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CORPORATE GOVERNANCE THROUGH PRIVATISATION: DOES DESIGN MATTER?

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CORPORATE GOVERNANCE THROUGH PRIVATISATION: DOES DESIGN MATTER?

Abstract

The paper discusses the nature and the corporate governance role of the institutional monitors, that is the privatisation funds, which have emerged out of the mass privatisation in Bulgaria. The focus is on the tension between regulatory design and actual development: the process led to the establishment of control-oriented holding groups as opposed to the intended portfolio-managing institutional shareholders. The paper examines the dimensions of this tension and its control implications. It offers some explanations for it. The findings are based on primary research conducted on a representative sample of privatisation funds.

INTRODUCTION

Two main approaches to the post-communist transformation of Central and Eastern Europe can be distinguished in the academic debate. The first one, known as ‘transition orthodoxy’, was largely espoused by international financial institutions and Western policy advisers. Based on the underlying assumption that it is possible to ‘draft’ institutional change, it focuses on the strategic choice of certain policies when a ‘window of opportunity’ is available. These policies, derived from the spirit of neo-liberalism, are the well known stabilisation, liberalisation and privatisation. The approach has been the subject of extensive criticisms for: simplifying the existing state of individual Central and East European countries (CEECs), insufficient understanding of the working of non-commercial institutions, such as the state, culture, crime, apart from the selective acknowledgement of some factors acting as ‘political constraints’, and for the rather prescriptive reduction of the process of change to the formulation and implementation of policy packages, while underestimating the role of other areas of social life. Indeed, developed as a reaction to this approach, is the attempt by representatives of various other theoretical persuasions to study the process of what actually occurs during transition. Such authors point at the lack of proper recognition of the variety of existing societal institutions. They conceptualise the process of ‘transformation’ as a complex reworking of old and new social relations and as a two-dimensional process of path-shaping and path-dependence (Smith and Pickles 1998). Accordingly, they emphasise that the strategic choice of policies and the adoption of new laws takes place in a path-dependent context, which ultimately determines the dynamics of the transformation away from state socialism of individual CEECs.

Set in this broad discourse, this paper will look precisely at the tension between ‘policy design’ and ‘intended development’ on the one hand, and ‘actual development’, on the other in the case of Bulgaria. What is meant by ‘design’ here is the putting in place a regulatory framework intended to steer economic development through a set of legislative and administrative acts. The particular focus is on the design of the privatisation funds (PFs), via the institutional innovation aspect of the non-standard method of privatisation through investment vouchers, and more specifically, on the ability of the privatisation funds (PFs): to be the new active owners to replace the inefficient ministries in governing enterprises; to ensure managerial accountability; and to induce the necessary ‘deep’ restructuring of the economy.

From the very beginning, the question of corporate governance was recognised as one of the salient problems in the transformation of the CEECs: that it

is necessary to ensure not only that the existing state companies are privatised but also that the new owners are able to influence the incumbent management and to affect the direction of the enterprise. Mass privatisation presented particular problems in this respect. It was an innovative policy proposal to respond to the specific conditions of post-communism. Such schemes, in quite varying forms, were introduced in most CEECs, as a principal or a subsidiary method for privatisation. Mass privatisation attempted to address problems such as the lack of domestic capital and of market mechanisms for pricing assets. Its use implied that speed was essential in carrying out state sector reform and that social justice would be achieved by distributing state ownership to the population at large. The resulting problem of effective corporate governance of the enterprises, namely how to ensure that a large number of small shareholders are really interested, qualified and able to influence the economic direction of these enterprises, was resolved through the creation of privatisation intermediaries. These institutions were envisaged either as specific investment companies¹ or as holding companies. Indeed, in the early 1990s a number of institutional designs were proposed on the argument that, despite the potential shortcomings of creating such owners, privatisation intermediaries can be regulated so that a proper balance between ‘the best and the feasible’ is achieved (Lipton and Sachs 1990, Blanchard *et al* 1991, Frydman and Rapaczynski 1991). For other authors, the design of privatisation intermediaries, regardless of variations in the design, suffers from inherent problems, such as lack of instruments, incentives, capital and expertise to restructure companies (Ellerman 1998).

Bulgaria adopted a mass privatisation scheme as a subsidiary or complementary method for privatisation² at the very beginning of 1996. The authors of the scheme took pride in creating a design which avoided the disadvantages of most schemes previously introduced in the other CEECs. Thus, the choice was for: *ex ante* regulation, as opposed *ex post* reaction; non-transferable vouchers; privately created intermediaries, as opposed to state created ones; strict entry criteria and supervision of PFs to protect the rights of small voucher holders against potential abuse on the part of promoters as well as to restore investor confidence after a prolonged period of speculative, unregulated security markets; and explicit corporate governance provisions to ensure that PFs engaged actively in the enterprises, by allowing them to hold up to 34% in each company and ‘locking them in’ for 6 months. In a way, the Bulgarian scheme fulfilled most of the guidelines for institutional engineering set out in the literature.

¹ Mutual funds in the USA, unit or investment trusts in the UK.

² To sales privatisation, MEBO, and restitution.

The question here is not so much about the advantages or disadvantages of the Bulgarian scheme compared to that of the other CEECs. It is about mass privatisation as a substantive rather than regulatory process. Indeed, the developments took place within the design, but also despite the design, as a result of a wide range of factors. One of the interesting aspects of the actual outcome is that it resembles what in the Czech Republic has been called ‘a third wave’ of privatisation of 1996: the formation of entities like business groups (more or less diversified holding companies) as opposed to the intended new institutional investors. The concentration of control, however, happened in Bulgaria even during the implementation of the scheme and despite the provisions to the contrary. It is important, then, to evaluate this substantive development from the point of view of the corporate governance of the enterprises.

In addressing the issue, this paper will begin by considering the regulatory framework of the Bulgarian privatisation funds (PFs). Then, it will discuss the dimensions of their investment and control behaviour. The paper is a part of a wider analytical and empirical endeavour. It draws on primary data for all 81 funds established with regard to their ownership structure, expenses, initial investment strategy and types of portfolios formed. A sample of just 14 funds is the subject of in-depth examination. In absolute number, the sample represents 17% of all funds, but in terms of voucher resources available, it accounts for 48.7% of all vouchers invested in PFs. The sample is weighted in favour of the larger funds in view of the more significant role they are likely to play. In addition, successive interviews (at the beginning and the end of the mass privatisation programme (MPP)), based on open-ended questionnaires, have been conducted with the managers of these funds.

DESIGN OF THE PRIVATISATION FUNDS

The privatisation intermediaries were envisaged as a tool for collective investment and a medium for the indirect participation of citizens in the mass privatisation. In such a way, they offer the small voucher-holders the advantages of risk diversification and professionalism. Accordingly, the legal form of privatisation funds in Bulgaria was modelled in view of this function of accumulating the resources of wide numbers of small investors and investing them for specific purposes. The PFs were envisaged as a specific type of mutual funds, or, as they are known under Bulgarian law, investment companies (ICs), closed for a period of 5 years.

