Niels Mygind

Enterprise Governance in Transition - a Stakeholder Perspective

CEES Working Paper No. 29 – February 1999

Abstract:
The purpose of this paper is to use the stakeholder approach to identify how the specific conditions in countries in transition determine the development of specific governance structures. First enterprise governance will be defined and some general determinants behind the governance structure in a market economy will be described. The focus is on the distribution of rights on different stakeholders. The governance structure in Western countries are used as a reference, but it is stressed that there are very specific conditions for developing governance structures in economies in transition concerning. An important determining factor for developing the new governance system is the privatization process. Different privatization models favor specific stakeholders. The conditions for governance structures change over different stages in the transition process. These different elements are taken together to see how they facilitate different types of governance structures with focus on the distribution of ownership on different stakeholders. The paper is concluded by proposing some preliminary theses about the trends in the development of governance systems in transitional economies.

1. Enterprise governance - introduction

Corporate governance can be defined narrowly as: “The ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997 p. 737). However, in this paper a more broad definition of governance of enterprises will be used to indicate that governance can be done by many of the stakeholders in relation to the enterprise. The main focus will not be on the classical agency problem between management as the agent and the owners as the principal. The problem of the flow of capital to firms is just one of the problems concerning designing well functioning governance structures in a market economy. The input of capital is only one of the necessary inputs for the firm. The analysis must include other inputs and stakeholders, as well. It must be stressed that not only corporations, but all enterprises including small ones have a governance system in relation to the coordination of its activities.

Enterprise governance is here defined as the coordination mechanisms of different stakeholders to produce and distribute the output of the enterprise. Defining the borderlines of the firm is part of the determination of the governance structure, but also the surrounding institutional system, state regulation and the relation to the capital market and to other markets determine the governance structure.

A *stakeholder* in the enterprise is an individual, a group or a legal unit with certain:

1) <u>interests</u> in relation to the enterprise,
2) <u>resources</u>: capital, technical skills, management skills, governance skills,
3) <u>rights and obligations</u> in relation to the enterprise, ownership rights and other rights defined by state-regulation or market contracts.

The enterprise is characterized by a certain technology and set of products, (production function with certain combination of capital, labor and other inputs needed to produce a specific combination of output). The enterprise can thus be characterized by the number of employees, needed capital equipment, capital intensity, specificity of capital and labor (to what extent capital and labor can be used in another production unit without loosing value).

The *governance structure* is the distribution on different stakeholders of the rights and obligations concerning: 1) control, 2) income flow, 3) assets and liabilities, and 4) information of the enterprise. Some of these rights and obligations are determined on the markets for products, labor and debt and/or they are determined by state regulation. The residual rights and obligations are connected to the owner (Grossman and Hart, 1986). These *ownership rights* are also often tradeable on the equity market. The rights and obligations are defined and can be changed in interaction with external institutions and markets. These institutions and markets are part of the governance structure. This is illustrated in figure 1.

figure 1

The distinction between ex ante fixed rights and residual rights or ownership rights, can be illustrated by control rights which are either defined in market contracts or state regulation determining restrictions on the scope of action of the company, e.g. environmental regulation, regulation of working conditions etc.. Within this framework the residual control rights are left for the owner - ownership rights. The rights to the flow of revenue can in the same way be divided between payments fixed in contracts: salary for employees, interest for debt finance, tax for the state etc. the residual profit is left for the owner. The liabilities can be distinguished from the residual net worth belonging to the owners. Finally, the enterprise can be obliged to deliver a certain flow of information to different stakeholders determined through contractual agreements or through state regulation, the residual information can be kept by the owner.

Using a stakeholder approach it is important to stress that the return on ownership do not only include the direct return on the risk capital used to buy the ownership rights, the equity, but also other types of returns to the stakeholders of the enterprise. A supplier might get a return of ownership by having the enterprise pay an additional price for the inputs. The owners use a dominating position of control rights to extract rents through transfer pricing. Employees might get higher wages or more secure jobs etc. The return does not necessarily need to be directly paid. A manager can take over ownership to secure his power or status even if sale to an alternative owner could give him a higher monetary return. The return on ownership shall thus be understood as the total monetary and non-monetary return of ownership to the stakeholders.

A centralized command economy with full regulation and no room for the market mechanism is also a type of governance structure, but in this paper the focus will be on different governance structures in a market economy with more or less state regulation. The state can get a part of the rights by direct regulation - as an example by directly controlling some environmental matters or directly taking a certain part of the revenue as taxes. The public authorities can also indirectly influence the governance structure by regulating different market. Finally, the state can behave like an agent on the markets buying different products and services which is then delivered to the population.

The purpose of this paper is to use the stakeholder approach to identify how the specific conditions in countries in transition determine the development of specific governance structures. When these elements have been identified, they can be used for an empirical analysis of different countries in transition to better understand the background for their governance systems and to understand possible future trends in the development of these systems.

The following section 2 describes some general determinants behind the governance structure in a market economy. Section 3 focuses on the distribution of rights of different stakeholders. Section 4 gives a short overview over the connection between background conditions and the resulting governance structure in some Western countries. Section 5 describes the specific conditions for developing governance structures in economies in transition concerning: different markets, state regulation, the specific situation of the enterprise, and stakeholder related conditions. An important determining factor for developing the new governance system is the privatization process. Different privatization models favor specific stakeholders. The conditions for governance structures change over different stages in the transition process. These different elements will be taken together to see how they facilitate different types of governance structures with focus on the distribution of ownership on different stakeholders. Finally the paper will be concluded in section 6 by proposing some preliminary hypotheses about the trends in the development of governance systems in transitional economies.

2. What determines the governance structure in a market economy?

In a situation with perfect information and no externalities a set of complete market contract can distribute all the rights and obligations in relation to the activities and assets of an enterprise. In this situation there will be no room left for ownership rights in the governance structure. Everything can be determined ex ante. A more realistic situation can be characterized by uncertainty, lack of information, non perfect capital market, and externalities. The determinants behind the choice of governance structure are: the interests and resources of the stakeholders, the conditions internally in the enterprise and externally on the market, and in relation to state regulation. These determinants are illustrated in figure 2.

figure 2

The conditions for making contracts on all markets depend strongly on the stability and transparency of the respective market. If the market is very unstable, high uncertainty and lack of information means high transaction cost and makes it difficult to make contracts on the market. Well designed state regulation can help to overcome some of these problems, but state regulation might also be a barrier for a well functioning market. As an example, contracting on the product market can be hampered by high unpredictable inflation, by lack of clear legislative rules for contract enforcement, and by state regulation directly restricting the possibility of making market contracts in certain areas. In the typical transitional situation where the rules of the game are changing fast, and many new players on the market are arriving, the market are very unstable.

