Corporate governance cycles during transition: a comparison of Russia and Slovenia[1]

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Abstract

The governance life-cycle, is here defined as changes in ownership structure, and including both the identity of the major owner and ownership concentration. The cycle is marked by key events and phases including start-up, initial growth, mature growth, and possibly a crisis and restructuring stage or exit stage. The governance cycle for transitional countries reflects some specific characteristics – e.g. often privatization produces specific initial ownership structures, with an unusually high proportion of employee ownership. This was in fact the case both in Russia and in Slovenia. Subsequently pressures for restructuring produce strong impulses for ownership changes. There is limited possibility for external finance because of the embryonic development of the banking system and the capital markets during early transition. The governance cycle during transition is also influenced by other specific features of the institutional, cultural and economic environment in a country. The varying importance of these factors is expected to produce differences in key features of ownership cycles such as the speed and specific pattern at which particular ownership changes occur.

To provide simple hypothesis tests, we use the enterprise data collected by REB (Russian Economic Barometer) for every second year over the period 1995-2003 and panel-data collected by the Institute for South Eastern Europe covering 1998-2003. The data enable various measures of ownership to be constructed (including the identity of the owners and ownership concentration). The empirical analysis covers the ownership cycle with emphasis on initial ownership and subsequent changes. The key method is to assemble a series of transition matrices showing both starting and final ownership configurations for sample enterprises and to simultaneously provide information on changes in concentration for the largest single owner. The findings show that in spite of important differences in institutional development, concerning the privatization process and the speed of the development of corporate governance institutions, we find that governance cycles are broadly similar in the two countries. Employee ownership is rapidly fading, but while both change to manager and non-financial domestic outsider ownership is typical for Russia, manager ownership seems not to be widespread in Slovenia. Instead change to financial outsiders in the form of Privatization Investment Funds is quite frequent in Slovenia. Foreign ownership, which is quite rare especially in Russia, is quite stable. The ownership diversification to employees and to some diversified external owners in the privatization process did not fit well to the low development of the institutional framework. As expected we observe a subsequent concentration of ownership on both managers, external domestic and foreign owners.

JEL-codes: G3, J5, P2, P3 - **Keywords:** corporate governance, life-cycle, privatization, ownership change, transition economies, Russia and Slovenia**.**

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I. Introduction

The identity of the owners and the concentration of ownership are key elements of the governance structure of enterprises. In the developed market economies these elements follow certain patterns of change over the life-cycle of the company, but at the same time with strong influence from the institutional framework in the specific country. In Eastern Europe these institutions have been changing very fast and in combination with the privatization process we have seen very fast changes in ownership and therefore a special pattern of governance cycles in these countries in transition. This has been studied for the three Baltic countries in Jones and Mygind, 2004. However, it would be interesting to contrast the change in ownership structures in two countries with quite different processes of privatization and large differences in the development of the new market institutions. Russia and Slovenia constitutes such a contrast. They are in fact on each side of what Berglof and Bolton (2002) call: "The great Divide" between countries, including Slovenia, which established a sound institutional foundation and those that did not, including Russia at that time.

In the following section we will first present the theoretical framework behind the governance cycle in developed market economies and the predictions about a special pattern of governance cycles in economies in transition. In section 3 we describe the differences in the transition process and developments in the institutional environment in Russia and Slovenia. Section 4 outlines the data, reviews previous work on ownership changes in transition economies, and present the results of the analysis Russia and Slovenia in a series of transition matrices that show the start and end of the governance cycles both covering ownership identities and concentration. The final section includes conclusions and implications.

II. A special governance cycle during transition?

The theoretical starting point is that the choice of governance structure is determined by: enterprise characteristics: size, need of capital, information asymmetries, etc. as well as surrounding institutions, market conditions etc. The enterprise characteristics change over the life cycle of the firm. Ownership structures are expected to change because different stakeholder groups can contribute in different ways to the development of the company at different times in the firm's development. This means a change in governance structure over the life cycle - a specific governance cycle. However, the surroundings differ between countries, and countries in transition have specific features and specific paths of development. Therefore, there can be identified a specific governance cycle during transition. Because of the rapid changing environment corporate governance patterns established at early stages of transition can be expected to change quite fast. But the speed of transition, the institutional framework, and the needs of capital and other inputs from different stakeholders vary across countries and are expected to produce differences in the nature of the typical life cycle across countries - for example in the speed at which particular ownership changes will occur.

The ownership structure in market economies is determined by enterprise level factor and a combination of institutional, cultural and economic factors. To the extent that there is a possibility for ownership structures to adjust it can be assumed that, given the institutional setting, the type of ownership that gives the highest return to the owners will prevail. The optimal ownership structure can be explained from several perspectives including agency-, property rights-, transaction cost- and resource dependence approaches (Jensen and Meckling 1976, Williamson 1985, Pfeffer and Salancik, 1978). Based on this eclectic theoretical approach we can identify explanatory elements behind the ownership dynamics. We will start with the most important elements at the company level:

The size and capital demands of the company may be very high even in relation to a wealthy owner. Therefore, growth is associated with a more diversified ownership structure, a fall in owner concentration (Jensen and Meckling 1976, Putterman 1993, Shleifer and Vishny 1997). Especially for wealth-constrained insiders, ownership of a high capital demanding company means a high concentration of risk. Insiders put all their eggs, jobs and capital, into one basket (Meade, 1972). There is a trade off between single proprietorship by the manager with no governance problem between manager and owners and the possibility of diversification and higher capital supply by external more diversified investors with less control with management (Fama and Jensen 1985). The *specificity of the different inputs* constitutes another microeconomic factor. If the fixed assets can be used in many alternative activities it is much easier to finance them by loans instead of by direct risk capital. In these cases banks will play a strong role (Williamson 1985). The larger the need for direct risk capital, there is less likelihood that a single provider of capital will emerge to fulfill these needs and more diversified ownership can be expected (Fama and Jensen 1985, Putterman 1993). The existence of specific capital means a higher dependence on other links in the value chain. The hold-up problem may lead to a stronger connection to core suppliers or customers with quite concentrated strategic ownership of the company (Grossman and Hart, 1986). A special relation concerns the inputs of human capital. If it is highly specific, the risk is high for the employees. To limit this risk, the employees have an incentive to take direct control and ownership of the enterprise. A large size of the company is often used as an explanation for no employee ownership because of the need for a central monitor to avoid shirking (Alchian and Demsetz, 1972) and the larger the group the smaller is each employee's share in the ownership rights and the easier it is for a single employee to free-ride. Hansmann (1996) argues that a larger group of employees combined with higher heterogeneity means higher costs for collective decision making.

Transaction costs for outside investors are also closely connected to the specificity of the assets of the company, information asymmetries, and of the institutional framework (see below.) New and yet unproven business ideas with complex human capital make it very difficult and costly for external investors, including both passive suppliers of capital like banks and active external owners to get reliable information about the company and to monitor the performance of managers.

The *economic performance* of the firm is another potential influence on the ownership type with, for example, an economic crisis often implying a shift in ownership. However, this ownership change may take several directions: An outside raider or a strategic investor related to the value chain may take over the company and perform the necessary restructuring. A managerial buy-out may be the result if, based on insider information, the managers estimate the value of the firm to be higher than estimates of external investors (Wright et al., 2001). An economic crisis may induce a defensive take-over by the employees to introduce more flexible wages and to save their jobs and their specific human capital. (Ben-Ner and Yun 1996).

Based on these influences on and determinants of ownership some trends in the development of a typical ownership structure for a firm can be noted in relation to the *typical life-cycle of the firm.* Over its life-cycle, a company will change technology, markets and relations to the different stakeholders. These shifts influence the role of different stakeholders including the identity of the dominant owners. Most companies *start-up* as small entities with few employees, low capital, and low knowledge about the economic potential of the firm. A high proportion fail in the early stage; but most of the succeeding companies go into a stage of *growth*, which demands higher inputs of capital, knowledge, networks and employees. The need for extra capital may eventually lead to some diversification of ownership. However, a specific shock in the environment may also lead the company into a stage of *crisis*, which makes some kind of new inputs necessary. This will often be a new input of capital, which can be facilitated through an ownership change. During these stages the change in ownership can be related to the different determinants of the ownership structure. Changing conditions both from within and from outside the company generate changes in ownership and hence changes in the development of the governance cycle, see table 1.

The *classic entrepreneurial company starts up* as a small entity with relatively low capital inputs, which can be covered by the entrepreneur and by debt based on personal loans e.g. with collateral in the family-house. Information about the core-competence, the yet unproven business idea, is difficult to transmit to an external investor. The asymmetry in information between the insider and external investor is very large and the transaction costs of writing and controlling a contract are very high. High uncertainty and lack of reliable information about the prospects of the new business and its market potential enhance the problem of asymmetric information and risks to the external investor. Therefore, most new companies are started by single proprietors, and owned by the entrepreneur sometimes with participation of close relatives and friends. The capital needed can in most cases be covered by the founders and by loans with collateral in the entrepreneurs' personal assets.