Like investment companies, the capital of PFs was divided into nominal, voting shares. Their major area of activity was also professional investment in securities. Both PFs and ICs were subject to similar restrictions on investment activity in the interests of the small investors whose resources they concentrated, such as the

need to maintain minimal liquid resources, diversification requirements, and borrowing restrictions. Both institutions follow the same principles of formation: private initiative, raising capital on the basis of prospectuses for public offering, approval by the Securities and Stock Exchange Commission (SSEC), licensing and external supervision on the part of the SSEC. Both were organised as joint-stock companies and their internal governance was regulated by the relevant provisions of the Commercial Act of 1991 as well as their statutes. Both could be managed by their own directors or by investment intermediaries.

Given the specific context in which the PFs had to operate, however, their regulatory regime differed in several respects from that of the general investment companies. The intention was on the one hand, to offer greater protection to small voucher holders, given the scale of the scheme and its political importance. On the other hand, the specific investment in the enterprises from the mass privatisation list as well as the active involvement in them had to be ensured.

Firstly, unlike ICs, no less than 70% of the capital base of funds had to consist of investment vouchers. It had to be raised under a special procedure with the participation of the post offices and the Centre for Mass Privatisation (CMP), in conditions of intense competition among the PFs. The remaining part consisted of liquid assets, namely cash and short-term, interest-bearing state securities, of a minimum value of 10 million Bulgarian levas (BGL), fully paid by the founders. The idea was for the latter part to help meet the expenses of the funds until they had some returns from their activities. As will be seen below this turned out to be quite unrealistic, and funds were ultimately dependent on the contributions of their founders.

Secondly, the PFs were subject to more restrictions on their investment activities compared to the ICs. At least 70% of their voucher capital had to be invested in MPP shares. The latter, according to the initial regime, would not be transferable before the publication of the first balance of accounts of the enterprise, but no earlier than 6 months after the end of the last auction round (art. 51a, Privatisation Act (PA)). The provision aimed at “locking in” the new owners for a certain period: until the financial condition of the post-privatised enterprise was known. The prohibition was repealed in October 1997, but still the PFs, unlike the individual investors, could trade these shares only on the stock exchange. The Stock Exchange opened on 21 October 1997 and, in law, this marked the beginning of restructuring PF portfolios. Moreover, unlike investment companies, the PFs could not invest in securities traded over the counter. They could only be securities accepted for trade on the stock exchange or state bonds. No shares of other PFs could be acquired except with the permission of the Commission. Given the state of

development of the stock market and the number of securities to be traded on it, the possibilities of stock exchange transactions in private securities was quite limited. In any case, such securities could not exceed 10% of the PF's capital. For state bonds the cap was higher: 25% of the PF's capital. Thus, the funds had less risk reduction possibilities than normally available to institutional investors.

Thirdly, at the same time, in view of the interests of small investors, they were required to maintain higher minimum diversification levels than the ICs. Thus, they could not invest more than 10% of their capital in securities issued by one and the same person. This principle was compromised with regard to the MPP shares for reasons of corporate governance of the portfolio enterprises. Accordingly, funds can invest as much capital as defined in their investment strategy, so long as it does not exceed 34% of the capital of the portfolio company. The implications of this threshold for enterprise control will be discussed further below.

Fourthly, unlike investment companies, the privatisation funds were by definition widely held joint-stock companies. The requirement of a minimum BGL 70 million capital meant that the PF had to have at least 2400 voucher shareholders. At the same time, there was the requirement that no shareholder could hold directly or through related entities more than 10% of the PF's shares. This provision clearly seeks to prevent the PF from being dominated by a single interest. For the same purpose, there are disclosure requirements applicable upon acquiring more than 5% of the funds' shares or becoming able to have decisive influence on the PF's activities in some other way.

The founders clearly had greater obligations with regard to the formation of the funds and the preparation of their investment strategies. Nonetheless their rights were equal to those of the voucher shareholders. This principle was reinforced by the prohibition on issuing preferential shares and reserving the right to appoint the first board of directors.

There was also a number of requirements related to the membership of the board of directors to be met with the aim of ensuring the professionalism of the PFs. Directors had to possess a "suitable professional qualification and experience" (art. 18(1), p. 2 Privatisation Funds Act (PFA)). In practice, the SSEC accepted that this meant having higher education. The principle of depolitisation was also carried through by the prohibition on officials of the Council of Ministers, of the central departments of ministries, as well as of the central departments of any other public organisations listed by the government, to be directors.

Finally, the PFs were envisaged as an explicitly transitory form. According to the initial design, the PFs, subject to the fulfilment of their role in using the vouchers

accumulated in the mass privatisation wave, could transform themselves either into investment companies or into holding companies. This could be done after the publication of the first balance of the portfolio companies, but no earlier than 6 months before the end of the privatisation wave. The possibility was left for a second wave to be carried out along similar lines as the first one, with a role for the PFs in it. The new reform government of the spring of 1997, however, decided that the scheme would not be repeated in its original form and the new policy will not allow for participation by the PFs in a voucher scheme. In practice, the fate of the privatisation funds was quite uncertain until April 1998, when provision was made for a mandatory liquidation of the funds which have not transformed themselves into holding companies or investment companies.

Nonetheless, a certain paradox can be observed, in that the PF's choice of institutional forms was significantly constrained. The regulation of the investment companies adopted in the summer of 1995 was of a framework character. It did not fully specify the features of the different types of ICs, open- and closed-end ones, and left much to be resolved in secondary legislation. Great powers, normative as well as administrative, were left to the Securities and Stock Exchange Commission, which was effectively in charge of significant rule-making and regulatory activities without a clear legal point of reference. In fact, the practice in regard to PFs preceded that for the ICs. The option of a holding company was not clear until April 1998, when it was established that the transformed funds would be treated as public companies. This meant that the trading in their shares would be subject to restrictions and the control of the SSEC.³ In other areas of their functioning, however, the transformed holding companies would be outside its supervisory competence and subject only to the provisions of the general commercial legislation.

Another characteristic of the regulatory framework of PFs in Bulgaria is that, unlike the situation in the Czech Republic or Russia, they were subject to strict entry criteria and very intensive preliminary and interim supervision on the part of the SSEC. To start with, the SSEC exercised control with regard to the prospectuses for public offering. It checked the contents of the prospectuses and their graphic designs for satisfying the legal criteria, as well as their clarity as to the risks and returns to investors associated with the investment strategy of the fund. The SSEC had the right to refuse to approve the prospectuses if the interests of investors were not sufficiently guaranteed. According to the SSEC, the interests of the investors primarily required full disclosure of the information needed and equal access to that information, as the main precondition for the formation of investor market culture (SSEC, 1997). Indeed, the SSEC followed a strict approach and approved 92 out of 104 applications of PFs.

³ The law, however, left an opening when one of the parties to the transaction was a physical person.

The funds were also required to update the prospectus information with the changes of the volume of the capital initially offered for subscription, and the occurrence of other circumstances that might affect share prices. Strictly speaking, given the macroeconomic situation in the country and the constant modifications in the MPP list, they were in permanent default. In addition, they were dependent on the efficient functioning of the CMP for current information on the number of voucher holders who had already subscribed. Nevertheless, the SSEC insisted on the updated prospectuses containing: an optimal strategy for management of the investments, based on a thorough analysis of the main macroeconomic indicators, of the financial market and of the MPP enterprises; reasonable diversification of the portfolios on the basis of prognoses for the development of the industrial sectors; secure guarantees for protecting the interests of investors and risk minimisation; clear strategies for participation in the auction sessions, as well as a strategy for influencing the economic policy of the portfolio enterprises; co-operation and partnership with appropriate partners to attract fresh capital; and excellent knowledge of the conditions of the enterprises (SSEC, 1997).

