidence.

Table A6.3
Dependent variable: TRCON

Model 1			Model 2		
Variables	Beta	Standard Error	Variables	Beta	Standard Error
YP	.22135*	.0940813	YP	.283986*	.0909822
E45	.1592096	.480547	E45	.1851834	.4615085
E51	-.0746151	.5425913	E51	-.1077107	.5554177
E52	1.170059*	.5589208	E52	1.00814	.5603349
E72	.7716108	1.050993	E72	.7425104	1.052649
E74	.2229696	.5341435	E74	-.1425281	.4906152
PEB	-.0090501	.0149918	PEB	-.0130646	.014418
PEMP	.0138286	.0080055	PEMP	.0137306	.0080533
LEV	-.0103815	.9979478	LEV	1.782148*	.7949507
GP	-10.68851*	4.01597	GPSQ	-12.18949	19.25507
INV	3.99472*	1.757969	INV	3.285604*	1.633644
LNREV	.2796222*	.1423512	LNREV	.2290985	.1387386
SDREV	.0000206	.0000351	SDREV	.0000114	.0000333
CONSTANT	-5.682625	1.820558	CONSTANT	-6.971307*	1.765485
N = 180 Log likelihood = -73.206408 Pseudo R^2 = .2917			N = 180 Log likelihood = -76.970407 Pseudo R^2 =.2553		

Asterisks indicate significance at the 95% level of confidence.