Many small entrepreneurial companies close down during the initial stages, but eventually, those that survive enter an *initial growth stage*. The company needs high capital investments, knowledge and networks to facilitate high growth to benefit from economies of scale. At the same time, the firm starts to create some reputation and market-experience, which can improve the information and give guarantees for potential external investors. Suppliers of capital, banks or other financial institutions will in most cases not claim direct control, but often they require to closely monitor the collateral behind the loan. In some cases the owner may get new capital by issuing extra shares to new owners found within a rather closed circle of stakeholders, typically top-employees of the company, investors from the local society or close business partners.

At a later more *mature growth stage*, when the company has developed its potential, it may attract a strategic investor with an interest in including the company in its value-chain. Another possibility for attracting capital at a developed stage is to go public. The development of going public is also often part of a process of diversification of ownership. Therefore, the process of growth is often combined with a lower degree of concentration.

Sooner or later many companies run into a *stage of crisis*. Diverse internal and external factors, including changes in technology and/or markets or the institutional setting, force the company to adjust to the new conditions. The company faces strong pressures to undertake restructuring. New external capital and expertise are needed, and banks, venture capital and strategic investors may play an important role. As an alternative to closure insiders may make a defensive takeover to protect their jobs and their specific human capital. The crisis may also result in an exit of the company and liquidation of the assets, which is then taken over by new investors for other activities.

The determinants behind the ownership structure and the governance cycle cannot only be found within the company. The *economic institutional and cultural environment* is important and variations across countries explain differences in governance systems and ownership dynamics.

Macroeconomic cycles have an impact on the performance of companies and therefore on the governance structure. MBOs are more frequent in business cycle troughs because of low pricing of assets during dips. This can be seen in relation to tendencies of going private (Wright et al, 2003) while boom periods on the stock market means that IPOs and going public give companies a cheaper possibility for raising external finance. Defensive employee takeovers can be assumed to be more frequent in recessions because of higher threats of closure and lower alternative employment possibilities (Ben-Ner 1988).

The *institutional setting* in relation to legislation may present specific barriers or provide advantages to different forms of ownership. The degree of protection of minority owners through legislation and the liquidity and development of the stock markets have impact on the diversification of ownership. Thus, *concentrated ownership* is widespread in countries with a lower degree of minority owner protection and less developed capital markets, while diversified ownership is more frequent in countries such as US and UK with highly developed capital markets and a high degree of protection of minority owners (La Porta et al 1999, Becht et al 2002). Also, the development of the banking sector enhances the possibility of financing growth through bank-loans, and for the role of the banks as creditors and potential owners in the governance structure of the firm.

Informal social relations and *culture*, defined as the historical traditions, cultural values, norms and preferences of the stakeholders, can also explain important differences in the governance structure between countries. Thus, the optimal ownership structure in Russia is expected to be different from the optimal structure in the Slovenia because stakeholders have different objectives and different relations to each other, and the historical experience of participation, local initiative versus paternalistic leadership styles and centralization are part of the path-dependency of the dynamics on both the macro and the enterprise level.

The *transitional economies* are characterized by a specific economical and institutional development and therefore we expect that a specific governance cycle exists in firms in those countries. The dynamics of enterprise governance and ownership are quite distinct because enterprises go through both a transition in ownership structure, a transition in relation to the changing institutions in the environment, and a transition of the market in relation to prices, costs, and competitive structure with a strong pressure for restructuring of products and production methods. Most enterprises in transition economies start with rapidly changing the structure of governance combined with a strong pressure for restructuring production simply to be able to survive. The specific elements in early transition that influence the governance cycle are shown in Table 2.

To understand the governance cycles appearing in transitional economies there are three special conditions that must be taken into account. The first of these factors is *the privatization process.* The early years of transition created specific conditions for the initial development of private ownership. The different methods favored different types of owners. In some countries employees had a strong political position resulting in a very high frequency of employee ownership. Often managers had a strong position in relation to the political system. On the other hand, voucher privatization supported a high degree of domestic external ownership, while direct sale without restrictions for foreign capital gave foreign investors the lead in the change to concentrated external ownership (Mygind 2001). Privatization is a state governed process where the specific methods create a specific ownership structure, which would not have developed in a more market based system for ownership adjustments. The path-dependency may create a learning process and institutional development, which may lead to specific paths for subsequent developments in the governance structure. Such path dependencies can to a high degree be used for explaining persistent differences in the governance structure in the West (Roe 1990). On the other hand, it is expected that there will be post-privatization adjustments bringing the ownership structure back to a "normal" equilibrium.

A second condition occurs because, from the start of transition, nearly all state owned enterprises are confronted with a strong *pressure for restructuring* of production, production methods, organizational structure and markets. They are in a situation of crisis with an acute need of capital, new skills, and new networks. In the developed market economies this would often lead to a change in ownership bringing new investors with the necessary resources for restructuring. In some cases, privatization has delivered the best-fitted investor for this restructuring. In other cases post privatization dynamics include a takeover to facilitate such restructuring.

However, the third and most important feature of transitional economies delays this kind of ownership adjustment. This concerns the process of building up a well-functioning market economy and especially developing the necessary *institutions* required to facilitate the adjustment of governance structures in enterprises. In the early stage of transition, the lack of developed institutions favors special types of ownership. Insiders have an advantage in relation to outside owners because the institutions supporting outside ownership such as credible auditing procedures and transparent stock markets are not developed (Mygind 2001).

Based on these three special conditions hypotheses about the specific governance cycle in transition can be developed (table 3). However, since some conditions give tendencies whose directions are ambiguous, the final conclusions must be based on empirical analysis.

The first set of hypotheses concerns the scope and resilience of employee ownership. Privatization in many countries, including Russia and Slovenia, led to a high degree of employee ownership. However, employees' lack of governance skills, their lack of capital and the risk-concentration may lead to a tendency to rapid sale to other investors. This movement away from employee ownership could be delayed by various factors: The employees may in the past or in the transition processes have acquired governance skills; there may be strong defensive arguments for keeping ownership to protect employment; or the specific company may have a high degree of specific human capital, which would be threatened by a sale to another investor.

The lack of development of the institutional environment weakens the role of external investors. The lack of transparency and high risk especially in the early stages of transition combined with the lack of markets for company shares means that, in general, managers have a strong advantage compared to external investors (Kalmi 2002). Therefore, especially during the early stages of transition, it can be expected that *managers take over* the shares that employees want to sell.

Some voucher-privatization provided for a high degree of public offering of shares to diversified external owners. This would often mean overly diversified ownership in relation to the volatility of the markets, the low quality of information to external owners and the lack of development of the institutional framework. At the same time most of these initial small external shareholders were under strong wealth constraints. Therefore, during the early years these companies will be in a process of *concentration of ownership* in the hands of especially *managers* and small groups of external investors who have been able to accumulate wealth in the early transition.

When the institutional framework becomes more advanced during the process of transition it can be expected that external investors will get a stronger position, and there will be shifts from *insider to outsider ownership*. This tendency will be strengthened if the company, either because of high growth or because of pressure for restructuring, has a strong need for extra capital.

The stock markets in the transitional countries are quite weak, with few companies listed, low capitalization and low turnover and IPOs are rare. Therefore, it is too early to observe the tendency found in the west for more mature firms to diversify ownership to small external investors. Instead we expect a dominating tendency in the direction of higher concentration of ownership also when we look at continued external ownership.

Foreign ownership is established both as new green-field entities, as takeovers directly in the privatization process, or as takeovers in the post-privatization adjustment process. In these cases we expect a rather stable ownership structure because these enterprises have reached their final stage of development in the ownership cycle at least within the relatively short time-horizon of our analysis.

The specific governance cycle during transition can also be understood as a sequence where different types of governance problems are in focus. We can distinguish between three different governance problems: The *stakeholder problem* related to the representation of the interests of different groups of stakeholders; the manager-owner problem, which is the usual agency problems between the manager as agent for the owner as principal; and finally the problem between a dominant core-owner and the minority owners. In transitional countries the starting point can be understood as a stakeholder system with the state representing the social interest. In the privatization models where ownership in the first round is transferred to the employees you can argue that this is done to solve one of the most important stakeholder problems – the relations to the firms' employees. With the change to manager ownership the focus shifts to solve the *manager-owner problem*. The clear-cut solution on this problem is simply to unite the position as manager and owner. When there are too weak possibilities in the governance system for the owners to control the managers, as is often the stage in early transition, insider- and especially manager ownership may be the solution on the owner-manager governance problem. With the development of governance institutions outsider ownership becomes feasible, but it is necessary to have a strong concentrated owner to minimize the owner-manager problem. Instead the *majority-minority* owner problem comes into focus because the governance institutions are still not so developed that minority owners are protected. With the development of institutions securing disclosure and transparency, and rules protecting minority shareholders interests against dilution of shares, and other forms of appropriation of rights by the majority shareholder it becomes possible to limit this governance problem to such an extent that a governance system based on diversified small shareholders may develop. In this way the focus changes from the stakeholder problem over the manager-owner problem to the minority problem as the economy passes through different institutional stages.

Also in advanced economies there can be a trade-off between the different problems so the solution of the manager-owner problem increases the majority-minority problem, or the solution of the stakeholder problem means that the manager extends his power as "representative of the different stakeholders" on the expense of the shareholder-owners. However, in the most advanced corporate governance systems all three problems are targeted simultaneously. The stakeholder problem is taken seriously e.g. in the form of Corporate Social Responsibility and/or employee representation in the company board.