In addition the SSEC made regular checks on all funds to control the implementation of certain provisions, mostly connected with the process of raising capital and the advertising campaign. In fact, 177 checks were made in 1996, and only a very small number of funds were not sanctioned in that period. The majority of funds were fined for failing to add in their advertising materials that the price of shares might fall and that profit was not guaranteed. In addition, general reviews were conducted. For example in the first half of 1997, 65 funds were investigated and 80 violations were identified (Racheva, 1997).

The last point to be made on the regulatory regime for the privatisation funds is their tax treatment. Privatisation funds, like the investment companies, were exempt from tax on profit that is to be distributed as a dividend. Thus, on the one hand, an extra incentive was created in favour of funds' shareholders. On the other hand, it represented a disincentive to invest in the portfolio companies. The provision highlights the possibility of conflict between the interests of voucher shareholders and those of the larger founders, who have parallel business links with the portfolio companies.

The institutional design of privatisation funds qualifies them as a special type of investment company; they were expected to contribute to the development of the stock market. As such, the main principle in their regulation is connected with the protection of the interests of small investors. The lack of investor tradition, the legacy of speculative and disorganised security markets, and the scale of the mass privatisation process, however, called for even stricter regulation of the formation,

ownership structure and activities of privatisation funds, allowing for significant supervisory powers to be assigned to the SSEC. Thus, PFs were over-regulated investment companies.

The first problem was the contradiction between the formal requirements and the substantive economic and wider political and administrative conditions. Secondly, the institutional form thus designed contained several potential shortcomings which disadvantaged it compared to other 'normally' constituted ICs. The PFs were restricted in their trading possibilities, a large part of their portfolios consisted of non-profit making but highly illiquid securities, and they were restricted in their diversification possibilities. Therefore, by definition, the PFs were placed under conditions where neither keeping shares in the short-run was profitable, nor was selling them⁴ possible. Funds faced a potential liquidity crisis, which was resolved in a number of ways to be pointed out in the next section.

The regulation of the PFs, at the same time, endeavoured to create incentives for them to exercise an active role in the portfolio companies by enabling them to hold up to 34% and initially 'locking' them into these companies. Although undoubtedly this gives more leverage to the new owners, the question still remained whether this was sufficient to stimulate shareholders' activism of the kind required for restructuring. Firstly, the PFs interest in the restructuring of companies is not clear. The managers' primary duty is to maximise the profit of PFs' shareholders, which in many cases means a conflict of that interest with the task of long-term commitment to an ailing enterprise. This condition is reinforced by tax law. Secondly, PFs potentially have very few liquid resources of their own (determined by the structure of capital and the prohibition on borrowing) that they can expend on active control or financial engagement in the portfolio companies. Thirdly, even if they had the resources, the PFs have difficulties in investing them in the portfolio companies. They cannot lend, they also cannot easily invest in new equity due to the dispersed and heterogeneous ownership structure of the companies and high majorities needed, as will be discussed in the last section. The regulation intends the PFs to be widely held companies, where all shareholders have equal rights and, in particular, promoters cannot reserve the right to appoint the first board of directors. This, however, is clearly in contradiction with the expectations laid upon the founders of the funds and build into the politics of the mass privatisation scheme, as well as in the requirements of the SSEC.

Thus, the PFs were a transitory, hybrid institutional form, suffering from serious organic defects, which affected accordingly the investment and control incentives of individual funds.

⁴ The Stock Exchange was opened only on 21 October 1997.

Formation and Investment Behaviour

The empirical study of the governance structure of the PFs themselves and of their investment strategies showed that, within the broad legislative constraints, they followed more or less a logic of development of their own.

Governance of PFs

As it was discussed in the last section, the regulatory intention was to maintain a dispersed ownership structure of PFs and to ensure the homogeneity of shareholders' rights. Indeed, all PFs have an extremely large number of voucher shareholders. As a group these shareholders hold on average 99% of the shares, that is also of the votes. The founders similarly hold quite small individual, but also collective, stakes. Only a few main characteristics of the founders of funds in Bulgaria will be identified here.

Firstly, a very wide range of founders took part in the process. As Table 1 shows, non-financial institutions, mostly private commercial companies and physical persons, were most active in the formation of PFs. The financial institutions participated in fewer funds, but as will be seen below, their importance in terms of voucher capital is significant.

A full description of the founder categories is not possible in this paper. Even so, it has to be mentioned that, as in other CEE countries, it is difficult to define clear types, especially in the area of non-financial institutions. The notion of “insiders” here is accepted as representing incumbent and former employees of enterprises included in the MPP list or coming from the same industry as the latter. Many of the physical persons are in fact “insiders”, and a lot of the private commercial companies represent parallel firms. Similar insider associations have NGOs such as local chambers of commerce, and one of the biggest trade unions *KNSB*, participating in the scheme. Also it should be noted here that a number of the founding entities are “straw” ones. Good examples are the *Armejski* PF, in which representatives of various army units participate through an insurance company, or PF *Sv. Sofia*, where the Sofia municipality participated through five municipally-owned companies. The clarifications, however, cannot be made without a thorough case-by-case investigation.

Secondly, most of the Bulgarian PFs have been founded by coalitions, organised on the basis of common investment platforms, as opposed to being founded

by a single entity. Only 11 out of the 81 funds represent an exception, but even these represent holding companies themselves and/or have a small number of physical persons as their co-founders. The coalitions formed vary quite considerably in character. Depending on the number of participants, they range from very broad to quite narrow, but the number of PFs founded by wide coalitions is much bigger. This criterion has to be checked against the degree of relatedness among founders: legal dependence, contractual, or none. The funds also differ with respect to the type of the participants. The review shows that two-thirds of the funds have been founded by homogeneous rather than heterogeneous coalitions. Also, in more than half of all PFs, the founders have made fairly proportional contributions in the founding capital.

The organisation of founders has two main implications. First, it testifies to the need to pool various resources in the formation of funds given the conditions of underdeveloped markets. These resources are financial, but also represent advantages in terms of: portfolio management and investor qualification leading to lower fees to external consultants; a branch or membership structure allowing to raise voucher capital in the most cost-effective way; access to mass media to aid advertising; the provision of administrative services and offices; and perhaps most importantly, access to detailed information on the quality of the enterprises for sale and their market potential. Second, the type of founder grouping also bears upon the stability of the coalitions. Complex structures and competition among interests proved to be obstacles to the smooth functioning of some funds. On the contrary, tighter organisation facilitated the agreement on investment priorities.

The study shows that voucher holders and founders form two distinct groups, with differing incentives and ability to exercise their rights and differing potential to influence the direction of the privatisation fund. Unlike voucher shareholders, founders have a stronger motivation to exercise the rights pertaining to their equity stake: they have invested real capital, they have constantly contributed for to the maintenance of the funds, and some of them have particular vested interests that they want to achieve through the participation in the PFs as it will be discussed further below. Despite the legislative prohibition for founders appointing the first board of directors, the process of formation demonstrated that founders hold a strategic position within the funds. That position is expressed in their ability to nominate the managing organs. It was reinforced by the crucial role played by founders in sponsoring the PFs, by the information and qualification advantage that they had over voucher holders, by the logistics of holding the founding general meetings and the proxy system, as well as by the political expectations laid upon them.