On the **product market** the enterprise makes contracts with customers and suppliers. These contracts are determined by the relative strength of the agents on the market. As well the customers, the suppliers and the competitors can be considered as important stakeholders in relation to the enterprise. If the market works smoothly with a high degree of competition it can be expected that most of the transactions will be determined by contracting on the product market without involving the stakeholders directly in the governance of the enterprise. This is a situation with low and predictable inflation, a stable regulatory framework securing competition, including openness to the world market, and clear legislation for contract enforcement. If some of these conditions are not fulfilled, if as an example some of the trading relations are characterized by a low level of competition the stakeholders might have an interest in more direct control of the enterprise, that is to have parts of the ownership rights. In some situations more specific conditions for cooperation can be put into a contract - e.g. creating a long run trading relationship - without involving residual ownership rights. In other cases some form of cross enterprise ownership might be relevant. An enterprise might takeover or merge with another parallel enterprise to exploit economies of scale or simply to increase the power position on the market.

The **labor market** is decisive for the role of the employees. If there is a high degree of mobility and if the employees are in a strong position, perhaps supported by strong unions, they might be able to negotiate such market contracts that they do not need any residual ownership rights. On the other hand there might be high unemployment in general or locally combined with limited mobility. Such a situation in combination with high specificity of human capital might give the employees a strong incentive to get some ownership rights to secure their jobs. The lower the level of unemployment benefits the higher the stakes for employees to secure their jobs. Employees might be willing to trade job security for lower wages. Strong unions can oppose such market flexibility, and unions might oppose a situation where the employees take over the ownership to secure their jobs, but by taking over a higher income risk. No final conclusion can be made on this stage, the focal point is simply that the situation on the labor market is important for the choice between market contracts and ownership for the employees.

Also from the point of view of the owners there can be situations at the labor-market when it will pay off to make closer links with (some) employees to avoid loosing the specific human capital which have been invested in them. The employees might be in high demand on the market, and high fixed wages might not be enough to keep them in the company. Ownership relations including residual rights could be a way to make a stronger connections to these employees.

The **market for debt** is included in this analysis to distinguish the capital which are remunerated independently from the residual profit of the company. Normally loans from banks or commercial bonds are low risk capital based on a market contract with quite secure collateral in the part of the enterprise assets that are not subject to high risk because of specificity. The degree of risk will to a high extent depend on the situation on the other markets especially the product market. A break down of the product market might devaluate even assets that before could have been used in many alternative processes.

The market for debt has always an element of rationing. The state makes regulations of the banks restricting their loans. The price (interest rate) and the possibility for getting loans are important determinants for how much high risk capital with residual rights are needed for the company. In this way the debt-market influence the governance structure. If the loan-contract cannot be fulfilled by the enterprise the bank will normally be entitled to ownership rights. Combined with the ruling bankruptcy procedures this gives banks an important role both as monitors of the fulfilling of the loan contract, and as potential owners in case of default.

The **stock market** - the market for ownership rights - is an important part of the governance structure in a market system. The function of this market is to maximize the return on ownership - to allocate ownership to those owners who can get the highest monetary and non-monetary returns on these assets. The supplier of high risk capital is included as a stakeholder. The equity owner can also have other stakes in the enterprise (as employee, manager, supplier etc.), but he does not necessarily have other interests or stakes in the enterprise except for his ownership of equity.

The **state** both at the national and the local level can be considered to have stakeholder interest in the enterprise ideally representing the interests of the majority of the population on the national or the local level. In reality many different interest groups will influence the state, and also the already mentioned stakeholders might try to support their interests by influencing the state. I will not go deeper into this discussion here, only emphasize that there are strong theoretical arguments for state regulation/taxation of the enterprise activities in case of externalities, public goods and special considerations for the distribution of income and resources in the society. This regulation of the enterprise will give the state a part of the rights to control, income, assets and information.

The specific **condition at the enterprise level** concerning products and technology can play an important role in determining the governance structure. There are quite different possibilities for acquiring ownership rights in a small labor-intensive enterprise compared with a large capital-intensive enterprise. As it will be shown in the following the specificity of human and fixed capital are also very important for the resulting governance structure.

The **stakeholder related conditions** are the interests and the resources belonging to the stakeholder or group of stakeholders. The *interests* are closely related to the specific stake, but there can also be more personal or cultural based interests. Employees might be more or less oriented toward individual goals (Mygind, 1992). The *resources* can be directly related to the stakeholder role, such as the specific employee skills. Other resources like the stakeholders´ access to capital, information or governance skills are not necessarily connected to the role as a stakeholder.

Access to capital is an important resource for potential owners. If there are a non perfect but well functioning market for loans, it is possible to finance the part of assets which with low cost can be transferred to alternative uses. The assets are used as collateral. In most cases there will a part of the assets which will be lost if the enterprise goes bankrupt. This part shall be financed by high risk capital typically financed by the owner. The proportion of high risk capital is determined by the specificity of the assets and by the institutional framework making it more or less possible to use the assets as collateral. The stakeholders´ access to capital and the amount of required high risk capital will play a crucial role for the stakeholders´ ability to be the owner. If the market for debt is not well functioning the required high risk capital might increase dramatically.

Access to information is also crucial for the owners. Before acquiring ownership it is important to make an assessment of the possible return of ownership. Reliable information is also important when performing the ownership rights because it often involves monitoring a manager, who himself has a stakeholder interest in the company and thus might be following other interests than the owner. This is the classical agency problems which often is the focus when discussing corporate governance issues (Shleifer and Vishny, 1997).
The ability to monitor the managers and to define and perform the objective of the enterprise is an important part of the governance skills needed to be an efficient owner. Lack of this ability can explain why some stakeholders do not have ownership rights.