The analysis has emphasized some general tendencies for the governance cycle in transitional countries in comparison to Western countries. However, the existence of cross national differences, especially concerning *institutional differences* related to the speed and form of transition, may make both the starting points and the speed of change between different phases of the cycle different across the transitional countries. The dominant form of privatization determine to what degree the starting point of the cycle for privatized firms will be employee ownership, management ownership or may be other groups with strong connections to the state have been favored (Mygind 2001). The specific rules for privatization may include restrictions for later ownership changes. Some shares may not be transferable for a certain period and some forms of institutional ownership by pension- and other investment-funds may set a path for low flexibility in the ownership structure.

In addition to the specific privatization methods the institutional development and the general economic and political stability determine the level of foreign investment (Bevan et. al. 2004). The speed of ownership change also depends on the transition of institutions. The development of the banking sector and the possibility of debt financing are especially important. The dynamics also depend on the development of the capital-market and the possibility of expanding the equity both for listed companies and for trading shares of non-listed companies. The protection of the right of the shareholders, especially minority owners, is important for diversification versus concentration of ownership in the post-privatization period.

It is not only the specific privatization methods and the development of institutions that make ownership dynamics in one country different from another. The *economic development* and the degree and duration of the initial fall in production and possible later reversals like the 1998 crisis in Russia can influence the governance cycle in several ways. The steep fall in income of the population may put a strong pressure on liquidity-strained employee owners and low-income owners of vouchers or shares. They will sell and concentration will grow. On the other hand, high risk of unemployment may increase the defensive motive of employees to keep their shares and sustain control over their jobs to secure their specific human capital.

Finally, *cultural factors* and historical experience of management style, employees participation in ownership and control over the enterprises, and attitudes of risk-taking and involvement may play a role for the development of a broader shareholder-culture with diversified ownership.

In the next section we look at specific developments in Russia and Slovenia and develop hypotheses for how this can be expected to affect the corporate governance cycles, especially the starting points and the speed and direction of ownership change in these two countries.

III. Privatization and Governance Institutions in Russia and Slovenia

The results of privatization in Russia and Slovenia are summarized in Tables 4 and 5 some main economic indicators are summarized in table 6.

The background for privatization in Russia was several generations of centralized planning with limited scope for each enterprise. The management style was paternalistic with a low degree of active participation of the employees in the governance of the companies. There were several waves of reforms to increase the efficiency of the system, but these reforms did not succeed in fundamental changes of the system before Gorbatjov started to make reforms to make the economy more market-oriented. His Perestrojka policy included in the end of the 1980es the possibility to start small individual private firms, the possibility for starting new cooperatives in formal ownership by the employees, and possibilities for leasing the enterprise by the collective of workers. The incidence of the lease-buyout scheme was particularly large in retail trade and consumer services, in light industry and some others. By February 1992, 9451 state enterprises accounting for 8 % of total employment were leased by their workers and managers, (Blasi et al 1997). The new cooperatives, individual firms and the leasing system were privatization processes starting up already in the time of the former Soviet Union. With the democratization process and the increasing power of the reform-wing in the different republics more wide-scale privatization plans were formulated e.g. in the Baltics and in the republic of Russia.

However, privatization did not take off before after the dissolution of the Soviet Union in 1991. Then privatization of small entities was done quite fast, mostly during 1992 and 1993. The specific method mainly based on auctions and tenders varied between the regions. The mass privatization directed toward medium and large enterprises started in the fall 1992. Vouchers were distributed to the whole population and could then be used for buying shares in the enterprises. The companies could chose between different models: Option 1: 25 % non-voting shares were offered to employees for free, with the option to buy a further 10 % of ordinary shares at a 30 % discount of the book value of January 1992 – already much below the market by the time of privatization. Managers were offered to purchase 5 % of ordinary shares at nominal price. Option 2: Employees could for cash or vouchers buy 51 % of ordinary shares at 1.7 times the 1992 book value. This was still lower than the market value. For implementation at least 2/3 of the employee should support this model. Option 3: A managing group could buy 30 % of voting shares. Further 20 % could be purchased by the insiders at 30 % discount., given the rapid inflation in Russia at that time, the prices to pay in all three options were so low, that the mass privatization really was a give-away (Hare and Muravyev, 2002).

The privatization was very rapid. Of the 24,000 or so medium and large enterprises, most had been corporatized and over 15,000 privatized by the end of 1994. Over 70 % of the firms offered for privatization chose option 2. Option 1 was chosen by 21 % giving insiders an overwhelming degree of control at most enterprises. In combination with the paternalistic ownership style it meant that managers could consolidate their positions. However, the incidence of employee ownership was much smaller in well-performing, capital-intensive, large enterprises. Here insiders were unable to accumulate enough funds to buy 51 % of shares under option 2, and most of these firms followed option 1 with a weaker position for insiders (Hare and Muravyev, 2002).

Foreign involvement was negligible. Investment funds collected some of the shares, owned by small external shareholders, but in general these funds played a minor role in the privatization.

Many of the large jewels of Russian industry like the metal company: Norilsk Nickel and the oil-companies: Sibneft, Sidanco and some shares in Lukoil were privatized through the "loans for shares" or "mortgage" privatization in 1995. The system was direct, non-competitive sales of blocks of shares at low prices to the leading Financial-Industrial Groups, which at the same time administered the whole process (IET, 1997). In the following years case-by-case privatization of a few large enterprises and leftover state holdings were performed with both increasing speed and increasing transparency.

In Russia there have been severe problems for the financial sector and its functions of channeling capital to the enterprises and to be part of the governance system by disciplining the efficient use of these capital inputs. Before August 1998 the banks could make more money from lending to the government or through their foreign transactions than from lending to business. Interest rates were extremely high and firms did not invest at all in these years or they based investment on internally created resources. Since the 1998 financial crisis, the banking sector remains underdeveloped and consists of over 1000 banks, most of which are small and undercapitalized except for the large and completely dominating state-controlled Sberbank.

Similarly to the banking sector, the Russian stock market has never played an important role in providing enterprises with financial resources. The number of listed equities is about 250 of which only around 60 regularly traded in 2003. Out of these 57 had American Depository Receipts quotation in New York (Buck 2003). Most equities are illiquid. While the market capitalization of several individual companies amounts to billions of dollars and capitalization of the Russian stock market is now in the start of 2004 approaching 200 billion US$. The turnover on the main Moscow stock exchange is about 100-120 million USD per week.

When looking at the governance institutions in transitional countries it is important not to focus on the legal framework, which may be quite advanced, but to look at the actual implementation of shareholders rights, protection of minority owners, and the quality of information and disclosure. Therefore, we will not here give a detailed description of the complex of governance legislation and codes, but indicate the level and the main tendencies in the development.

Because of lack of legislation, regulation and enforcement the early 1990es were in Russia characterized by a very strong position of management often allied with a few strong external investors. In these days most of the powerful financial industrial groups such as Menater, Onexim, Inkombank and Alfa were created. Managers and their allies appropriated rights from employees and diversified external owners, and through widespread tunneling large fortunes were accumulated and concentrated in the hands of relatively few people. In the mid 1990es the legislation on companies and securities market developed, but lack of trained officials and widespread corruption meant that enforcement was quite weak (Puffer and McCarthy 2003).

The legislation and enforcement in relation to disclosure, transparency and protection of minority owners were strengthened somewhat in the new millennium with stronger state policies and with the start of the process for Russian accession to WTO membership. The Russian Federal Commission for the Securities Markets unveiled in 2002 a Code of Corporate Conduct, which is in line with the OECD Principles for good corporate governance. However, the code is voluntary, and it remains to seen if the Commission will strengthen it activities as a watchdog. In the past investigations have been very rare. The new millennium also saw an increasing number of large companies improving their corporate governance systems with higher standard of disclosure, accountability, and protection of minority owners. In general, the development since 2001 has improved both regulation and enforcement. From a regime characterized by widespread abuses, the Russian companies have in the new millennium started to develop into a stage where corporate governance issues are taken seriously. (Puffer and McCarthy 2003). Cases where foreign investors take active part in governance and actually take over controlling positions in large Russia enterprises are still very rare with BPs' takeover of a strong position in the oil company Sidanco as an important exception.

Bankruptcy is part of the governance mechanism for adjusting ownership. Therefore bankruptcy legislation and enforcement is important for the development of the governance cycle. The Russian development in this field has followed the general pattern of other Russian governance institutions with very weak legislation and enforcement in the 1990es, but then followed by some improvements in the new millennium. The number of bankruptcies was extremely low in Russia over the most part of the 1990es. However, in January 1998 the amended Law on bankruptcies was enacted. This provoked a sharp jump in the number of bankruptcies. The number of bankruptcy petitions, which were accepted by courts and were in the process of implementation were only 4.200 at the end 1997, but increased to 10.200 in 1998, 15.200 in 1999 and 27.000 at the end of 2000. Actually, bankruptcies were often used as a cheep method of hostile takeovers or asset stripping. In order to optimize tax payments many companies created special "profit centers" that accumulated revenues while enterprises per se (production entities) were transformed into "liabilities centers" (via transfer pricing etc). So a raider who succeeded in buying enterprises debts might submit a petition on its bankruptcy and easily become its new owner. The paradox is that the best performing enterprises became victims of these raiders. In 2003 the Law on bankruptcy was amended once again to stop this wave of false bankruptcies.