Objectives of investment policy

All privatisation funds declared in their prospectuses the intention to achieve high returns on their investments while incurring minimum risk. In this respect they resemble any other typical investment institution. The return was expected to result in varying degrees from capital gains through sale of mass privatisation enterprise (MPE) shares after the prohibition period, from dividends of the MPEs, and from returns on state bonds and interest on cash. In principle, it was clear that few enterprises would be able to provide dividends. Furthermore, the initial prohibition of sales of MPE shares was another obstacle to rapid returns. The risks of acquiring the enterprises and being “locked in” with fewer possibilities for diversification, however, were substantial. The risk-reduction options, then, were careful analysis and choice of good enterprises, diversification into a number of industrial sectors, and gradual increase of the share of state securities in the portfolios and decrease in the number of enterprise shares.

Apart from the above considerations, all funds declared their intention of contributing to the restructuring of the enterprises in which they would invest, and assisting in setting up new market strategies and finding investments. Particular mention was made of the business contacts of the founders and their intention to use them for the revival of the economy. Some funds went into greater detail, promising to deal with the unemployment problem, etc. On the one hand, it was difficult at the stage of investment prospectus preparation to judge these statements, since they were very much part of the rhetoric of the advertising campaign for subscribing voucher capital as well as of the requirements of the SSEC. On the other hand, the interviews suggest that fund managers were very aware of the need to restructure enterprises before capital gains or dividend returns could be expected.

For some funds, however, the motivation for their commitment to enterprise activism was clearer. Firstly, these were the insider-affiliated funds which were explicit in stating that, in fulfilling their strategy, they would enable managers and employees of state enterprises to acquire additional shares in these enterprises. Secondly, there were some funds, which expressed their intention to assist the co-operative system through acquiring enterprises in related markets.

Thus, it is possible to identify several groups of funds according to the objectives of their investment strategies:

- funds with stronger portfolio orientation, which, unlike their Western counterparts, realise the need for some stronger involvement in their portfolio enterprises and have the legal means to achieve a blocking minority - these are

most of the financial institutions and financial and investment experts affiliated funds;

- funds with a control orientation, which demonstrate to a greater or lesser degree an interest in acquiring contractual partners;
- funds with control orientation, which intend to complement MEBO privatisation;
- funds with shorter-term horizons, intending to use a situation favourable for speculative benefits.

Portfolio structure

The empirical review shows that in their prospectuses, all funds distinguish three parts of their portfolios: a control-oriented, strategic part, with regard to which they will act as more or less long-term, active investors; a portfolio investment-oriented one, which they will hold as passive investors; and a sales-oriented short-term one, which is expected to bring quick profits.

Where funds differ is in the definition of the strategic part and its relative size. The funds with portfolio-orientation define the majority of this part by applying economic methods to the information available to determine the best combination of assets.⁵ The control-oriented funds define it predominantly by targeting specific enterprises or sectors, chosen because of the interests of their founders. They use economic models mostly for selecting enterprises for the purposes of diversification, but also depending on their access to them. Further, it is typical for all groups that classical prognostic models for portfolio formation have to be supplemented by qualitative methods of evaluation of individual enterprises as well as comparative sector methods, because of the nature of the official quantitative information, as discussed above. The criteria for the definition of the portfolio-investment part were similar to those above but also acknowledged the trends of the general privatisation policy and the resulting ownership structure of the enterprises. For some funds, passive stockholding was to be maintained where a strategic investor was present and a good dividend was expected. The sales part took account also of:

- the availability of final strategic buyers on the basis of preliminary contracts with the funds: indeed, many funds reported concluding such contracts and receiving advance payments on them, which enabled them to meet their expenses before it was possible for them to realise any other profit;
- agreements with other funds for swaps of voucher resources: as will be discussed further below that was a “public secret” general practice;

⁵ i.e. standard methods used in the West, such as the Markovitz diversification method, Beta Analysis, or the Capital Asset Pricing Model.

- the likelihood that big enterprises would be traded on the stock exchange; and
- privatisation to a core investor in progress leading to rise the market value of the shares.

It could be said that at the stage of preparing the investment prospectuses not all funds were clear about the ratio between the three parts. Some funds, regardless of particular ownership types, had a 70-75% strategic portfolio, others 50%. A much smaller group of funds, mostly consultancy-related, indicated the prevalence of the sales part. PFs were more specific about the sector diversification of their portfolios, presented in Table 2. The dispersion undoubtedly depended on the amount of voucher capital collected, but also on the control intentions of the founders. The concentration of insider-affiliated funds and business-oriented ones is much higher than that of the financial institutions-related ones.

The official results of the Centre for Mass Privatisation at the end of the first wave relating to the portfolio structures of funds, however, revealed significant differences from the sector structure in the prospectuses. As Table 3 shows, on the whole all sample funds have invested in a higher number of sectors with a higher average dispersion coefficient. Also, there was a clear mismatch between the priority sectors indicated by individual funds and those that had emerged at the end of the first wave. The difference has been explained by fund managers by as resulting from a combination of factors: the specifics of the voucher-share conversion;⁶ changes in the investment plans between auction rounds due to uncertainties and the numerous modifications in the list of enterprises offered in the scheme; and joint action commitments.

Despite the above-mentioned distortions to the outcomes of the investment activities of PFs, it is important to look at the portfolio structure in terms of the size of the holdings in individual companies. Apart from being indicative of the corporate governance of the latter, it testifies to the institutional form in which PFs will be aiming to transform themselves to and the magnitude of the restructuring they will need to undertake in order to do that. In fact, all funds have a more or less significant control-yielding part of their portfolios (Table 4). There is a difference between the funds from different capital groups but also within them, according to founder type and investment strategy orientation. The more portfolio-investment oriented *Zlaten Lev, Bulgaria, Sv. Sofia* and *Nadezhda* have less controlling stakes than the other more control-oriented funds.

At this stage it is not possible to judge the implications of that for the portfolio companies. Clearly, the high 34% legal limit, the need to spend vouchers and to

⁶ On average, only 70-75% of the auction bids of the PFs were satisfied.

restructure the enterprises has pushed funds to seek control. This, however, has to be set against the character of the joint action of funds and the availability of final buyers.

It is important to make a special point about the extent of joint action between funds. This proved to be a very important factor for acquiring the desired enterprises and achieving control in them, despite the legal limit of 34%, as will be discussed further below. One type of co-ordinated participation occurred on the basis of common investment platforms and common founders. The other type is the so-called “exchange of voucher resources”, which was the most common case. Examples of such joint action, involving sample funds, are given in Table 5. Only one fund manager in the sample pointed to independent participation and judged it a major cause of the higher prices paid for shares, the smaller number of companies acquired, and the difficulties expected in the restructuring process.

Trading Activities

Trading activities with shares of MPEs were absent before October 1997 due to the legal prohibition. The only proceeds in the period were derived from interest and currency operations with the cash part of the portfolios. Since PFs did not receive dividend from the MPEs for 1996,⁷ most of them reported significant losses in their 6-monthly financial reports for 1997.