3. Factors favoring ownership by different stakeholders

To what extent can agent A fulfill her *interest* best? Either by selling her *resources* on the market by making a contract (specifying some rights to control, income, assets and information from the enterprise), but no residual rights, or by getting ownership rights? This question depends partly on which *resources* she possess and to what extent these resources can be exploited by having the residual ownership rights. This is again dependent on the specific conditions on the markets and the state regulation? Figure 3 illustrates this relation by specifying which interests, which resources and which market conditions and regulation that favor ownership by a specific stakeholder group.

figure 3

In what situation will it be likely that employees (other than managers) get a high share of the ownership rights? This is shown in the top of figure 3. They might have a specific interest in governing themselves, and since they are the active participants in the production process they want to have part of the control right (Mygind, 1992). To have control the employees, however, will also have to take over the risk connected to the residual rights to income/loss and assets/liabilities. Employee-owners are exposed to the double risk of both loosing the job and the ownership stakes (Meade 1972). On the other hand the risk of loosing the job might exactly be the factor motivating employees to take over their enterprise. This is especially the case if the cost of loosing the job is very high - in a situation of high unemployment, low mobility of labor and low unemployment benefit. The cost of losing the job is high when employees possess a highly specific human capital - skills which are developed in close connection to the specific production process in their enterprise and, therefore, cannot be moved to another type of production.

A high interest in being owners might not be implemented because the given group of stakeholders does not possess the necessary resources of capital, governance skills and information. Lack of capital is usually the most serious problem f or employees. They have often low savings, or these savings are reserved for pensions and the risk should be diversified over a wide range of different assets (Putterman 1993). They might also have special barriers for getting loans from banks because the banks consider their interests to diverge from profit maximization indicating a higher risk of default. Therefore, the employees are more likely to be able to take over a company when the capital-requirements are low. Since more workers can invest a higher amount of capital it is capital per worker, capital intensity, which is relevant. There is a special problem concerning the distribution of ownership among the employees. It is much easier to organize an employee takeover when each employee can invest approximately the same capital. Such a distribution makes it easier to have the group acting as a block behind their stakeholder interests (Mygind, 1992). A rather equal distribution of ownership might imply that the investment per employee will be determined by the employees who can invest the lowest amount of capital.

The homogeneousness of the group of employees have also been raised as an important issues for the ability of this group to effectively govern the enterprise (Hansman 1988). It can be misleading to take employees as one group of stakeholders because they might have different interests. A homogenous group of employees will probably be in a stronger position defining the strategy of the company and monitoring the manager. A smaller number of employees can also be expected easier to govern themselves than it is the case in a large company. The possibility of free-riding will be lower and the ability to make mutual monitoring higher in smaller enterprises.

Access to information can be included in this discussion. Employees working in the top administration and employees with a high educational level will normally have easier access and higher understanding of the information about the enterprise. This group can, therefore, be expected to have a higher proportion of ownership than blue-collar workers. In a situation of lack of transparency about the performance of the company, the group of informed employees have a strong advantage compared to outsiders. These insiders might be the best to monitor the manager.

State regulation can support employee ownership by special advantages e.g. on taxation (the US ESOP-system) or discourage this type (unemployment benefit in Denmark). A well developed debt market can to some extent overcome the employees lack of capital. A well functioning labor market might imply that the employees make non-ownership market contracts instead of seeking ownership rights. When this is not possible because of high transaction cost on the labor market there will be a stronger tendency for employees to seek ownership. Unions can both work in favor and against this development. Strong unions can enforce a high share of fixed rights of control and income to the employees leaving only weak incentives for employees also to aquire residual rights. On the other hand, especially, local unions can organize employees for local takeovers of enterprises.

Summarizing the different conditions favoring employee ownership. We have on the one hand the typical defensive takeover situation when employees because of risk of loosing their jobs on a depressed market take over the ownership of enterprises. The takeover price per worker will often be low, (low nominal capital intensity), because of the crisis situation of the company. On the other hand there can be a strong tendency for employee ownership in profitable enterprises with high specific human capital, often with core owners among a group of highly educated employees who are very important for the competitiveness of the enterprise.

The case for *manager ownership* follow to some extent the arguments for employees. The managers will also often have some specific human capital connected to the specific technical and market conditions for the enterprise. Persons who have made a career as managers have often been driven by a high desire for selfgovernance (they do not want to follow orders), and here lies a strong motive for defending their position even at the sacrifice of some monetary rewards. Managers might be willing to pay a price to continue to be managers of their companies.

Like for employees in general access to capital is often an important problem for managers. However, the problem for managers depend more on the absolute level of needed capital input, not capital intensity. Managers have direct access to information of the enterprise. The degree of asymmetry in relation to outsiders is important for the choice between management and outside ownership. To what extent is it possible for an outside investor to get the relevant information to monitor the managers. By definition the conflict manager-owner disappears in a situation of direct governance by the managers. In comparison with employees the manager is also in a strong position concerning governance skills. The problem of size and homogeneity disappears being only one person or a small group of managers. On the other hand it can be argued that the manager might not be able to see his own lack of skills in relation the needs of the enterprise. A strong outside owner would be able to identify the problem and influence or change the manager.

A special situation of new entrepreneurial enterprises shall be mentioned. The entrepreneur who has got the innovative idea might not have strong intentions of being an owner or the only owner of the new enterprise. Capital is needed to start and develop production. The risk is to high for ordinary debt capital to fulfill the gap. There is thus a strong demand for outside owner capital. However, the asymmetry of information and the lack of possibility for the outside owner to monitor the entrepreneur/manager might imply that no outside owner capital can be attracted. The result might be no start up or a start up at a lower level with only the managing entrepreneur owning capital.

According to Hill and Jones (1992) managers are the only group of stakeholders who enters into a contractual relationship with all the other stakeholders (Hill and Jones 1992). They formulate a stakeholder-agency theory with the manager as the agent. However, there is no need to appoint one of the stakeholders as the agent. Instead, the game around the enterprise shall be understood as performed by different stakeholders who in relation to each other have a varying degree of conflicting interests.

The development of manager ownership critically depend on the alternative possibilities for on the one side to make non-ownership market contracts that fulfil the interests of the manager and on the other hand to make contracts giving the outside (or employee-owners) enough monitoring abilities in relation to the manager. The latter depends especially on the development of the stock market and the market for management skills, further discussed below. When these markets are not so developed there will be less outside and thus more management ownership.

In short, management ownership will be strong, when managers have a high desire for no intervention from outside owners, when the need of high risk capital is quite low, and the conditions for such outside capital are bad because of asymmetric information, high cost of monitoring and low developed markets for equity and management skills.

Turning from the stakeholders supplying labor to the suppliers of capital we distinguish between high risk capital and debt capital. Debt capital have collateral in some of the assets of the enterprise (or other assets belonging to the owner) and the remuneration are not dependent on the actual performance of the enterprise unless when the collateral cannot cover the obligations or in case of default). High risk capital do not have collateral and the remuneration is part of the residual ownership rights to income. In reality the two types cannot be clearly distinguished. There is a grey area e.g. with risky high interest loans with only partly coverage by collateral.