The economic indicators in table 6 are included in this analysis because the economic development can as discussed in the theoretical section also influence the identity of ownership and thus the dynamics over the governance cycle. From the table it is clear that Russia had a much steeper fall in production than it was the case for Slovenia. Not before 1997 production started growing again in Russia, and then in 1998 came the financial crisis, which in that year had a negative effect on production. However, in the following years production increased rapidly because of favorable oil-prices and import-substitution effects after the steep devaluation of the Ruble in the months following the crisis. Unemployment did not increase so much as the fall in production up to 1997 should indicate, because most Russian enterprises tended to keep the employees although they produced below their capacity-level. Instead wages were kept on a very low level. Measured in USD fell steeply following the crisis in 1998, but then recovered in the following growth period. The table also indicates the extremely low FDI going into Russia.

Slovenia's economic development has been quite different from the situation in Russia. The initial fall in production was quite turned around to steady growth. The relatively high level of productivity and competitiveness, which characterized the Slovenian self-management economy since the 1960es, meant that the Slovenian income level during the whole transition period has been the highest in Central and Eastern Europe. This is the background for the relatively high wage level measured in USD. It has been 8-15 times higher than the Russian level. Although Slovenia as described below did not give many opportunities to foreigners in the privatization process FDI has gradually increased so that the accumulated amount per capita over the period is on level with the most advanced transitional countries and dwarf the FDI going into Russia.

As the most developed part of former Yugoslavian self-management system Slovenia had a quite strong tradition for active employee participation in the governance of enterprises, which were socially owned in the sense that the employees had the formal right to control and they had the residual cash flow rights, but they could not sell shares of the company and get a capital gain if the firm had increased its market value. Formally, the governance of the enterprises was in the hands of the employees since it was the workers' councils that selected the management team. In practice however, governance of the enterprises was a bargaining process between four institutions: the self-management institutions of the employees, operative management, socio-political organizations and socio-political communities.

With the decrease of political influence on business at the end of 1980es, the power of managers in decision making increased. The managers were leading the privatization process, which in most cases was based on the internal privatization method - one of several ways of ownership transformation provided by the Law on Ownership Transformation, passed by the Slovenian Parliament in November 1992. After the compulsory free transfer of shares to different State-controlled Funds (10 % to the Restitution Fund, 10 % to the Capital Fund (for reserve and pension purposes) and 20 % to the Development Fund (for further sale to the Privatization Investment Funds for cash or in exchange for vouchers) and after the distribution of 20 % of the shares to insiders in exchange for their vouchers, companies could freely decide on the allocation of the remaining 40 %. They could either privatize internally and sell them to insiders according to a special scheme or privatize externally and offer them to the public through a public offering of shares, public tender or public auction. The first scheme of internal privatization required the participation of at least one third of the employees. According to the scheme, the shares had first to be transferred to the Development Fund with the first 25 % acquired by the insiders immediately, while the remaining 75 % within the next four years (25 % per year over the whole period). The shares were sold under a 50 % discount and were transferable only among the participants of the internal buyout within a period of 2 years. Alternatively, firms could choose to be liquidated and sell off their assets. In this case, the social capital and liabilities of the firm were transferred to the Slovenian Development Fund, the firm was cancelled from the Company Register, while the funds gathered by the sale of assets were used for the repayment of liabilities and the implementation of an active employment policy.

The Privatization Law was a compromise between three main approaches, all of which stressed privatization, but differed in the role of the state, managers, workers and foreign capital: i) the decentralized model that stressed worker-management buyouts of existing enterprises (proposed by Mencinger, 1989; ii) the centralized model, which was based on the re-nationalization and subsequent privatization of all enterprises with domestic as well as foreign capital (advocated by supporters of the ideas of Jeffrey Sachs) and iii) the semi-decentralized model based on mixed ownership taking into account the heterogeneity of the enterprises (advocated by Ribnikar and Prasnikar in 1991, see Prasnikar, Gregoric and Pahor, 2004). The adopted privatization method involved a combination of cash and voucher privatization; with regard to the latter, about 2 million vouchers of a total value of DM 9.4 billion (representing about 40 % of the total estimated book value of social capital) were distributed to citizens of the Republic of Slovenia. The vouchers were non-transferable and could be used only for acquiring shares in the internal distribution, the internal buyout, public offering of shares, and in exchange for shares of the Privatization Investment Funds (PIFs).

The model favored employee ownership, but at the same time it addressed the problem of risk concentration in employee owned enterprises. In this sense the 10 % to the pension fund was the base for the fully risk-diversified pension-scheme. The Privatization Investment Funds (PIFs), where Slovenian could place part of their vouchers, reflected personal investments also with a high degree of diversification, while the shares received in the internal distribution and bought in the internal privatization implied a concentration of risk at the enterprise level, but this was at the same time the basis for the continuation of employees control of the company (Mygind 1991).

The companies could chose one or a combination of the proposed privatization method and submit their approvals to the Agency for Restructuring and Privatization in charge of the ownership transformation in Slovenia. Each company had to prepare its own program of ownership transformation consisting of the plan for organizational and financial restructuring to be done before privatization, the proposed method of sale of the company chosen, etc.

The Privatization Agency gave its first approval on 29 July 1993 and its last approval at the end of October 1998. During these six years, more than 1300 companies (96.2 %) successfully completed the ownership transformation and were entered into the Court Register. The 55 companies that did not end the privatization program were either transferred to the Development Fund or liquidated. Among privatized firms, more than 90 % chose the internal distribution and internal buyout as the main privatization method. Internal owners ended up holding about 40 % of the social capital subject to privatization. The social capital to be privatized represented only 68 % of the existing social capital, while most of the remaining 32 % remained under the ownership of the State (Privatization Agency, 1999). PIFs got about 25 %, state funds got 22 %, while the remaining 13 % were publicly sold in exchange for vouchers. Internal ownership prevailed as dominant mostly in smaller, labor-intensive firms; workers and management obtained more than 60 % stake in 319 firms (24.4 % of all firms), but only 8.1 % of total capital. On the other hand, their share did not exceed 10 % in 82 companies (6.3%) accounting for nearly 30 % of total capital (Privatization Agency report 1999), see Table 7.

The model based on state funds, Privatization Investment Funds and employee shares with restricted transferability for a certain period implied some limitations on trade of shares and adjustment of ownership structure. Simoneti et.al. 2001 point to the problems connected to this delay in the transferability of large volumes of shares. They also criticize the distribution of ownership on different agents with conflicting interests, often implying a battle between the outside funds on one side and the insiders on the other.

In general the Slovenian legislation related to *corporate governance* is on level with the standard in most EU-countries, and the implementation is also about to reach this level. Some special features are however worth emphasizing:

An empirical analysis conducted in 2001 of 35 shareholders' general meetings, shows that 70 % of the votes were cast (Gregoric 2003). However, this relatively high percentage is mainly explained by a quite high concentration of ownership. The system of small shareholders representation and proxy voting are not so developed in Slovenia, except for cases where managers have organized the proxy voting of employee shares. Slovenia has like in Russia a system of 25 % blocking shares for important decisions at the general meeting of shareholders. Other rules give 5-10 % of the shareholders the right to challenge decisions threatening the value of their shares e.g. by calling extraordinary general meetings of shareholders (Gregoric 2003).

Concerning equal rights of shareholders the Companies Act imposes the one-share-one-vote rule, however this equality can be broken by issuing preference shares with priority on dividends, but without voting rights (Gregoric 2003). Caps on voting rights have been used to limit the control of large shareholders and have functioned as anti-takeover devices in some large Slovenian companies. However, voting caps have been prohibited for listed firms with the amendment of the Companies Act in 2001. There were a series of battles for ownership in large Slovenian companies in the latest years, and there are recent attempts demanding higher transparency in relation to takeovers.

The Privatization Investment Funds, which were originally capitalized through vouchers, took over quite large part of the enterprises. They were managed by management companies, which through proxies and later through direct ownership de facto controlled the PIFs. This happened often parallel to a process where the PIFs were transformed to Public Limited Companies (PLCs), without the PIFs' 5 %-limit for the single largest shareholders (Gregoric 2003).

The Slovenian Co-determination Law from 1993 (amended 2001) gives the employees some rights to control in questions concerning human resource management. They have the right to form workers' councils and to be represented in the supervisory board by 1/3 of the seats. On top of this there are 68% of workers as members of the main union.

In 1994 Slovenia introduced new bankruptcy legislation. Implementation was reasonable, but according to the EU-Commission (2002) procedures were rather slow. However, in 2000 and 2001 the number of bankruptcy cases rose sharply because of the introduction of more appropriate legislation, higher efficiency in the judicial system and with the state becoming more actively involved in tax recovery procedures and as petitioner in bankruptcy procedures.