The removal of the prohibition and the opening of the stock exchange at the end of October 1997 led to a rapid change in the situation. The trading activities of funds pursued two main objectives: consolidation of the strategic parts of the portfolios up to the still present legislative maximum of 34%,⁸ and sale of the short-term ones. Indeed, the end of 1997 witnessed a boom in the block trade between PFs through which ‘the exchanges of voucher resources’ were validated. The sales largely represented the finalising of preliminary agreements with buyers, but some new deals were concluded as well. In most cases enterprise shares were sold at quite high profit margins, compared to their nominal value and even higher, compared to the prices paid in the auctions. As the 1997 financial reports show, 80-90% of all proceeds resulted from trade in companies’ securities.

At the same time, stakes in the strategic enterprises were increased through transfers among funds, but also by use of some of the profits realised to purchase shares. An additional, although not so significant, source for the consolidation of

⁷ a Council of Ministers Regulation (CMR) provided that the 1996 dividend would be received by the state despite the fact that PFs were valid shareholders at the time of the dividend distribution.

⁸ despite the PFs intensive lobbying, the 34% threshold was not removed.

stakes is represented by the preferential shares of the insiders. Some fund managers also point to collaboration with the manager and employee collectives of the portfolio companies and with the founders of these funds for participation in the cash privatisation. The restructuring was intensified with the convening of general meetings of shareholders for the transformation of PFs into holding or investment companies. After being transformed into holding companies, PFs clearly attempted to achieve a higher than 34% control in selected enterprises.

Full data on the restructured portfolios only gradually becomes available. Nonetheless, the examples in Table 6 point to sales of shares, resulting in significant changes in the number of enterprises held and controlled.

Transformation of PFs

The empirical review shows that all sample funds except *Zlaten Lev* transformed themselves into holding companies. For the control-oriented funds that was more or less a part of the initial strategy. The others, including those with greater portfolio orientation and financial institutions as founders, opted for this institutional form for a number of reasons. What seems to have proved decisive, according to the interviews, were three groups of factors:

- the unduly strong supervision exercised by the SSEC;
- the understanding that portfolio investment could not be an option at the stage of development due to the legal regulation of investment companies and the state of development of the stock markets; and
- the need to restructure enterprises and raise their value through active involvement in their management and additional investment before any trade was possible.

The transformations were also accompanied by contribution of additional cash capital on the part of some of the founders. In such a way, a certain consolidation of the funds' ownership was achieved. The new equity also made possible the greater engagement in the restructuring in the daughter companies, as it will be discussed further below. Most of the new holding companies had not fully restructured their portfolios at the time of the new registration. The processes of consolidation of equity participation and sale of minority stakes depend on the market conditions for doing so.

ROLE IN THE PORTFOLIO COMPANIES

Source of governance power

The last section showed that funds normally distinguished three parts in their portfolios. It is mostly with regard to the strategic part that they planned to engage in active management. Therefore, they sought to acquire the maximum stake allowed under the law, namely 34%. Nearly all fund managers expressed the opinion that 34% gave the right to veto on major constitutional issues and would ensure one or two places on the board of directors, but it does not provide for the control necessary to restructure the enterprises. Thus, as a general practice, funds entered into agreements with other funds in order to ensure higher voting power before the consolidation of ownership titles became possible: through exchange of voucher resources or contracts to exercise the voting rights of shares within a certain period of time, normally one year. This process was more intense as far as the control-oriented funds were concerned. Thus, the clarity of the involvement commitment depends on the ability to achieve consolidation and the speed of the process.

The portfolio investments were treated differently. Normally, where stakes were above 15% (lower thresholds in a few cases due to ownership structure) representatives of the fund were elected on to the boards, but, apart from exercising the basic statutory functions of directors, a more passive approach was followed. That was particularly the case where another big investor was present, private or state. Where the stakes were less than 10% no control was possible, unless joint representation was agreed upon. The companies where minority stakes were held or those for sale were rarely the subject of attention. As fund managers commented: “we have not even visited the small ones”, “we are not interested in what is not for us”.

Generally, the principle was that of shareholder representation proportional to the stake in the capital. Two problems were, however, observed immediately after the first general meetings of shareholders were summoned. Firstly, in some companies where ownership structure was particularly dispersed, no voting majorities could be formed. In these cases ownership remained anonymous and no efficient outsider control could be established. Secondly, in most cases there were no problems in the proceedings as far as other PFs or other private owners were concerned. There were many instances reported, however, of conflicts with the representatives of the state. The practices depended on the particular line ministry involved, but on the whole, fund managers pointed to the desire of the state to prolong its control or to the existence of vested interests on the part of some of its representatives.

Funds’ representation on enterprise boards

There are a number of questions that need to be discussed with regard to the relationship between the funds and their agents in the portfolio companies. The first concerns the recruitment of these agents. This depends on the human resources available to the fund, or rather to its founders, the degree of founder involvement in the activities of the fund, and the size of the fund's portfolio. According to the interviews, in most cases the directors of the funds become representatives in several portfolio enterprises. Other recruits are founders' employees, particularly managers of regional branches, which is typical where founders have a developed branch structure as well as having explicit control-interests. Big funds, such as *Doverie*, which have a well-developed organisational structure, also appointed fund officers. External consultants, who assisted some funds in the period of investment strategy preparation, were also relied upon. The remaining seats were filled with local people who, according to the interviews, have business experience and can be trusted. Thus, the competence of PFs' representatives in particular areas of decision-making depends largely on founders' orientation.

The control over the representatives on the companies' boards and the link between them and the fund, however, is not straightforward. In cases where fund directors or officers act as company directors, there is a direct communication. Then, the problems of the enterprises and the types of solutions can be discussed on the regular board meetings of the fund, joint solutions can be sought with other companies' directors, information can be exchanged. Indeed, that is a positive development according to some fund managers, because of the common problems faced by enterprises.⁹ At the same time, there is a mutual check-up on the activities of directors. When directors are founders' employees or local people, the question of "the control of the controller" becomes more problematic. Some interviews show that in individual cases the links with the representatives have been lost and that "they have forgotten whose shares they represent". Then the danger of opportunistic behaviour or conflict of interests, particularly where insiders or founders with parallel business interest are concerned, is obvious. Apart from that, there is the problem of lack of governance traditions: one fund manager commented that directors often go to extremes in that they either agree to everything or interfere unnecessarily with the operational management of the companies.

Problems of this kind could possibly be remedied by the funds *ex post* through the statutory rights of the general meeting and the principles of accountability. That is why some fund managers underlined their reliance on good *ex ante* selection of representatives. Others have used a specific feature of Bulgarian company law, allowing legal persons to participate in the boards of directors. In such cases, any

⁹ E.g. revaluation of assets, the need for current account resources, etc.

change of representative because of dissatisfaction requires only a change of the power of attorney, as opposed to convening a new general meeting.

The links between funds and directors ultimately are contingent on the position of the enterprise in the funds' portfolios and on the availability of an overall control package towards the strategic enterprises. Differing degrees of control can exist within the same portfolio depending on the strategic prospects of the enterprise and on the choice of representatives. Nonetheless, as will be discussed further below, funds with clear control-orientation and good advances in the portfolio restructuring process design short- and long-term programmes, which require close communication and monitoring of the representatives.

Relation to insiders

The relation to insiders is one of the most sensitive issues in establishing efficient modes of corporate governance in the context of CEE transition. This research shows that, regardless of their ownership affiliation, Bulgarian PFs have followed the policy of keeping the incumbent executive managers. Several reasons for this can be pointed out.