The *high risk capital* can be *venture capital* screening the market for investment possibilities - new or existing enterprises demanding a large share of new capital for restructuring/starting new projects. An outside investor brings the necessary risk capital and take over a dominating share of the ownership. This takeover can be hostile provoking resistance from the existing management or friendly in cooperation with the manager. The venture capital are hunting existing assets that are underperforming with the current ownership and management or it goes into realization of new ideas/mobilizing new assets.

By definition this type of stakeholder has access to high risk capital. Information is a crucial problem, but venture capital firms have specialized in collecting and evaluating information on enterprise performance and future potential. They have developed professional skills in governing and often taking over management. The venture capital are to a high extent dependent on a transparent and effective equity markets making it possible to acquire information about prices and performance and implementing the actual takeover.

While venture capital concentrate their capital inputs in a relatively narrow range of companies to take over control, *portfolio capital* normally spread their capital investment to diversify risk. Portfolio capital will thus typically only own minority share holdings in enterprises. Portfolio capital can be shareholders investing their personal capital individually or they can use pension funds or other type of investment funds to spread their risk and to administrate their investment. The main idea of portfolio capital is to spread the investment on enterprises and other assets which each can have a quite high risk, but combined the risk decreases considerably. Normally they are passive owners. For an individual with only a fraction of the shares in a company it is not profitable to invest time and effort to try to follow the performance of the company and monitor the managers. They will have a tendency to “free ride” letting other groups of investors do the monitoring. However, investment funds might own such a big share that it is both possible and profitable to do some monitoring, using professional staff to perform these functions. If the investment funds through the capital market or other channels get information indicating that management must be corrected or changed they might together with other owners take a more active position in management.
Normally, this type of capital mainly relies on the information from the equity market to determine their investments. Portfolio capital is thus heavily dependent on the state regulation of these markets, especially concerning the legislative efficiency securing shareholders´ rights. In most cases the transparency and quality of information will be the best for “blue chip” companies - scale economies of information (Putterman 1993). These companies can be expected to have the highest share of portfolio proportion of ownership. For the whole economy the share of portfolio ownership depend on the investment pattern of the population in general. State regulation especially concerning pension schemes has a big role. Alternative investment possibilities in bank-deposits, treasury bills, commercial bonds and property of land and buildings are of crucial importance. Also the attractiveness and openness to foreign portfolio capital play a considerable role in a global situation of massive amounts of portfolio capital floating around.

Portfolio capital is usually diversified and quite passive in relation to the management. Therefore, more concentrated ownership is usually considered to be more efficient. However, high capital requirement might be the reason why many large, capital intensive enterprises are often owned by a diversified group of owners (Putterman 1993).

Another type of passive capital is the *debt-capital* - short- and long-term loans coming from banks and commercial bonds sold on the capital market. By definition loan capital are not owner capital, but in case of default the bank take over the assets which was used as collateral and in this way the bank also take over the ownership rights. In some cases the bank might be interested in acquiring direct ownership to be able to improve its possibility to monitor the enterprise. This is especially the case in an unstable situation when the bank fears that the loans are at high risk. At the same time the banks have professional expertise to collect and evaluate information from the enterprise and monitor management. Therefore, a combination of loan-capital and owner capital might often be the result unless the legislation directly excludes the possibility of direct ownership by banks.

To secure the functioning of the system of collateral an effective system of bankruptcy procedures to transfer ownership right in case of default is of utmost importance. A developed bankruptcy system is thus necessary to develop the supply of loans to the companies. At the same time it can result in direct ownership by banks especially in times with high uncertainty on product markets.

Strategic investors are another type of core owners than the earlier mentioned venture capital. For these firms it is their interests as producers of a certain product which determines their role as stakeholders. It can be a supplier, a customer or a competitor (parallel firm) in relation to the analyzed enterprise. Their interests are defined from their role as stakeholders. The strategic investor can maximize profits by maximizing the profits on the relationship with the target enterprise: A supplier by maximizing profits on sales and a customer by cutting the cost of inputs from the enterprise. A parallel firm can have the interest to use the production facilities of the target company to specialize and use economies of scale or it might want to take over the market and this can imply a close down of the target enterprise.

The strategic investor will normally have good access to high risk capital. In transitional economies it will often be foreign enterprises taking over, and they have a high supply of risk capital compared to most domestic investors. However, foreigners might have more problems/higher cost in getting reliable information about the enterprise both before and after the takeover. Although especially large multinational companies have access to high professional governance expertise and although they often send a manager from the mother company cultural differences might imply some governance problems at lower levels in the company.

When do the acquiring enterprise prefer ownership to a market contract with the target enterprise? This is the case when competition on the product market is limited and when high transaction costs makes it difficult to make and monitor a market contract. This happens especially when there are high uncertainty/low stability on the product market and when market contract enforcement are weaker than legislation concerning direct ownership. Vertical integration is especially important if there are high lock in between the enterprises in the value chain (Williamson 1985).

Finally, the state and local society are also listed as important stakeholders in relation to the enterprise. They represent the interests of the people in the whole nation or in the local area. On a perfect market they do not need to interfere with the enterprise, but if there are strong externalities that cannot be internalized through contracting they will have incentives for direct regulation. This regulation can be so detailed that no residual ownership rights are left for other stakeholders. Some sectors of the economy are in this way owned by the state or local municipalities. The degree of regulation and the number of activities and enterprises under public ownership depend on the political goals, the evaluation of the actual cost or benefits of externalities, the policy concerning distribution etc. In many countries in the West there has been a tendency in the 80s and 90s to let private enterprises take over some of the activities which was earlier completely under public ownership. An important criteria has been whether it was possible to create competition in relation to a certain activity, and whether this activity could be specified in a market contract.

For the state or local municipality access to capital is usually not the important barrier, although also tough budgets might be an argument for not taking over or for privatizing public owned assets. Information and monitoring, however, are some of the main problems connected to state ownership, and belonging to the main reasons for the transition from plan to market in the recent years. The incentives for the politicians and the bureaucrats to monitor the managers might be quite weak. There are important governance problems both in the relations between the manager of the enterprise and the bureaucracy as well as inside the state bureaucracy (Phelps et al. 1993).