There was already from the self-management period a tradition for commercial banks. They were, however, strongly dominated by the largest companies, and loans were based more on rationing and soft budget constraints than on sound principles like in developed market economies. However, the transition to a fully market oriented system started with the establishment of a bank-restructuring agency in 1991. In the process of rehabilitation the banks came under state governance, bad loans were cleaned and privatization process initiated. The rehabilitation process was concluded by 1997. Bad loans dropped from a level of 22% in 1994 to 10% of loans in 2002 (EBRD 2003). The privatization of banks was relatively slow with one of the largest banks privatized as late as 2002 to a Belgium banking group. After this most of the banking sector was privatized and 16% of the total assets in Slovenian banks were in banks with majority foreign ownership. The banking function of lending to the private sector was already in 1991 on a level of 35 % of GDP. Then it fell somewhat during the period of cleaning bad debt and since 1993 is has been increasing steadily to reach a level of 41 % of GDP in 2002. Although this is lower than the EU average, Slovenia is on a quite high level measured by East European standards (Cufer et. al 2002).

The stock exchange in Ljubljana opened already in 1990, but capitalization and trading did not take off before the first privatized firms were listed in 1996. Then the capitalization of shares grew quite fast to reach 23% of GDP in 2002, and total capitalization as share of GDP was in 2001 the highest in Eastern Europe (Caviglia et al 2002). However, like in other transitional countries the trade is still rather thin and concentrated around relatively few shares.

Before we go to the empirical analysis we will sum up the *hypotheses* for how the cultural, economic and first of all the institutional development can be expected to influence the governance cycle in the two countries. What specificities of the cycle can be expected? What can we say about the speed of adjustment at different stages? How advanced do we expect the cycle to be?

In both countries the privatization model gives a starting point with a high degree of employee ownership. The question is if the next step for these enterprises will be management ownership as predicted in the theoretical section and how fast this process will happen?

In Russia the managers are in a strong position because of: the paternalistic leadership style, the low development of governance institutions implying low transparency and high possibilities for transactions moving the assets into the hands of the manager, low experience and tough liquidity constraints for the employees. Although the financial system is not advanced and it is difficult for managers to get loans for buy-outs the price may be so low, that this is not an important barrier. Therefore, we expect the change to manager-ownership to be quite fast and widespread in Russia.

In Slovenia the financial system was quite early relatively advanced, but at the same time the governance institutions were also highly developed making it difficult for the managers to make covert deals. The most important barrier for manager takeovers from employees in Slovenia is probably the fact, that the employees are used to participate in ownership. Thus, we assume that they are not easy to manipulate, and they have understanding for the value of their shares. Because of the high competitiveness of most Slovenian firms the actual market value of the shares may be relatively high. Even if managers could get some loans in the banks it would often not be enough to finance a manager takeover. The prices for the employee shares could not be substantially reduced because the Slovenian wage-level is rather high and the employees are not desperate to sell their shares at rock bottom prices. Furthermore, the Slovenian privatization model included regulations that made employees shares less transferable for a certain period. Thus, instead of a takeover it may be a more realistic strategy for managers to make an alliance with the employees e.g. in the form of Workers' Associations (AWAs). Such a strategy would make employee-ownership more stable in Slovenia than predicted in the theoretical section.

The next step in the governance cycle to external, but concentrated owners, demands a more sophisticated development of the governance institutions to avoid the manager-owner governance problem. Therefore, it can be expected that this development will be quite slow in Russia. The exception will be large companies where the manager needs an alliance with strong external groups to get a dominating position.

The different funds defined in the Slovenian privatization model, the different state funds and the developing Privatization Investment Funds, mean that external owners have a quite strong position already from the time of privatization. Slovenia's faster development of the financial sector, early tough bankruptcy legislation and in general the fastest institutional development can be expected to encourage a faster adjustment to external ownership than in the other countries.

Finally, a fast transition process and development of the institutional system improve the business climate and attract foreign investors, and therefore facilitate a faster change in the direction of foreign ownership. We do not expect to see this development for the Russian enterprises in the period under observation. Slovenia offers foreign investors better conditions, but a move to more foreign ownership may be postponed because the ownership may to some degree be blocked by the different Slovenian funds.

We expect a strong tendency in the direction of stronger concentration in Russia to limit the owner-manager problem in a relatively weak institutional setting. These tendencies may not be so strong in Slovenia. The question is, if the Slovenian institutional setting has reached such a level that the majority-minority governance problem has been so much reduced that is open up for an increased weight on diversified share-ownership. The developed system of both state governed pension funds and Privatization Investment Funds may work as alternative channels for small diversified investors. Thus, the tendency for higher concentration may prevail in the observation period.

IV. Data and empirical analysis

Much literature has examined ownership structures after privatization in transition economies with considerable attention paid to investigating the relation between ownership and performance (e.g. Estrin and Wright 1999; Djankov and Murrell, 2002.) Studies that investigate post-privatization ownership dynamics are more rare. Earle and Estrin (1996), Blasi et al (1997), Estrin and Wright (1999) and Filatochev et al (1999) analyze Russia and document the strong position of insiders in privatization and the tendency for management takeovers of employee owned enterprises. The same tendency is found for the Baltic countries by Jones and Mygind, 1999 and 2004.

Jones et al (2003) using data for Estonia, also document the strong tendency away from employee ownership most often to manager owners.

Simoneti et al 2001 have analyzed ownership dynamics of 183 Slovenian mass-privatized companies from the time or privatization to 1999. They found increased concentration especially in insider owned companies. State funds and small shareholders including employees had reduced their shares while managers and strategic investors had increased their ownership. They also found that quite few foreign investors had taken over dominant shares in Slovenian companies.

In this section we wish to see if there is empirical support for our notion of the governance life cycle and to see if there are marked differences between the two countries. Ownership groups are determined according to the widely used "dominant owner" approach, where the firm is assigned to the owner group holding more shares than any other group. By using the dominant rather than the majority ownership approach we are able to include firms in our analysis, which would otherwise be dropped to the "no overall majority" group.

We have got ownership data for a panel of firms in each country through special ownership surveys. However, because of varying opportunities for data collection, the panel sets data varies between the two countries. The Russian panel has been collected by a team connected to The Russian Economic Barometer (REB), which is a Moscow-based independent research center founded in 1991. They do regular business surveys and the REB respondent network of industrial enterprises includes about 700 entities from different industries and regions of Russia. In terms of size, industries and methods of privatization the REB sample is representative for the whole population of the Russian medium- and large-size industrial enterprises. The usual response rate is close to 30 %. In two years intervals starting from 1995 blocks of questions on ownership and corporate governance have been included in the standard REB questionnaires. Since 1999 the questionnaire included the identity and ownership of the largest shareholder.

In Slovenia the target group consisted of a representative sample of 623 Slovenian non-financial joint-stock companies (all companies) with shares registered in the Shareholders' Register of the Central Clearing Securities Corporation. The questionnaires were collected during the summer of 2003. 150 companies returned filled questionnaires giving a response rate of 24 %. They employed on average 500 employees and generated 10 billions SIT (around 50 million Euro) of yearly income. The questions addressed the whole period between 1998-2003 on a yearly basis concerning: Corporate governance: ownership structure (total ownership by separate group of owners), evaluation of the influence of separate groups of owners, composition of the supervisory board. Data on identity and ownership stakes of the largest shareholders were obtained from the Official Shareholders' Register, which is kept and updated by the Central Clearing Securities Corporation.

The evidence for ownership dynamics based on the Russian sample for the period 1995-2003 is shown in tables 10 and 11. The response in the second-yearly surveys count around 150, but although the sample has remained the same there has been a rather high shift in the firms responding in every round. Table 10 shows the dynamics for each two years period including the companies who responded in two consecutive rounds. The transition matrix for 1995 to 1997 shows in the total column to the right, that out of the 41 reported firms 26 of them were employee dominated in 1995 – the group of employees had a higher stake than the other mentioned owner-groups. 7 firms were dominated by non-financial domestic outsiders, 4 by financial outsiders etc. From the diagonal it can be seen that only 13 or 50% of the employee-dominated firms in 1995 were still employee dominated in 1997. 2 firms have changed to manager ownership, 5 to non-financial outsiders, 3 to financial outsiders, 2 to foreign and 1 back to dominant state ownership. It is clear from the table that outsider domination is much more stable than domination by insiders. Only one out of the 11 domestic outsider dominated firms has changed and this was to foreign dominant ownership.

The changes from 1997 to 1999 are quite similar to the first matrix. The tendency away from ownership dominated by employees is again very strong, and the most frequent change is again to non-financial outsiders. Dominant employee ownership continues to be reduced by around 50% per period also in the two latest matrices. Now the changes to management ownership are on level with the change to non-financial outsiders. By far the biggest number behind the category non-financial outsiders covers domestic firms. Some of these firms may be dominated by managers from the target company. Therefore, the numbers for management domination are probably too low.

The speed of change can also be summarized in the *gross intensity of redistribution* (Kapeliushnykov 2001), which shows the average percentage of shares changing from one group to another over a given period[2] . It was 31% for the two year period 1995-97, 30% for 1997-1999, 34% for 1999-2001 and 35% for 2001-2003. This means that each year on average 15-18% of the shares change from one group to another group.

Table 11 summarizes all the changes for companies, which have been observed for at least two periods. More than half of all the companies are changing. Employee dominated firms are changing the most with highest frequency going to non-financial outsiders, closely followed by a large group going to managers. The change for financial outsiders is also quite high, but spread on many different directions. The lowest frequency of change is for managers and non-financial outsiders. The single foreign company represented is too thin evidence for conclusions on stability for this group, but it is a strong indication of the extremely low importance of foreign ownership in Russia.