Firstly, funds, with the exception of the clearly insider-dominated ones, generally have insufficient information about the performance of managers. That is due in part to the inadequate information available on the enterprises offered for privatisation, to the difficulty of establishing causation in an unfavourable economic situation, or to the underestimation of this issue during the period of the auctions.

Secondly, there was the perception that, where companies were functioning, in a relatively good economic state, and giving no signal as to self-interested behaviour or major abuses of position, there was no need to change the managers. Moreover, as one fund manager said, "if the enterprises have survived so far in these conditions, it is because of their managers." The question of continuity was important as well.

Thirdly, incumbent managers have all the insider information, and it is necessary to cooperate with them. The issue was exacerbated by the short-term horizon of some funds and the uncertainties surrounding their own restructuring, preventing them from expending effort on getting involved with the enterprises.

Lastly, all funds acknowledge that recruitment is difficult and there are few sufficiently prepared specialists with managerial skills as well as knowledge of the production in question. The problem, given the underdeveloped managerial market, is to find not only appropriate executives, but also to constitute a whole managing team.

There was a common belief that a change in the package of incentives would be sufficient to expose managers to working in a market situation and testing their abilities. The positive incentives included, firstly, providing certainty of office. The

latter was in marked contrast with the uncertainties due to changes of governments and corresponding waves of political appointments and demands on the part of a wide number of interest groups.¹⁰ Especially during the pre-privatisation period, managers had limited decision-making powers and were bound by the slow, bureaucratic operation of the line ministries, while being exposed to the need to take bold, innovative responses to abnormal economic situations. In these circumstances, managers adopted pragmatic, defensive, political behaviour. Secondly, funds attempted to improve the remuneration of managers while tying it to the average company wage. Some PFs envisaged in addition the introduction of performance-related schemes. There was also reliance that the tax incentives provided to post-mass privatisation companies would motivate managers.¹¹

At the same time, managers were subject to improved monitoring. As was discussed in the previous section, there were differences in the approaches. Some funds' representatives gave full operational freedom and backing to the managers, exercising control only on the basis of the review of the final financial results. Others adopted a wider range of monitoring mechanisms, including official and unofficial checks on the part of funds' working groups. *Doverie* also reported a proactive *ex ante* approach by organising qualification courses for managers. Some funds opted for a "sword at the neck" approach, as one fund manager put it, by appointing a second executive director and scrutinising all operative decisions.

There are also instances of clear strategic alignment of interests of funds and managers, which are likely to make funds more lenient in their control approach. Such cases, for example, occur where manager and employee collectives relied upon participation in the cash privatisation for consolidation of the ownership titles, or where parallel business interests exist, involving incumbents as well as founders.

Involvement in decision-making

The depth and dimensions of fund involvement in companies' decision-making depend on a number of factors: the progress in restructuring the portfolios, the investment strategies of funds, the competence and commitment of founders and representatives, and the particular situation of individual enterprises.

Not all funds had a clear strategy of involvement, exacerbated by their lack of own financial resources until the last months of 1997 and their gradual clarification of investment strategy. Others underestimated the requirements of the actual process of governance of enterprises with huge restructuring problems. On the whole, all funds

¹⁰ For more on the role of interest groups in the system of control of state-owned companies, see Peev, 1996.

¹¹ There is a tax holiday on post-mass privatisation companies deciding to reinvest 50% of their profit.

agree that full involvement is necessary in order to give effect to the ownership changes and to increase the value of enterprise shares. Certain differences as to the understanding of control are observable only to a limited degree, because of the ownership structure of funds. The more consultancies-dominated funds, for example, saw their rightful place on the supervisory boards, exercising general control and supervision, with no interference in management. Others pressed for places on the managing boards or, as mentioned earlier, appointment of second executives.

Despite the still short time-span in which to make definite observations, it is possible to see that there are several major levels of fund involvement:

- adoption of short-term, emergency measures. These measures required, firstly, analyses of the current economic and financial status by using more detailed and realistic information. According to all funds, the first measures have to address the lack of current account resources for supplies, readiness of production and efficiency of use of machines and equipment.
- formulation of long-term business programmes for restructuring and development of the enterprises. This was contingent on the progress with the emergency measures, the improvement of the macro-economic situation of the country, and the success of ownership consolidation.
- monitoring the implementation of the adopted programmes.
- involvement on a macro-level - the Association of Privatisation Funds pressed for a number of legislative changes and took other initiatives, such as talks with the trade unions, etc.

The empirical investigation shows that funds engaged in several particular areas of enterprise decision-making.

1) *Restructuring of old debts*. Given the scale of the bad debt problem and the partial measures of the state to address it, one of the big problems of enterprises is the bank loans as well as ZUNK debts to the state.¹² *Doverie*, for example, reported efforts in renegotiation of unfavourable contracts and recontracting some debts in general. Debts owed to one of the founders, the *United Bulgarian Bank*, were subject to the same logic, and some concessions were made on the part of the bank. Of course, having a banking institution, being subject to the currency board constraints, might also lead to pressures for debt repayments and ultimately to bankruptcies.

¹² Bad bank loans transformed into debts to the state under the Unserviced Credits Settlement Act of 1993.

2) *Management of financial flows*. As was mentioned above, the lack of current account resources was one of the greatest problems, which needed immediate attention. Where enterprises depended on imports, the exchange rate instability before July 1997 made things worse. Thus, active measures were needed in a number of directions: finding extra capital through short-term borrowing; faster realisation of production; sales of unused equipment and other long-term assets; inter-company use of resources. In addition, all enterprises need new investment for production and technology modernisation and innovation.

The privatisation funds, however, have suffered from lack of financial resources or of legal means to provide such resources. They were not allowed to borrow or give loans; tax laws encouraged distribution of profit rather than reinvestment; and most importantly, until the end of 1997 they could not receive proceeds from sales. In addition to the lack of resources, many fund managers pointed to the insufficient control they have in order to decide on major investments. Thus, funds saw their role in two areas: i) preparation of good business plans and investment proposals for fund-raising; ii) the financial institution-related funds recommended the services of their founders or partners. The actual terms of borrowing, however, given the tight refinancing restrictions and overall credit contraction in the bank sphere, were agreed on cautious considerations entirely on a market basis.

The situation clearly changed with the transformation of PFs into holding companies. As Table 6 shows, funds sold a large number of shares and all of them reported realised profits. It is yet to be seen what character these holding companies take and what their dividend policy will be. One example, already known, is that of *Petrol*, which transformed itself earlier than other PFs. It can be seen in Table 6 that it managed to consolidate its portfolio significantly, holding more than 50% in eight companies. *Petrol* has reported the constitution of a special commission for granting credits for current account and investment purposes, as well as the fact that 7 companies have already made use of this option.

3) *Marketing policy*. The PF acknowledge the other big problem of enterprises to be the break-up of the distributional networks and general loss of markets. Some of the fund managers consider this should be the main area of involvement of the PFs. According to them, insiders know how to produce but do not know how to market and manage the whole flow of the economic cycle. Indeed, most sample funds have assisted with finding new contacts, mostly related to their founders. *Petrol* also opened a trade representation office in Moscow to organise exports of its daughter companies. At the same time, it is in the area of marketing that most abusive practices

were reported, involving parallel entry and exit firms and “draining” the companies’ businesses.