An owner can have more than one type of stakeholder interest in the enterprise. At the same time a bank can be an important creditor, administrate portfolio-shares of individual investors, and be a direct owner. In fact direct ownership might increase the credibility of the bank seen from the point of view of individual investors using the bank as an administrator of their shares. The German universal banks are quite good examples of such a combination of stakeholder interests.

Often different groups of stakeholders have ownership of the enterprise. The specific combination determines the distribution of actual control. In a situation when shares are distributed on a group of small outside shareholders, some employees also with quite small shares, and perhaps some banks having minor interests the manager can be in a quite strong position even without formal ownership rights. If ownership is diversified, however, often an owner with a minority share might be able effectively to control the board of the enterprise and thus be a strong monitor of the manager.

If a stakeholder owns a smaller share of the enterprise than his stakeholder interest in the company he will have an interest in transferring the returns away from the shares to stakeholder remuneration. If the employees control the company they could decide to pay out the profits in the form of higher wages leaving the other owners with no return on their shares (Nuti 1995). The exploited shareholders might go into negotiations with the dominating owner to try to improve their situation. State regulation might give minority shareholders some rights to veto important decisions. They might also have some power based on their role as stakeholders. As an example a bank might threaten not to renew loans to the enterprise.

The interests of different stakeholders can be more or less conflicting or complementing each other. Managers and employees can make alliances on the continuation and growth of the company. Venture capital, banks and portfolio investors will have a common interest in maximizing profits. However, in some situations the bank will chose to support the security of the loans instead of maximizing the value of the equity. Strategic investors will in pricing decision often be in conflict with the other stakeholders. When there are conflicting interests between the stakeholders there will probably be a quite complicated game between them. To avoid Nuti´s stakeholder problem the resulting ownership structure can very well give a large majority to one single stakeholder. Ultimately, one stakeholder holds the all the residual rights while the rest are remunerated through fixed contracts.

A minority share holding can be offered to other stakeholders to align their interests with the owners. This is especially used for managers, but also for giving incentives to other employees, such insider minority shares has become more widespread in recent years in the Western industrialized economies. Also different forms of cross holdings can be a way to strengthen the cooperation in a value chain network.

4. Some examples from the West

To illustrate the connection between the markets and surrounding institutions and the resulting governance system I will shortly present some Western examples. In the Western discussion of corporate governance we usually talk about the Anglo-American and the German-Japanese model (Shleifer and Vishny, 1997). Figure 4 summarizes some of the main elements in these models together with some of the main background conditions. The figure also includes some features from Italy that in fact represents a model that is also widespread around the world.

figure 4

The *US system* is based on a very liberal model without much interference from the state. An important exception is a well functioning legal system with clear rules for enforcement of contracts and clear rules supporting the ownership rights of shareholders and supporting a high standard of information about financial performance of companies. At the same time there have been a quite restrictive legislation limiting the possibilities for banks to build large holdings including both ownership of and loans to companies.

In contrast to the Anglo-American system *Germany* has had a long tradition for universal banking, where banks can own large amount of shares in parallel to being the main creditor of the company. German banks often control large parts of the shares on proxy for individual shareholders. This means that the banks are the core owners of most of the large enterprises in Germany. At the same time the stock market is not very developed. The number of publicly quoted enterprises is relatively low compared to the situation in UK and US. Enterprises get most of their capital from internal accumulation, but also bank loans play a considerable role. Another feature of the German governance system is a relatively regulated labor market with strong unions and a system of "codetermination" introduced through state regulation (Fitzroy et al 1997). This system gives the employees in large companies 50% of the seats in the supervisory board, which is the highest strategic decision making authority and which selects the executive managers. In the case of 50-50 votes, which happens very seldom, the supervisory board chairman representing the shareholders have the decisive vote.

In *Italy* the regulation of shareholders´ rights and the quality of information have not been strong enough to develop a strong stock market. The banks are not important owners either. The typical Italian governance structure is singe proprietorship with individuals or families as the core owners. (Shleifer and Vishny, 1997).

I will not try to make any evaluation of the three systems, just mention that all the three of them have worked relatively well for long periods of time. However, there are important differences concerning the distribution of control and financial returns. There is not a single ideal model of governance. There are many possibilities and important political choices to be taken. These choices on questions like bank legislation, labor market rules and privatization shape the paths for the development of the governance systems in the economies in transition.

5. Specific conditions of transition shaping the governance system

The variety of governance structures in the West shows that each country will develop a specific system of governance. At the same time there are some general conditions in the transition process which shape the governance systems in certain directions. This is first of all the case with the specific privatization methods. The following subsection overviews how different privatization methods favor different governance structures. Then it is shown how the specific conditions and changes on the different markets influence the governance structure.

5.1 Privatization methods favoring ownership by different stakeholders

The privatization process is to a high extent determining for the development of the new governance structure at least of the initial structure which in the post-privatization period will be further developed. Figure 6 summarizes how different privatization methods favor the ownership of different groups of stakeholders:

figure 5

Employees and managers can directly be given the enterprise as a gift, or they are offered to buy ownership for a relatively low price. Their cash constraint might be released by voucher privatization, favorable installment systems, subsidized credits, leasing with the option to buy etc. At the same time insiders and especially managers can use their informational advantage and their position to inform the authorities in such a way that they will get advantages in taking over the enterprise. Different forms of “wild privatizations” belonged to the early stages of transition. Manipulation with information about financial performance could be used in later stages to support a takeover by insiders for a low price, and perhaps also to discourage alternative outside investors.

Portfolio type of domestic investors would get access to ownership through different forms of mass privatization schemes often based on vouchers. Such schemes would give a broad group of the population easy access to ownership. *Investment funds* could be build into the system like in the Polish model or they might develop more spontaneously like it was the case in the Czech Republic.

Direct sale would favor groups with good access to *high risk capital*. Venture capital could be a possibility, but this type of capital would probably not be an important player before in the later stages of transition. High risk capital can also be supplied by strategic investors. If some domestic financial groups have developed in the privatization process they might develop so-called FIGs (Financial Industrial Groups). Other important investors can be foreign multinational companies who see a

possibility for buying cheap subsidiaries for their value chain.
The new commercial *banks* can take advantage of different types of privatization methods. They can establish strong investment funds in connection to a voucher system. If they are allowed and if they have enough capital they can go into investment banking and be the center in the earlier mentioned FIGs. In Russia we have the example of loans for shares where the government got loans in exchange for cheap shares to the dominating FIGs. The state could also follow the opposite strategy by restricting the banks in their possibilities for playing an active role in the privatization process.