Table 12 includes those enterprises for the period 1999-2003 with data on ownership for at least two points in time and at the same time we have data for ownership by the single largest owners. Here, it is possible to see the connection between dynamics of identity combined with tendencies for concentration of ownership. Not surprisingly, the employee-dominated firms have the lowest concentration, and financial outsiders, foreign and state have the highest. In general the average stake of the single largest owner has increased from 31 % to 38 % over the observed period. The biggest increase is found for enterprises taken over by managers from employees and from non-

[2] Gross intensity of redistribution in t-th year = $1/N\ \Sigma d_j(t)$, $(j=1\ldots N)$, where $d_j(t)$ is intensity of redistribution of j-th company in t-th year. $d_j(t) = ½\ \Sigma|\ sh_{ij}(t)-sh_{ij}(t-2)|$, $(i=1,...6)$, where $sh_{ij}(t)$– share of i-th group in j-th company in t-th year.

financial outsiders – these two changes are also the most frequent in this table. Some of the enterprises staying in the same category (frequencies reported on the diagonal) - management, and the two groups of domestic outsiders – also have quite steeply increasing concentration, and at the same time some of the categories of changes e.g. from state to non-financial outsiders or from non financial outsiders to financial outsiders have falling concentration.

When comparing table 11 and 13 we observe some striking similarities between the ownership dynamics in Russia and *Slovenia*: For both countries employee ownership is the most frequent observation in the initial period, and decreasing very rapidly in both countries with quite many changing to other types of ownership and with nearly no supply of new employee dominated firms. On the other end of the specter foreign dominant ownership is quite rare, but in Slovenia it is increasing rapidly and foreign ownership seems to be rather stable. Employee ownership has the highest degree of change and non-financial domestic outsiders are in the other end with a quite low frequency of changes. Exactly 50% of the observed 150 Slovenian firms changed dominant owners over the period, which is for the average firm a bit shorter than the observation period for Russia.

However, there are also important differences between the observations for the two countries. With only 2 cases in the start and 4 in the end, management dominant ownership is surprisingly rare in Slovenian medium and large enterprises. Employee domination rarely shifts to manager ownership. The governance cycle away from employee ownership goes in Slovenia directly to outsiders both financial and non-financial. Like in Russia the group non-financial outsider mainly consists of domestic companies, and some of them may be owned by managers from the target company. Financial outsider ownership is much more stable than in Russia. The PIFs have become one of the most important dominant owners in Slovenia making up 35 of the dominant financial owners in the end of the period.

The speed of change measured as the *gross intensity of redistribution* is somewhat lower in Slovenia. For the two years period the average change of ownership in each company is around

22% in the first years of observation and 17% for the period 2001-2003. This means an average change per year of 9-11% compared with 15-17% for Russia.

Table 14 covers both the owner identity and the concentration on ownership on the first largest single owner. It covers only the period 1998-2001 because we do not have information on the identity and share of the first largest owner for 2002 and 2003. On average the level of concentration on the single largest owner is quite similar to Russia. It has increased from 32 % to 39 %. The insider owned enterprises have the lowest concentration, while foreign and state owned has the highest concentration. Those enterprises staying insider owned have a stable concentration, while enterprises continuing with outsider ownership have growing concentration. The largest increases in concentration are recorded for the change from employees to foreign ownership, but also changes from employees to non-financial outsiders imply a strong increase in concentration.

Table 15 shows the Slovenian ownership transition matrix based on the first largest single owner of the given enterprise. It is quite disaggregated to give a more precise picture. The PIFs play a strong role also in the initial period, because they usually belong to the largest investors in the companies, where they are represented. It is however, noteworthy that their frequency of domination is falling over the period, with domestic firms as the main beneficiary. The explanation is probably that they are increasing their prevalence in some firms, while they sell out in other firms. The domestic firms have also increased their position by taking over from the state funds (Capital Fund and Development Fund). No employees or managers are represented as the first largest single owner. However, some managers may be hidden behind the group domestic firms. Employees are often organized collectively in Workers' Associations (AWAs). In this way the employees get apparently a strong and stable stake of ownership. The concentration percentages for the AWAs are quite stable and somewhat higher than the average for the total observations

The state funds keep a quite stable ownership share in the enterprises where they continue as the strongest single owner. In the transitions from the capital fund we see a strong increase in concentration, especially when sold to domestic enterprises, while the sale to domestic firms on average means unchanged concentration. The remaining quite few and diversified cases of change of the largest owner show a quite varied pattern of concentration/diversification processes. Like in the matrix for aggregated stakes some of the cases of no change in identity of ownership have quite strong growth in concentration. This is the case for firms owned by individuals, domestic firms and foreigners, while AWAs, PIFs, and the state funds have on average quite stable ownership stakes.

V. Conclusion

We have analyzed changes in governance structures with focus on concentration and identity of owners over the life-cycle of the company. Based on agency, property rights, transaction cost and resource dependence theory and related to key stages of the life-cycle of the firm, we can identify a typical governance cycle for developed market economies, namely: manager➔outside investor participation➔outside investor takeover. This cycle develops in parallel with a tendency for a change from concentrated to more diversified ownership. The governance cycles are also determined by developments in the institutional and cultural framework and by specific market developments.

The transitional economies are undergoing fundamental changes in institutions with emerging and changing markets creating specific transitional conditions for enterprises and their life-cycles. Privatization, pressures for restructuring and weak, but developing institutions define the conditions for the evolution of ownership structures. Therefore, specific transitional governance cycles can be predicted. Most medium and large enterprises have been privatized.

The specific method used for privatization from state to private ownership determines their initial ownership structure. In many transitional countries including those investigated here, privatization lead to widespread employee ownership. However, this type of stakeholder oriented ownership are not sustainable if managers de facto control the firm and can manipulate the employees and set low prices for manager takeovers of the shares from liquidity-starved employees. Such takeovers solve the basic governance problem between owners and managers and management ownership can be expected to be prevalent in the framework of very weak governance institutions. More advanced governance institutions can give external owners better opportunities to control the managers, but still at this stage a high concentration of ownership is needed to give external investors both the incentives and the strength to control the managers. Finally, the most advanced governance institutions also deal with the governance problem concerning the relation between majority and minority owners. This opens up for diversified external ownership, but none of the transitional countries have yet reached this stage. Therefore, the most widespread governance cycle in transitional countries with privatization schemes favoring employee ownership can be predicted to be: employee➔manager➔outsider (with the last stage split in domestic➔foreign in the most advanced transitions) and this governance cycle is accompanied with increasing concentration.

Like in many other transition countries employees were favored in the privatization process in both Russia and Slovenia. This resulted in an ownership structure dominated by insiders of which the majority of firms had employees as the group with the most shares. The exception was in both countries the very large and most capital-intensive companies. Foreign ownership was practically excluded from the privatization in both countries and the role of foreign investors was negligible at the start of the post-privatization process. The state still owned shares, in Slovenia in the form of specific state funds, but it is rare that these state controlled entities have dominant ownership.

The post-privatization dynamics show both important similarities and differences between the two countries. The Russian results supports to a high degree the proposed typical transition governance cycle of ownership employee➔manager➔outsider. Russia is still in a stage with very weak governance institutions and the managers are in a very strong position both in relation to employees and in relation to potential external owners. Most of the employee owned enterprises have changed to either manager ownership or to the next step in the governance cycle, outside domestic ownership. Change from managers to outsiders is quite rare. However, many of the changes from employees to outside firms are probably a cover for manager ownership and outsiders can be quite closely

closely related to the managers. Therefore, outsider ownership may be somewhat exaggerated compared to manager ownership. The last step in the cycle involving foreign owners is extremely rare in Russia.

In Slovenia we have also seen a strong development away from employee-dominated ownership. However, in contrast to Russia the Slovenian managers have only taken over dominant ownership position in quite few cases in the sample. The Slovenian cycle has to a high degree skipped this stage so the typical development is employee→outsider ownership. There can be several explanations for this development: It can be argued that the institutional development in Slovenia is so advanced that outsiders are in a stronger position than what is typical for most transitional economies. The owner-manager governance problem has not been solved by manager ownership, but by concentrated outside owners. However, if the cycle is so advanced in Slovenia, that the insider stage based on weak institutions have been passed, it is surprising still to find a relatively high number of employee dominated firms. Here, the cultural historical heritage, the relatively high Slovenian income level, and specific institutional settings like the format of AWA – workers associations – may be the explanation. The AWAs represent an alliance between managers and workers. The managers have probably a strong position in this alliance, however, they are not strong enough to manipulate the workers nor take over the workers' shares for a low price like it has been common in Russia.

A high proportion of Slovenian companies have ended up as dominated by domestic financial outsiders in the form of Privatization Investment Funds. It may be questioned if this can be taken as an indicator of the high sophistication of the institutional system in Slovenia. The PIFs were integrated in the specific Slovenian privatization model, and although the regulation has been stronger than in Russia the governance system in relation to the PIFs have been much debated and new legislation has been enacted in 2003 (EBRD 2003).

An argument supporting that Slovenian governance is not so advanced after all, is the fact that the companies are still in a stage of increasing concentration. The stock exchange and the protection of minority investors have apparently not been strong enough for the development of more diversified shareholder ownership. The PIFs to some extent represent diversified domestic investors, but in the latest years a concentration of ownership has also taken place within these funds.