4) *Restructuring of production.* Most funds acknowledged the need for improving and expanding production lines, reducing waste and inefficiency, better use of the equipment and internal resources and quality controls. Most of them, however, intended to deal with the problem within the general mechanisms of control and through changing the incentives of the executives. Only two sample funds have reported production plans, related to businesses of their founders.

5) *Organisational restructuring and employment.* This is the area where the insider affiliation of funds becomes even clearer. For example, *Trud i Kapital*’s manager indicated that any costs of production will have to be improved by intensive methods rather than shedding of labour. Other funds are positive about the need to do that but no major actions have been reported yet. Bigger funds also intend to cushion the process by providing qualification courses for the unemployed, etc.

CONCLUSION

The authors of the Bulgarian mass privatisation designed the privatisation intermediaries as mechanisms for collective investment with a role in the development of security markets. These institutions were, at the same time, expected to exercise minority control in the portfolio companies and to affect its direction through balance of votes and joint action. The developments, however, showed that all privatisation funds acquired maximum control-yielding stakes in a number of strategic enterprises. With regard to these enterprises, PFs achieved higher voting power, despite prohibitions to the contrary. The process resulted in the establishment of holding companies in the process of restructuring their equity holdings as well as their own ownership structure.

The analysis shows that the prevalence of control-oriented institutional form is not accidental. First, it has to do with a certain necessity. Mass privatisation enabled the existing economic interests to participate in the redistribution of state assets, which was impossible or difficult through other mechanisms. In particular, the banking crisis reduced the availability of credit for participation in sales deals. At the same time, the low level of development of the stock markets, the vague regulation of investment companies and the lack of information transparency, proved that portfolio management is not an option at this stage. Furthermore, the state of the portfolio companies proved that no capital gains can be expected unless there is an active engagement in their restructuring. The legal instruments for the latter are available only to holding companies. Second, high concentration is connected with the need for certainty and security of stockholding. The new owners strove to acquire 2/3 majorities so that control over constitutional issues, including over the increase of capital, is ensured. That was particularly important given the low level of efficiency of enforcement procedures. Third, the holding form proves to be very practical. As the process of formation of funds shows, pooling resources in the conditions of underdeveloped markets increases competitiveness. Not least, the holding form is familiar given the legacy of state conglomerates.

Another interesting question is why did this control orientation with regard to the strategic enterprises happen despite the design. On the one hand, the very fact that the PFs were established as transitory institutions structured their incentives accordingly and the preliminary contracts were only the tool to be used. On the other hand, it could be argued that the design, and its implementation on the part of the state administration, failed to achieve the necessary credibility, as a result of the quality of the design. Such an argument can be supported by looking at the role of law in the post-totalitarian context in general: namely, law has been often misused; it had

declaratory rather than regulatory role; and its proper importance in the transformation process has been underestimated.

Finally, some conclusions on the governance implications of the developments have to be added. One of the clear problems relates to the non-strategic companies. Funds do not have a direct importance in them. Rather, they will be acting like mini-privatisation agencies in finding final buyers. As long as this process prolongs the transition period of the enterprises and delays the establishment of efficient consolidated outsider control, the effect is unlikely to be positive. It ultimately depends on the progress of the overall privatisation in the country, the development of security markets, and the establishment of a generally favourable investor environment.

The PFs and their institutional transformations are going to play a significant part with regard to the strategic companies. With the progress in restructuring of their portfolios, they will increasingly establish themselves as clearly personified owners. As the empirical review shows that most funds have their representatives elected on to the managing organs of the portfolio companies. Despite the lack of major changes of incumbent managers, most funds have attempted to place the latter within a new system of positive and negative incentives. They have shown a commitment for judging the performance of the enterprises on the basis of profit as opposed to non-economic considerations. Most funds have also attempted short-term rescue measures and some have made longer-term plans. They see their role mostly with regard to the outward orientation of the companies, namely in managing markets and financial flows. Yet, the efficiency of the control they have established cannot be judged without careful consideration for a number of reasons:

- A large number of the funds are founded by insiders, or have reasons to seek a strategic alignment with them which, as is widely suggested in the literature, may adversely affect the restructuring process. There is also the danger of reconstituting the old patterns of business links, especially given the scale of spontaneous privatisation over a prolonged period of time in Bulgaria.
- The clear dominance by founders, especially with regard to the business-oriented funds, can result in significant conflicts of interest. The situation could be exacerbated where the control over the agents is insufficient. This danger is perhaps lower with regard to funds founded by larger coalitions, where it is more difficult for a single interest to prevail, as well as with regard to the bigger funds, which are subject to high public scrutiny.
- Another problem is the general lack of experienced representatives, of efficient mechanisms of communication with them, and of traditions in governance.

- The financial soundness of the groups, especially those not related to sources of fresh capital, is questionable as well. Funds have received an initial boost from the sale of the minority stakes, but in the long run that might not be sufficient given the scale of the restructuring effort.
- Lastly, conflicts between founders can block the ability of funds to engage in meaningful long-term commitment.

What seems, important, then, is to maintain a market and regulatory environment conducive to healthy deaths of unhealthy structures and for the survival and spill-over effect of the best practices.

Table 1: Types of founders and number of funds, with their contribution

Type of founder	No of PFs
Financial institutions:	
Banks	*19
Insurance companies	15
Other non-banking	13
Non-financial institutions:	
Private commercial companies	53
Investment and privatisation consultancies	17
Media	7
Agricultural/producer cooperations	8
“Insiders”	15
Foreign financial and non-financial	14
Physical persons	57
NGOs (incl. trade unions)	8
Municipalities	4

* the number was reduced in the course of the MPS because of banks going bankrupt

Source: Author's compilation

Table 2: Intended portfolio structure: sectoral diversification

No	Sectors	DOV	PET	BUL	GMZ	AKB	TIK	LEV	KOG	IDS	SVS	RAZ	NAD	NIK	RUF
1	non-ferrous	0	0	0	0	0	2.8	0	0	0	6	0	0	0	0
2	ferrous	12.25	0	0	0	5.25	6.71	5	0	5	6	0.2	0	20.3	0
3	machine-building	14.48	0	11	3	0	9.25	6	2	6.5	7	3	9.06	0	17
4	electric	8.02	7	17	2	0	12.97	8	4	7	10	6	5.23	8.8	0
5	chemical	10.8	22	10	8	15.25	23.54	22	23	14	16	17.1	41.43	0	12
6	building materials	6.2	3	3	4	1.25	0	0	0	9	0	0	0	0	4
7	wood-cutting	3.3	3	8	4	5.5	2.55	4	4	5	0	5	0	0	0
8	pulp and paper	8.63	0	2	5	5.25	3.7	6	21	4	0	7	9.82	30.8	0
9	glass	10.33	7	1	8	5.75	6.62	12	14	4	0	2	0	17.2	5
10	textile	6.37	0	21	0	2.5	17.95	4	3	3	5	13	0	0	0
11	tailoring	2	0	3	0	3	0	1	0	5	0	24	0	1.8	18
12	leather and shoe	2.29	3	6	0	2.5	0	0	3	5	0	12	0	0	0
13	other industries	0.84	5	9	0	0	0.6	0	0	3	13.5	0	0	0	0
14	construction	0	3	0	0	3	0.7	6	0	0	5.5	0	0	0	25
15	food-processing	9.6	2	5	45	34.25	9.44	18	20	20.5	15	8.3	34.46	14.8	19
16	transport	0.3	0	0	5	0	0.32	2	0	0	3	0	0	0	0
17	trade	0	35	0	6	4.5	0	2	3	0	5.5	0.4	0	0	0
18	culture	0	0	0	0	0	0	0	0	0	0	0	0	0	0
19	tourism	4.59	10	4	10	12	2.85	4	3	9	5.5	2	0	6.3	0
20	energy	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	mean	5	5	5	5	5	5	5	5	5	4.9	5	5	5	5
	variance	21.8	73.6	34.8	94.2	61.0	42.3	35.3	56.9	26.0	26.4	43.9	130.5	74.8	64.2
	standard deviation	4.7	8.6	5.9	9.7	7.8	6.5	5.9	7.5	5.1	5.1	6.6	11.4	8.6	8.0
	coefft. of variation	0.9	1.7	1.2	1.9	1.6	1.3	1.2	1.5	1.0	1.0	1.3	2.3	1.7	1.6