Finally, the public authorities can continue to play a role as owners in cases of “no privatization”. This applies to enterprises producing public goods, activities with important externalities, and enterprises which is politically defined as “strategic”.

5.2 Other conditions for shaping the governance system

Privatization is not the only determinant of the governance system. Many enterprises are started from scratch (although often with some of the assets more or less legally taken over/privatized from state owned enterprises) and in the period after privatization stakeholder positions and ownership are developing into new structures. It is important to see the transition and also the development of the governance system as a dynamic process. Figure 6 show the conditions concerning the different markets, state regulation, and the position of stakeholders and enterprises in the early stage of transition. Figure 7 indicates the different stages of transition in these areas. Note, there shall also be vertical relations between the different markets etc. In the following both the situation in the early stage and the possible development in later stages will be described.

figure 6 and 7

In the transition process the *product markets* are changing in a drastic way. All the countries in transition experienced a steep fall in production when the command economy was abolished and new rules were imposed on the companies. The enterprises should no more produce for the planners, but for the customers on the market. Quite rapidly the enterprises realized that they could not sell their products, could not pay for the necessary inputs etc. Production was cut, many product lines completely closed down, old links between enterprises and between national economies were broken down. The new developing product markets were changing very fast and also the opening for foreign competition from Western industrialized countries made a hard pressure on domestic companies. The result was fast and deep changes. In the first years in the form of a steep fall in production and then gradually recovery combined with development of new products, production methods, markets and networks. Many companies faced a serious crisis and in this process of fast change and high uncertainty short term relations dominated. After some years production has started to increase, inflation has been stabilized and there are not big uncertainties around the relative prices. The enterprises have started to go from reactive to strategic restructuring, further discussed below.

The steep fall in production is reflected in a depressed situation on the labor market. In some countries especially in Central Europe the result was immediately a steep increase in unemployment. In other countries especially in the Former Soviet Union except for the Baltics the increase in unemployment was delayed and instead real wages were drastically cut while the employees formally stayed at their enterprise. In both situations there are only few alternative employment possibilities, lack of mobility, low unemployment benefits - high costs of loosing the job for the employees. The problem is often concentrated in places with one large company employing most of the labor force in the local area. During the transition process training, increased mobility (by privatization and development on the market for housing) and growth on the product market can improve the situation.

The debt market is undergoing deep changes in early transition. New commercial banks are developing from scratch and from the old banking system. Before, the role of the banks was more or less to register flows of money and debt according to the plan. In the new market system the banks shall evaluate the debtors - the prospect of the business and the security of different forms of collateral. This change involves many complicated processes including legislation on registration of assets, bankruptcy etc. and it involves developing new skills for bank employees. There will be a long period with only a fragmentary functioning debt market. The banks concentrate on simple bank operations and loans are restricted to short term with a high real interest rate. Regulation of banks are also fragmentary in the early years and in most countries in transition there have been bank-failures with negative effects for the general thrust in banking and sometimes with serious consequences for the whole society (e.g. Baltija Bank in Latvia). Lack of thrust in the banking system also means that people are reluctant to deposit their savings in the banks. When regulation becomes more efficient and the banking sector develops, more funds can be channeled through the banking system and lend to private investors. However, the governance structure of the banks themselves is often very problematic (Brada 1996) Often state owned banks continue the system of coft credits to enterprises throwing good money after bad (Phelps et al. 1993) by lending more money to enterprise to avoid their complete bankruptcy.

The stock market shall be developed from scratch in all transitional economies. This includes not only legislation on the functioning, registration, auditing, rules for disclosure of information etc., but also that the participants on the stock market develop the necessary skills and experience. Privatization is an essential part of the development of a market for ownership. Some methods of privatization can give an important push to the development of the stock market. This is especially the case with voucher privatization when shares are diversified and many of the new owners want to trade their shares on the exchange. If on the other hand there are uncertainties on the trading system, information from the enterprises, uncertainty on shareholders´ rights etc., formally many enterprises might be registered on the exchange. This means a high capital value of the registered enterprises - high capitalization, but the trading of the shares in these companies might be rather thin - low turnover. Therefore, one of the main functions of the exchange: valuation of enterprises, do not work. The stock exchange can, therefore, not be used to evaluate the performance of the managers. Another function of allocating capital by issuing new shares for new or expanding companies cannot function either.

However, a few blue chip companies revealing good quality information etc. might be more heavily traded and they can be the basis for a more developed stock exchange. The list of blue chips can gradually be increased and the stock exchange might thus play a more important role in the later stages of transition.

The quality of *state regulation* also goes through different stages. Except for East Germany taking over the Westgerman legislation, it is not possible to make a real big-bang reform of state regulation with the introduction of all the necessary new legislation in a very short period of time. In the early stage legislation will be fragmentary and often internally contradicting. There is not a given single package of legislation that must be chosen to make a market economy function. A lot of difficult political choices have to be made, and during the transition process the political power balance changes and so do the legislation. However, introducing new legislation is only the first step. New state organizations must be build up and the administrators shall be trained for the new tasks. The bureaucrats are lacking basic management skills for proper regulation of the market. Furthermore, the state is under a severe financial strain limiting the possibility for paying a competitive remuneration to the state employees. Most likely old routines and habits will prevail for a long period. Therefore, it will take many years before there will be a well functioning state bureaucracy imposing clear rules and strict enforcement on the private sector.

The *enterprise related conditions* are closely related to the situation on the product market and the labor market. In the early transition process the market value of most of the old enterprises were quite low. That is one reason why privatization by direct sale has often resulted in very low prices. The enterprise could engage in reactive restructuring: cutting down production and employment, but lack of capital was and still is an important barrier for strategic restructuring building up new production processes, developing new products, new distribution channels, networks etc. If some of the enterprises have profitable activities they might be able to finance the strategic restructuring. This is especially the possibility for small new enterprises, and the starting up and development of these enterprises can be taken as part of the strategic restructuring of production.

During the period of command economy Eastern Europe was dominated by very large enterprises, often sole employeer in the local area. Employees had quite specialized skills, high technical training, but low knowledge about management in a market economy. The enterprises were organized strictly hierarchical and the management style was paternalistic with a low degree of participation from the employees. During transition many of the large enterprises will be closed down or divided in smaller entities. The employees will need more market oriented and more flexible skills. New management methods will imply more decentralization and empowerment of the employees.