The analysis has shown that the governance institutions are more advanced in Slovenia than in Russia. Both countries have followed parts of the proposed governance cycle for transitional economies changing the ownership from employee ownership in the direction of concentrated domestic outsider ownership. Especially in Russia this transformation has happened through a stage of manager ownership, a stage that seems to play a minor role in Slovenia. However, the strong role of ownership by other domestic firms may in both countries cover manager ownership. This should be investigated further, but it will need quite deep analyses based on a series of case studies of the complicated owner structures, pyramid schemes etc.

The analysis shows that both countries have had a quite rapid change in ownership structures with more than half of the companies changing dominant owners over the period of analysis. The gross intensity of redistribution is somewhat lower in Slovenia than in Russia, indicating that the first stage of rapid changes have been passed.

Insider ownership has apparently not been a serious barrier for the ownership changes, and the widespread fear from, especially, Western experts about "halfway privatizations to insiders" does not seem to be well grounded. The speed of change depends highly on the development of the institutions for corporate governance including the development of the financial sector. There is no reason to worry about unwanted effects of employee privatizations, so long as institutional developments are fast.

The actual development of the governance cycle in a specific company depends on a multitude of different factors. Even if there are no barriers for ownership change, some companies may keep and deepen their employee ownership, as it has been the case in some of the Slovenian Workers Associations (AWAs). This form may turn out to be both an efficient and sustainable ownership structure for some companies.

Table 1. Governance cycles in developed market economies

Core stages of change in governance/ownership – classical cycle

start up stage entrepreneur-ownership (management, family ownership) **early growth stage** change in ownership/governance because of need of supply of external capital, management skills and networks by: - bank (often rather passive role in relation to management) - closely related investors, take active part in management - venture capital, take active part in management **later growth stage** change in ownership/governance because of need of supply of external capital, management skills and networks by: - strategic investor, take full control with the company - public investors, often diversified ownership **crisis/restructuring stage** change in ownership/governance because of takeover by - bank (bad loans de facto transferred to ownership capital) - venture capital (often specialized in takeovers (often unfriendly)) - strategic investor (use opportunity to take over cheap assets) - defensive takeover by insiders (to avoid close down and unemployment) - close down (assets transferred to other use)

Table 2. Specific elements in early transition influencing the governance cycle

Starting stage determined by privatization method, which may favor managers, other employees, concentrated foreign investors or diversified external ownership. Most enterprises have a **strong need of restructuring** (inputs, production methods, outputs not adjusted to new market conditions, with a new set of prices and incentives.) The **financial system** not developed, - external finance from banks limited - the stock exchange not functioning - venture capital firms not existing The **governance institutions** for securing property rights (especially shareholder rights) not fully developed **=>** widespread insider ownership enterprises have to rely on internal finance slow strategic restructuring

Table 3. Expected governance cycles in countries in transition

Privatized (starting point depends on privatization method)

employee → manager → outside concentrated (domestic → foreign)

diversified domestic → manager → outside concentrated (domestic → foreign)

outside concentrated, foreign stable (very long run more diversified for large listed companies)

New

manager → outside concentrated (domestic →foreign)

foreign concentrated (stable)

Table 4. Overview over privatization

	Private % GDP	Large privatizat.	Small privatizat.	Main method	Secondary method	Peak years
	95 99 02	**95 99 02**	**95 99 02**			
Russia	55 70 70	3 3 3+	4 4 4	voucher/insider	share/loans	1993-95
Slovenia	50 60 65	3- 3 3	4 4+ 4+	voucher/insider	funds	1995-97

The Table is based on Mygind 2000, and EBRD 2003, where scores for privatization and governance range from 1 = none to 4+ = full.

Table 5. Some economic indicators for the transition process

	production 1989=100			unemployment			av. wage/month USD			FDI/capita
	1995	**1999**	**2002**	**1995**	**1999**	**2002**	**1995**	**1999**	**2002**	**1989-2002**
Russia	62	61	74	9.2%	12.6%	8.6%	117	64	123	48 USD
Slovenia	93	110	122	7.4%	7.4%	5.9%	945	953	911	1702 USD

based on EBRD 2003

Table 6 Overview over privatization of enterprises in Russia and Slovenia

	Russia	**Slovenia**
Starting point pre-privatizaiton	large centralized enterprises paternalistic management only formal influence by labor collective	medium to large enterprises self-management with social ownership influence of labour-collective
early privatization / early private oriented enterprises during 1980es	1986 law on new cooperatives, employee own, manager control 1987 law: individual micro firms 1989 law: labor collective lease + right to buy, management control Feb 92,9500 firms, 9% of workers	managers get quite strong position in the end of the 1980es with further liberalization
wild privatization	tunneling to new private entities => management or outside domestic core-investor ownership	probably not so widespread
small privatization	strong regional differences auctions or lease buy outs, By June 1994: 80% privatized, of which 60% employee-owned	integrated in large privatization
large privatization	**mass privatization** fall 1992-94, 15000 large and medium sized firms with > 70% of production, 150 mill vouchers to population **option 1:** (21% of firms) 25% non-voting free to employees 10% option to buy at 30% discount on low book value Jan 1992 **option 2:** (over 70% of firms) 51% for cash and vouchers to employees at 1.7 * book value 1992 => 70% of firms employee owned **option 3:** (quite few firms) 30% to buy for investor group 20% buy for insiders 30%discount 1995 **loans-for-shares**, mortgage privatization of 12 large jewel firms to Financial Industrial Groups closely related to the president 1996- **case-by-case** privatizations, direct sale often through tenders, increasing speed and transparency	December 1992 vouchers distributed (non transferable) **privatization model:** 10% to State Restitution Fund 10% to State Capital Fund 20% to Development Fund, later sale to Privatization Invest. Funds remaining 60%: **internal priv: 90% of firms** 20% for vouchers to employees up to 40% internal buyout by min 1/3 employees, 50% discount rest: public sale (Slovenians preemptive rights before foreigners) or: to Development Fund **liquidation 4% of firms,** employee involved in the process **ownership after privatization:** 40% internal, mostly to labor-intensive SMEs 25% Privatization Investmt Funds 22% Restitution/Capital Funds 13% publicly sold (for vouchers)

Table 7 Ownership of enterprises in Russia, various samples, average shareholdings, %

	REB	World Bank	J. Blasi *et al*		Nottingham University		Institute for Economy in Transition		Higher School of Ecs.	BEA
	1995	1994	1994	1996	1994	1996	1994	1996	1995	1994
Insiders, total	**55**	**69**	**65**	**58**	**66**	**57**	**62**	**56**	**51**	**68**
Managers	***11***	***21***	***25***	***18***	***22***	***12***	***9***	***16***	***8***	***23***
Workers	***44***	***48***	***40***	***40***	***44***	***43***	***53***	***40***	***42***	***55***
Outsiders, total	**35**	**20**	**22**	**32**	**22**	**36**	**21**	**34**	**40**	**20**
Non-fin. outsiders	***26***	**-**	**-**	***21***	***17***	***24***	***10***	***9***	***17***	***18***
Private individuals	**11**	**-**	**-**	6	6	11	10	9	5	10
Other enterprises	**15**	**-**	**-**	15	11	13	-	-	12	8
Financial outsiders	***9***	**-**	**-**	***11***	***22***	***12***	***11***	***25***	***12***	***2***
State	**9**	**11**	**13**	**9**	**12**	**9**	**17**	**10**	**10**	**12**

Table 8: Slovenia 1998 Insider ownership by firm, capital, and number of employees

insider ownership	**total capital** 1000 SIT	**total capital** %	**number of companies**	**number of companies** %	**number of employees**	**number of employees** %
0-10 %	238.909.289	29.0	82	6.3	20.912	7.8
10-20 %	128.067.033	15.5	68	5.2	18.570	6.9
20-30 %	92.248.314	11.2	81	6.2	27.714	10.3
30-40 %	93.379.520	11.3	122	9.3	31.700	11.8
40-50 %	82.526.405	10.0	155	11.8	47.302	17.6
50-60 %	122.317.335	14.8	483	36.9	78.990	29.3
> 60%	66.778.045	8.1	319	24.4	44.083	16.4
TOTAL	824.225.941	100.0	1310	100.0	269.271	100.0

Source: Agency For Privatization and Restructuring (Porocilo Agencije), 1999:145.