Source: PFs' prospectuses

Table 3: Portfolios at the end of first wave (Summer 1997): sectoral diversification

	Sectors	DOV	PET	BUL	GMZ	TIK	AKB	LEV	KOG	IDS	SVS	RAZ	NAD	NIK	RUF
1	non-ferrous	0.95	0	0	0	1.93	8.58	0	11.04	0	0	8.14	0	2.69	7.49
2	ferrous	9.36	1.18	0	0.74	0.25	3.25	3.17	0	0	11.17	0	0	0	0
3	machine-building	16.19	4.97	25.57	30.7	13.61	7.35	7.73	35.51	61.31	4.52	17.98	31.38	25.02	23.48
4	electric	4.26	5.37	13.34	2.62	8.73	12.81	14.43	12.59	32.1	11.11	0	9.8	33.14	0
5	chemical	12.69	32.39	11.97	23.2	20.41	46.96	29.57	8.59	0	23.08	7.47	22.2	0	0
6	building materials	0.76	1.29	0	0	0	0	0	0	0	0.07	0	0	0	2.85
7	wood-cutting	2.27	2.09	3.12	2.21	4.68	1.95	1.74	0.44	0.47	2.52	12.73	0	6.88	0
8	paper and pulp	4.62	0	7.26	4.56	4.28	2.26	0	3.9	0.91	0	0	10.74	0	0
9	glass	5.04	1.62	0	3.12	8.36	1.97	8.85	0	0	4.72	0	0	0	0
10	textile	12.3	18.84	9.67	3.13	10.14	4.65	13.48	0	2.26	17.29	25.84	0	0	0
11	tailoring	1.07	0.28	1.87	0	0.74	0	0	0.05	0	1.8	3.17	0	1.4	0
12	leather and shoe	0.09	0	0.13	2.65	1.79	0.18	0.28	2.05	0	0	2.76	0	10.38	0
13	other industries	1.01	0	0.3	0.49	7.87	2.24	0	0.03	0	0.91	0	0	5.25	0
14	construction	12.19	3.42	0.91	1.17	0.79	0.86	3.51	3.23	1.55	10.42	13.55	2.74	11.83	57.3
15	food processing	8.4	4.57	17.23	16.2	9.83	1.2	5.39	12.25	0	3.75	1.76	20.98	3.25	6.53
16	transport	1.29	0	7.05	0.44	2.52	1.41	1.49	9.68	0	2.4	0.69	0	0	2.36
17	trade	3.09	17.97	0.38	4.51	0.62	0.93	2.1	0.22	0	1.29	1.04	0	0	0
18	culture	0	0	0	0	0.57	0	0	0	0	0	0	0	0	0
19	tourism	1.97	5.41	1.2	1.97	2.8	3.42	8.02	0.42	1.4	4.93	4.88	2.15	0.16	0
20	energy	0.11	0.6	0	0	0.06	0	0.24	0	0	0	0	0	0	0
	mean	4.9	5.5	5.8	5.6	5.7	5.7	5.4	5.9	5.8	5.6	5.6	5.8	5.9	5.9
	variance	26.8	81.5	56.7	80.4	32.3	125.2	60.5	81.6	264.1	45.7	59.3	98.3	92.5	209.9
	standard deviation	5.2	9.0	7.5	9.0	5.7	11.2	7.8	9.0	16.3	6.8	7.7	9.9	9.6	14.5
	coefft. of variation	1.1	1.6	1.3	1.6	1.0	2.0	1.4	1.5	2.8	1.2	1.4	1.7	1.6	2.5

Source: CMP

Table 4: Enterprise structure of sample funds' portfolios

Fund	No companies	25-34%		10-25%		0-10%	
		No companies	% shares	No companies	% shares	No companies	% shares
<i>Doverie</i>	174	79	50.8	58	39.7	37	9.5
<i>Petrol</i>	66	26	42.4	29	36.6	11	21
<i>Bulgaria</i>	88	20	31	48	54.6	20	14.4
<i>Severkoop-Gamza</i>	68	30	57	19	13.8	19	29.3
<i>Trud i Kapital</i>	90	34	46.8	37	37.2	19	16
<i>AKB Fores</i>	80	37	75	21	9.7	22	15.3
<i>Zlaten Lev</i>	67	21	25.7	22	32.4	24	41.9
<i>Jug</i>	53	15	42.3	19	46.3	19	11.4
<i>Industrialen Kapital</i>	21	7	64.8	5	16.9	9	18.3
<i>Sv. Sofia</i>	55	20	36.6	11	13.1	24	50.3
<i>Razvitie</i>	38	15	51.4	16	40.8	7	7.8
<i>Nadezhda</i>	17	4	14.7	6	0.4	7	34.8
<i>Sv. Nikola</i>	20	12	74.8	2	11.1	6	14.2
<i>Rusenski</i>	11	1	21.7	2	40	8	38.3

Source: CMP

Table 5: Examples of joint action between sample funds

	Number joint holdings	Joint holdings > 33.33%	Joint holdings > 50%
<i>Bulgaria - Mel Invest</i>	56	8	29
<i>Doverie - Petrol</i>	41	8	26
<i>Severkoop-Gamza - Jug</i>	24	6	6
<i>Razvitie - Sever</i>	17	3	7
<i>Trud i Kapital - Zlaten Lev</i>	11	3	2
<i>AKB Fores - Nov Vek</i>	10	3	4

Source: CMP

Table 6: Restructuring of PF portfolios

	Difference in no. MPE shares (%)	Difference in no. sectors	Difference in no. of companies	Companies with 33.33- 50% stakes	Companies with >50% stakes
<i>Doverie*</i>	- 27	0	- 48	44	0
<i>Zlaten Lev*</i>	- 5.89	- 1	- 7	11	0
<i>Petrol**</i>	- 20.6	- 4	- 36	5	8
<i>Trud i Kapital**</i>	- 9	- 3	- 30	17	6
<i>Severkoop- Gamza**</i>	- 40	- 1	- 15	13	3
<i>Industrialen Kapital**</i>	- 49.1	- 4	- 11	5	0
<i>Jug**</i>	- 21	- 1	- 16	4	0
<i>Sv. Sofia**</i>	- 28.7	0	- 8	11	0

* - according to the data in the Annual Reports as per 31.12.1997

** - portfolio structure in April - May 1998

Source: Author's compilation

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