The *stakeholder related conditions* are to a high degree dependent on the conditions on the different markets and there will be important differences between different stakeholders. For employees short run survival will be the main goal in the early years of transition. They have very limited access to capital and if they get shares through privatization many of them will quickly sell them to cover daily living expenses. Like for other stakeholders the capital constraint might be somewhat released during transition, and their skill for understanding the situation of the firm and for controlling the manager will probably increase.

6. Hypotheses about the trends in governance systems in transitional economies

We have seen how there are quite specific conditions for the development of enterprise governance in the economies in transition. What type of governance systems will develop under these conditions? A theoretical paper cannot answer this question. The answer must be based on an empirical investigation of the specific conditions and development in the analyzed countries. There will be many important differences depending on the specific background in each country and the specific strategy for transition including, as earlier mentioned, the privatization method. However, some possible trends can be suggested. This section will summarize how the specific transitional conditions point towards ownership by specific stakeholders, and conclude with some preliminary theses about trends in governance structures under transition.

Insider ownership is not only supported by the special methods of privatization favoring employees and/or managers. Also the unstable product markets with short term relationships and high transaction cost favor the persons who have the closest access to the information about the enterprises. The insiders expect to have a long run relationship with the company. For many outsiders on the product market only more short term oriented contracts are made. The labor market conditions also point in the direction of *employee* ownership, especially in cases where one company is the dominating employer in the local area. In a situation with high unemployment, low employment benefits, low mobility, and highly specific human capital there will be a pressure for defensive takeover of the "white elephants" (Earle and Estrin, 1995). Insider ownership is further strengthened by the relative weakness of the stock market, and the relatively weak state regulation of ownership rights. Even if the privatization model are not directly favoring insiders these conditions combined with the fact that the market value of many of these "white elephants" are quite low should facilitate insider takeovers in spite of insiders´ limited access to capital.

Hypothesis 1: Insiders will have a relative high proportion of ownership in transitional economies. This will especially be the case in economies with privatization methods favoring insiders, but also when privatization methods are more "neutral" insiders will have a relatively high share of ownership.

If the banking system is more developed, *managers* should have a better chance than other employees to get loans because the banks believe in higher alignment of interests with managers than employees in general. In many cases it will be possible for the managers to use some formal ownership by employees as an instrument for de facto transfer of ownership to themselves. The paternalistic tradition of management pushes further to such a development. The managers´ advantage in relation to access to information can especially be important in the early stages of transition when the price--mechanism is still hampered by hyperinflation, general uncertainty on the market, and fragmentary and contradicting state regulation.

Hypothesis 2: Managers will dominate most of the insider takeovers and management will increase its share of ownership during the process of transition.

Hypothesis 3: The share of insider ownership will decline during the transition process with the development of a more sophisticated financial system and stock market.

When more advanced production methods are developed there will probably be a high demand for well educated, flexible and highly motivated employees. To let the employees own a share in the company might facilitate a higher motivation and alignment of interests with the core owner. Therefore, also outside owners can be expected to support such a development by offering minority shares on favorable terms to the employees and especially to the managers, or to support that insiders retain a minority share after an external takeover of the majority of ownership.

Hypothesis 4: Minority shares will be used to motivate managers and other employees.

In some cases the specific production need so much human capital that the enterprises with complete identification between employees and enterprise will have the highest ability to compete on the market.

Hypothesis 5: Employee learn to take more active part in the ownership especially in enterprises where high involvement is needed, this means that strong employee participation in the ownership rights will not only be a transitional phenomenon, but be an integrated part of the new governance structure in companies with advanced technology and highly developed human capital.

Hypothesis 6: Risk capital of the venture type have limited possibilities because of the lack of a well developed stock market. In later stages of transition there might be both room and need of this type of ownership.

Hypothesis 7: Portfolio capital will be widespread in countries using a voucher scheme for privatization of enterprises, but without a well functioning stock market their role for the governance of enterprises will be limited.

Hypothesis 8: Loans will play a minor role in the early stages of transition, but grow in importance during the transition process.

Hypohesis 9: The banks role as owners will depend on the specific legislation concerning universal banking versus arms length banking. If universal banking is made possible in the legislation financial industrial groups will develop turning the governance structure in the direction of the German-Japanese model.

Thesis 10: The importance of foreign strategic investors will be high if transition is developing fast with a high degree of international openness and if privatization is based on direct sale.

Figure 1 - The elements of enterprise governance

Enterprise governance

governance structure

distribution on different stakeholders of:

	ownership rights	
rights/obligations	fixed e.g.:	residual:
1: control	regulation, contracts	control restricted
2: revenue (flows)	interest, tax, wage	profit
3: assets (stocks)	liabilities	networth
4: information	minimum required	inside information

external conditions	markets for
	- product
state regulation	- labor
	- debt
	- ownership

technological conditions at the enterprise	stakeholders´ interests and resources

Figure 2 - Determinants behind the governance structure

---

market conditions

for all markets: stability, transparency, transaction costs, competitive situation, state regulation, enforcement of contracts

product market: concentration, international openness, functioning of networks

labor market: unemployment, mobility of labor, unions, unemployment benefit

debt market: interest rate, degree of rationing, regulation of banks, collateral system

stock market: number of enterprises, capitalization, turnover, quality of information regulation of shareholder guarantees, insider trading etc.

state regulation

externalities, public goods, political goals for distribution, administrative capacity

enterprise related conditions:

capital: total capital needed, C/L, capitalspecificity, high risk capital needed.

labor: number of employees, homogenity of L, specificity of human capital

stakeholder related conditions:

stakeholders interests: e.g. employees preference for selfgovernance, homogenity

stakeholders resources: access to capital, governance skills, access to information