Table 9 The development of governance institution in Russia and Slovenia

	Russia			Slovenia			
Bankruptcy legislation	Strict law 1998 adjusted 2002 , enforced?			first law 1994 stronger enforcement 2000-			
Governance	**1995**	**2002**	**2003**	**1995**		**2002**	**2003**
enterprise	2	2+	2+	3-		3	3
competition	2	2+	2+	2		3-	3-
corporate governance developments	1990es much tunneling + abuses of minority investor rights, 1994 MMM pyramid investment fund scandal 1996 JSC law, securities law, but still weak implementation 2002 Code of Conduct			Companies Act 1993, quite secure shareholders' rights, Takeover act 1997, problems Worker codetermination 1993 Investment Fund law 1994 revised 2003, PIF problems			
Bank market	**1995**	**2002**	**2003**	**1995**		**2002**	**2003**
total number (foreign)	2297 (21)	1329 (37)		39 (6)		22 (6)	
state owned banks % assets	37 (1997)			41.7		48.6	priv
private loans as % GDP	8.7	17.3		27.3		41.0	
bad loans as % of total loans	12.3	11.4		9.3		10.0 (2001)	
regulation	Quite loose			quite good			
EBRD score	2	2	2	3		3+	3+
Stock market start	1991 Moscow			1990 Ljubljana			
	1995	**2002**	**2003**	**1995**	**2000**	**2002**	**2003**
listed firms		247		ca.40	154	139	136
share capitalization % GDP	4.8	36.5		2	17	23	23
turnover/capitalization %		5			21	23	23
EBRD score	2	2+	3-	3-	3-	3-	3-

based on EBRD 2003, Gregoric 2003, ECB 2002, RTS (www.rts.ru), Ljubljana Stock Exchange (www.ljse.si),

Table 10 Ownership transition matrices for Russia 1995-2003

1995 \ 1997	**Dominant Shareholders 1997**						
Dominant Share-holders 1995	**Manag-ers**	**Em-ployees**	**Non-fin. outsiders**	**Financial outsiders**	**Foreign**	**State**	**Total 1995**
Managers	1	0	1*)	0	0	0	2
Employees	2	13	5	3	2	1	26
Non-fin. outsiders	0	0	6	1	0	0	7
Financial outsiders	0	0	2	1	1	0	4
Foreign	0	0	0	0	0	0	0
State	0	0	1	0	0	1	2
Total 1997	3	13	15	5	3	2	41

*) for this firm share of managers and workers were equal in 1995

1997 \ 1999	**Dominant Shareholders 1999**						
Dominant Share-holders 1997	**Manag-ers**	**Em-ployees**	**Non-fin. outsiders**	**Financial outsiders**	**Foreign**	**State**	**Total 1997**
Managers	5*)	2	0	0	0	0	7
Employees	1	13	8	0	0	0	22
Non-fin. outsiders	1**)	3	4	0	0	0	8
Financial outsiders	0	2	0	2	0	0	4
Foreign	0	0	0	0	1	0	1
State	0	0	1	0	0	4	5
Total 1999	7	20	13	2	1	4	47

*) for 2 firms share of managers and workers were equal in 1997
**) for this firm share of non-financial outsiders and workers were equal in 1997

1999 \ 2001	**Dominant Shareholders 2001**						
Dominant Share-holders 1999	**Manag-ers**	**Em-ployees**	**Non-fin. outsiders**	**Financial outsiders**	**Foreign**	**State**	**Total 1999**
Managers	9	0	1	0	0	0	10
Employees	9	9	7*)	1	0	0	26
Non-fin. outsiders	2	4	21	3	0	0	30
Financial outsiders	1	0	0	4	0	1	6
Foreign	0	0	0	0	0	0	0
State	0	0	2	0	0	4	6
Total 2001	21	13	31	8	0	5	78

*) for 1 firm share of non-financial outsiders and workers were equal in 1999

2001 \ 2003	**Dominant Shareholders 2003**						
Dominant Share-holders 2001	**Manag-ers**	**Em-ployees**	**Non-fin. outsiders**	**Financial outsiders**	**Foreign**	**State**	**Total 2001**
Managers	7*)	3	2	1	0	0	13
Employees	4	9	4	0	0	0	17
Non-fin. outsiders	6	1	16	2	1	0	26
Financial outsiders	0	1	2	1	0	0	4
Foreign	0	0	0	0	0	0	0
State	0	0	1	0	0	0	1
Total 2003	17	14	25	4	1	0	61

*) for 1 firm share of managers and workers were equal in 2001

Table 11 Ownership transition matrix Russia 1995-2003 (first by last years recorded)

1995 \ 2003	Dominant Shareholders (end)							
Dominant Share-holders (start)	Mana-gers	Em-ployees	Non-fin. outsider	Finance outsider	For-eign	State	Total start	change
Managers	10*)	2	3	0	0	0	15	33%
Employees	17	22	21	6**)	1	1	68	68%
Non-fin. outsiders	9	4	25	5	1	1	45	44%
Financial outsiders	2	1	2	4	1	2	12	67%
Foreign	0	0	0	0	1	0	1	0%
State	0	1	5	0	0	5	11	55%
Total (end)	38	30	56	15	4	9	152	56%

*) for 2 firms share of managers and workers were equal in the beginning
**) for 1 firm share of workers, financial outsiders and state were equal at the end

Table 12 Russia 1999-2003 with average concentration on first largest owner

1999 \ 2003	Dominant Shareholders (end)						
Dominant Share-holders (start)	Manag-ers	Em-ployees	Non-fin. outsiders	Financial outsiders	Foreign	State	Total (start)
Managers	10*) (30/37)	0	2 (20/37)	0	0	0	12 (29/37)
Employees	5 (14/28)	10 (15/14)	3 (11/21)	0	0	0	18 (14/19)
Non-financial outsiders	7 (30/57)	2 (11/21)	19 (31/40)	3 (54/54)	1 (20/51)	0	32 (32/44)
Financial outsiders	0	0	2 (61/68)	3 (41/50)	0	0	5 (49/57)
Foreigner	0	0	0	0	0	0	0
State	0	0	2 (64/21)	0	0	3 (87/68)	5 (76/49)
Total (end)	22 (26/41)	12 (15/15)	28 (32/38)	6 (48/52)	1 (20/51)	3 (87/68)	72 (31/38)

Average size (%) of the first largest block (beginning /end) in parenthesis.
*) for 1 firm share of managers and workers were equal in the beginning

Table 13 Ownership transition matrix for Slovenia 1998-2003 (first\last years recorded)

1998 \ 2003	Dominant Shareholders (end)							
Dominant Share-holders (start)	**Mana-gers**	**Em-ployees**	**Non-fin. outsider**	**Finance outsider**	**For-eign**	**State**	**Total start**	**change**
Managers	1	0	1	0	0	0	2	50%
Employees	3	23	24	14	3	7	74	69%
Non-fin. outsiders	0	0	17	0	1	1	19	11%
Financial outsiders	0	1	5	17	0	0	23	26%
Foreign	0	1	0	0	3	0	4	25%
State	0	1	4	5	2	12	24	50%
Total (end)	4	26	51	36	9	20	146	50%

Employees include (few) former employees, Non-financial outsiders = domestic firms and individuals, Financial outsiders = Privatization Investment Funds (PIFs) + one bank, State = state funds+other (state).

Table 14 Slovenia 1998-2001 with average concentration on first largest owner

1998 \ 2001	Dominant Shareholders (end)						
Dominant Share-holders (start)	**Manag-ers**	**Em-ployees**	**Non-fin. outsiders**	**Financial outsiders**	**Foreign**	**State**	**Total (start)**
Managers	2 17/17	1 12/20	0	0	0	0	3 15/18
Employees	1 12/10	25 23/22	17 27/49	15 27/38	3 23/66	8 24/36	69 25/35
Non-financial out-siders	0	0	16 40/49	0	0	1 18/20	17 39/47
Financial outsiders	1 50/40	1 12/13	3 21/38	16 34/42	0	0	21 32/40
Foreigner	0	1 28/21	0	0	3 52/67	0	4 46/55
State	0	1 74/19	5 38/47	2 22/40	2 37/31	12 60/51	22 50/46
Total (end)	4 24/21	29 24/22	41 33/48	33 30/40	8 37/58	21 45/44	136 32/39

Table 15 Slovenia first largest owner matrix, & average concentration *1998/2001* %

1998 / 2001	**AWA**	**Indi-vidual**	**Dom. firms**	**PIF**	**Bank**	**For-eign**	**Capi-tal F**	**Restit. Fund**	**Dev. Fund**	**State**	**Total**	**change %**
AWA	6 *45/43*	0	0	0	0	0	0	0	0	0	6 *45/43*	0
Individuals	0	6 *19/30*	0	0	1 *36/43*	0	0	0	0	0	7 *21/28*	14
Domestic firms	0	0	22 *37/54*	0	1 *12/13*	1 *20/59*	1 *25/17*	0	0	0	25 *35/51*	12
Privatization Invest. Funds	0	2 *21/23*	9 *37/54*	34 *30/35*	2 *21/41*	2 *20/50*	0	1 *20/10*	0	2 *12/40*	52 *28/36*	35
Banks	0	0	1 *34/52*	0	0	0	0	0	0	0	1 *34/52*	100
Foreigners	1 *28/21*	0	0	0	0	9 *41/57*	0	0	0	0	10 *44/53*	10
Capital Fund	0	0	9 *19/40*	1 *22/60*	0	0	12 *21/21*	1 *12/12*	0	0	23 *19/30*	48
Restitution Fund	0	1 *10/23*	0	0	0	0	0	3 *26/27*	0	0	4 *22/26*	25
Development Fund	0	1 *35/20*	5 *35/35*	2 *51/26*	0	0	0	0	0	0	8 *39/31*	100
State	1 *70/64*	0	2 *55/65*	1 *20/27*	0	0	0	2 *24/25*	0	8 *66/59*	14 *56/53*	43
Total	8 *46/43*	10 *20/27*	48 *33/47*	38 *31/35*	4 *22/35*	12 *36/56*	13 *21/21*	7 *23/22*	0	10 *55/55*	150 *32/40*	33

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