---

Figure 3 - Factors favoring ownership by different stakeholders

stake- holder	**ownership interest**	**access to capital, gover- nance skills, information**	**State regulation Market conditions**
employees	high cost of loosing job if high specific human capital high unemployment, low mobility, low unemployment benefit desire for selfgoverning high risk aversion	lack of capital, low wealth difficult to get bankloans =>low C/L necessary, educated employees best access to information, governance easiest when small, homogenous group	(high specific human capital) labor market: non transparent high transactioncost difficult to monitor contracts unions for or against?
managers	high specific human capital desire for selfgoverning continue as manager	lack of capital => low capital inputs needed, asymmetric information, direct governance => no agency problem	Unstable markets Low development of Market for managers And equity markets
risk capital: venture portfolio -funds -individuals	 hunting potential profits in underperforming firms following signals from capital market	access to high risk capital professional governance scale economies of inf. usually passive ownership diversified, free riding,	Especially dependent on: Transparent and effective Capital market Legislatitive efficiency On shareholders´ rights
loan capital banks	takeover to secure loans or build holdings: FIGs	access to high risk capital, often lower risk segment high information demand professional governance	Good bankruptcy rules Legislative efficiency On creditors rights, Stable product market
other firm: supplier customer parallel firm	target enterprise buys big part from supplier high price on input, sells large part to customer low price on output, scaleeconomy/specialize or close down/market takeover	usually access to high risk capital - mainly foreigners some information barriers especially for foreigners professional governance	Ownership alternative to Market contract, when low product market competition And/or high transactioncost Weak contract legislation
public local state	important externalities and/or political defined: “strategic” for local society or for the whole country	access to high risk capital information problem, governance problem: incentives for bureaucrats	Ownership alternative to Market contract, when low product competition market And/or high transactioncost

Figure 4 Western cases: specific conditions => specific governance structures

----

US (similarities with UK)
well functioning product markets, quite strong regulation to secure competition
well functioning capital markets
well functioning labor markets, quite weak unions
well functioning management market
restrictions on banks possibilities to be owners,
=>
dominating owners: diversified shareholders, pension funds
=> passive owners and strong management position
separation of ownership and control
to some extent monitored by risk of hostile takeovers,
capital market monitoring**,** market for managers,

Germany (similarities with Japan)
well functioning product markets, quite strong regulation to secure competition
banks can be owners and can represent other shareholders
capital markets not so developed
quite regulated labor market, quite strong unions, codetermination legislation
=>
dominating owners: banks, strong owners monitor managers,
employees strong influence through codetermination

Italy
well functioning product markets
capital market not so developed
weak regulation of ownership rights
=>
dominating owners: managers, families

Figure 5 Privatization methods favoring ownership by different stakeholders

stakeholders	**privatization methods**
employees	give aways, low price, favorable loans, leasing first offer, last offer,vouchers
managers	wild privatizatons, use of informational advantage give aways, low price,
risk capital: venturetype portfoliotype -funds -individuals	direct sale without advantage for insiders mass privatization investment funds voucherscheme with restrictions for invest funds
banks	special scheme: shares for loans, debt equity swaps
strategic investors other firms, (foreigners)	direct sale with no restrictions
public state/local	“strategic enterprises” not privatized

Figure 6 - specific conditions in early transition

----

market conditions	
product market:	unstable, fast and deep changes, many companies in crisis, competitive structure not clear, networks not established relations between agents on the market short term oriented, no climate for long run relationships, high transaction cost,
labor market:	high unemployment or very low wages, low labor mobility, low unemployment benefit, high cost of loosing job
credit market:	very high real interest rate, high degree of rationing, nearly no long term loans, weak regulation of banks, poor registration of property, difficult to get collateral,
stock market:	few enterprises traded, low capitalization and turnover, weak regulation, low quality of information insecure guarantee of shareholders rights, insider trading
State regulation:	early legislation fragmentary and often contradicting when legislation OK, still problems with implementation
Privatization	specific initial systems of enterprise governance, table 5
Enterprise related conditions:	
capital:	the market value of many old enterprises quite low, much capital needed for strategic restructuring,
labor:	many enterprises with a high number of employees often one large company dominating employer in local area employees specialized,high technical,but low economic skills employees accustomed to paternalistic leadership style

Stakeholder related conditions:

stakeholders interests: short run survival

stakeholders resources: limited access to capital, governance skills and information

----

Figure 7 - Stages of transition of governance structures

product market:

steep fall in accellerating
break down of production continued growth
command system----------------------->reactive------------------------->strategic
old network high inflation restructuring improved restructuring
pricesystem

labor market

increasing mobility
break down of differences bottlenecks and trainingnew wage and
old stability of-----------------> areas with high------------------------->employment
employment steep fall unemployment recovery structure
in wages of wages

debt market

start commercial banks----->simple bank operations----->more advanced operations
currency exchange increasing amount of loans
deposits, state bonds contribute ever more to bank profits
more long term loans

ownership market

liberalization privatization market for ownership
stateownership->commercial enterprise ->initial private own ->adjusted private own

equity market------------->few enterprises traded--------->advanced capital market
thin markets many enterprises, capital and turnover
uncertain shareholders´ rights clear rules

state regulation

new difficult political

break down of fragmentary process
command system----->legislation----------------------->clear rules, strict enforcement
training new
bureaucracy

-

Literature

Berle, A. and G. Means (1932): *The Modern Corporation and Private Property*, New York, Macmillan.

Brada J.C. (1996): Privatization is Transition - Or is It? *Journal of Economic Perspectives, vol. 10, no. 2, pp 67-86*

Earle, J.S. and S. Estrin (1995) Employee Ownership in Transition, mimeo, Central European University / Stanford..

Fitzroy F. R., J.A. Zoltan and D.A. Gerlowski (1998): *Management and Economics of Organization*, Prentice Hall Europe.

Grossman S. And O. Hart, (1986): The costs and benefits of ownership: A theory of vertical and lateral integration, *Journal of Political Economy* 94, 691-719.

Hansman H. (1988): Ownership of the firm, *Journal of Law, Economics and Organization*,vol 4.no2.

Hill C.W.L. and T.M. Jones (1992): Stakeholder - Agency Theory, *Journal of Management Studies,* vol. 29, no 2, pp.131-154.

Meade J. E. (1972): The Theory of Labour-managed Firms and Profit Sharing, *Economic Journal*, 82, 402-28.

Mygind, N. (1992): The Choice of Ownership, *Journal of economic and industrial democracy*, vol. 13, no. 3, pp. 359-399.

Nuti, M. (1995) "Employeeism: Corporate Governance and Employee Ownership in Transitional Economies", mimeo, London Business School.

Phelps E.S., R. Frydman, A. Rapaczynski and A. Schleifer (1993): Needed mechanisms of corporate governance and finance in Eastern Europe, EBRD working paper no 1, March 1995

Putterman L. (1993): Ownership and the Nature of the Firm, *Journal of Comparative Economics*, vol. 17, pp 243-263.

Shleifer S. and W. Vishny: (1997): A Survey of Corporate Governance, *The Journal of Finance*, vol LII, June, 737-783.

Williamson, Oliver (1985): *The Economic Institutions of Capitalism*, NY, Free Press