EASTWARD ENLARGEMENT: PRIVATIZATION IN MECC

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Abstract

This paper tries to offer a review of the literature on the main privatisation methods adopted by the Central and East European Countries which have joined European Union in 2004. After having analysed the major advantages and shortcomes of each privatisation method the paper briefly describes the privatisation processes adopted by each single country.

Keywords: privatization, corporate governance, investors, Estern Europe, MEBO, vouchers

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Introduction

On May 1st, 2004 ten new countries joined the European Union; except for Cyprus and Malta, the remaining eight countries represent, for the most part, the Middle Eastern European Countries (so called MEEC) belonging, fewer than 15 years ago, to what was known as Middle Eastern European Soviet bloc. Joining the E.U. is subject to some principles stated by the European Council of Copenhagen in 1993. Among these principles, the economic one established that candidate countries should have adopted an effective market economy to be able to cope with competitive environments and spurs given by markets being part of the European Union.

This principle was achieved through a huge plan of privatisations which started after the collapse of communism in 1989-1991; this plan has not been entirely accomplished yet.

Nellis (1998) estimated that in the first half of the 90s more than 50,000 middle and large MEEC firms were privatised, while only about 6,000 companies were privatised in the rest of the world during the 80s. What distinguishes privatisations in eastern countries is the huge amount of state-owned assets transferred to private ownership[1] in a very short time and the particular techniques used in this process. State-owned firms privatisation was harder to realize in Easter countries than in western ones. In fact, on one hand, a public offering to domestic investors could not be implemented at fair market price, owing to the extremely little financial savings of MEEC citizens.

At the beginning of this process, an IPO was not even possible because capital markets were still to come. On the other hand, a direct sale to private investors could hardly be realized because of the lack of domestic industrial groups. Selling state-owned firms to outside investors could have been a possible solution, but in some countries this process was hampered because of political reasons. Moreover it would have required a longer time in valuating firms characterized by significantly different accounting standards compared to western ones.

On account of these reasons, some countries adopted mass privatisation plans in which citizens were given some vouchers that could be used to bid for shares in companies being privatised.

The object of this work is to give an overview of the methods and privatisation processes implemented by the eight Middle Eastern European countries that joined the European Union[2].

2. Methods of Privatization

The way in which firms are privatised is the outcome of a complex strategy. This process does not involve economic factors only (i.e. assets valuation), in fact privatisations are strictly linked to political policy. Thereof, Megginson and Netter (2001) indicate some of the factors affecting the way in which the privatisation is conducted: the firm's history to be privatised; the state-owned firms financial and competitive position; the government ideological view of market and regulation; the past, present and potential future regulatory structure policies; the need to pay off important interest groups in the privatisation; the government's ability to credibly commit itself to respect investors' property rights; the capital market conditions and existing institutional framework for corporate governance; the sophistication of potential investors, institutional and individual ones; the government's willingness to let foreigners own divested assets. Different countries have used many different methods in the privatisation process and these different methods can be reconstructed to the taxonomy pointed out by Brada (1996) who indicates four different categories or methods which were sometimes used as a combination of the different types of divestment:

- restitution: the expropriated property could be returned to the original owner;
- direct sale to individuals or to foreign/domestic groups; share issue privatisation in which stake of the state-owned firms were sold to investors through a public share offering;
- Management-Employee Buy-Out (MEBO): stakes were sold to employees or managers of the firm;
- mass privatisation process through vouchers.

In a broader meaning of the concept of privatisation, the process through which a state economy turns into a market economy can be comprehended too.

Further, among different methods of privatisation in MEEC, we can include what Megginson and Netter call *privatisation from below*: the start up of new private business. In addition, Havrylyshyn and McGettigan point out the importance of new private ownership firms in the transition process toward a market economy.

Table 1 shows the main methods used in the privatisation program by each country that joined the EU. It also shows the secondly method employed in privatising middle and large firms according to a ranking by the European Bank for Reconstruction and Development.

Table 1. Methods of privatisation for middle-large enterprise in MEEC

Country	Direct sale	Vouchers	MEBO
Czech Republic	Secondary	Primary	
Slovak Republic	Primary	Secondary	
Poland	Primary	Secondary	Secondary
Hungary	Primary		Secondary
Slovenia		Secondary	Primary
Estonia	Primary	Secondary	
Latvia	Primary	Secondary	
Lithuania	Secondary	Primary	

Source: European Bank for Reconstruction and Development (Transition Report 1999), table reported in World Bank (2002), *Transition – The first Ten Years – Analysis and Lessons for Eastern Europe and the Former Soviet Union*, The World Bank, Washington, D.C. Page 75.

By observing table 1, it can be noted that the direct sale of state-owned enterprises is the primary used method in most of MEEC. Czech Republic and Lithuania employed the innovative voucher method mainly, while Slovenia used MEBO the most.

Most important features of privatisation techniques will be analyzed next.

2.1 Restitution

Restitution consists in returning state-owned assets to former owners where previous expropriations were unfair because issued in violation of law. This method allowed the return of real estates and lands mainly (houses, flats, shops, restaurants or other small assets) and this return was for still existing owners or being able to demonstrate their original property right. In the case of larger properties (i.e. factories, mines), state investment has usually become commingled with the original property, so the most common form of restitution was to provide a compensation to original owner with cash or vouchers (Brada 1996).

From a legal perspective, restitution of the original property appears to be the most natural approach through which middle class could be given properties rights. Moreover restitution could also increase the faith in protecting the private property by the state. There were opponents to this method sustaining that it was an attempt to restore justice for what happened in the past. In addition this process could not give back people what they lost in terms of freedom, careers and way of life during the forty years of the communist regime (Bornstein, 1997). Moreover quite a long time was necessary to satisfy the restitution requests, hence the privatisation program slowed down its beginning. Restitution was used at the beginning of the transition process in Estonia, Czech Republic, Hungary and Poland mainly. It was implemented in three different forms: the restitution of the expropriated good itself, cash liquidation or vouchers assignment which could be used to buy other state-owned assets to be privatized.

2.2 Direct Sale and Public Offering

In the early 90s, at the beginning of the transition process, many MEEC wanted to privatise their firms according to advanced market economies (i.e. Great Britain). They also looked at those methods employed by developing countries (i.e. Chile) where enterprises were successfully privatised through a direct sale. Therefore, both a direct sale of firms to outsider domestic or foreign investors and an initial public offering for the security market was the initial goal for MEEC. The first technique seemed to have three advantages (Gray 1996): new revenue to the state; "real" owners could manage the acquired firm in a more efficient way; the sale conditions could be set to deal with every single need. Nevertheless, a direct sale to domestic investors could have also some disadvantages. The required price could be lower than a fair market price because of investors limited amount of capital (particularly domestic). In addition, some behaviour could favour a sale at a discounted price to some bureaucrat belonging to the former regime. That's why people perceived this method as an unfair one if compared with privatisation through vouchers which allowed everybody to take part to it. Direct sales to foreign investors were revenue maximising. They also favoured firms restructuring through fresh capital, this allowed new owners to yield new managerial skills that were often lacking in transition countries. By the way, these sales were hampered by several factors, particularly in the first stage of the transition. Among these, the lack of information about the firms to be sold and the inadequate account standards were unfair to be used for a proper firm evaluation in accordance to western ones. That's why investors were wary about privatisations. Some countries were affected by an unstable political situation; this framework slowed down the costly and complex negotiation deals. On one hand, this kind of method was also hampered by mangers and employees working in the privatising firms. They were afraid of firings and redundancies; on the other hand they wanted to take part to privatisations of most profitable firms.

Public share offering is another form through which firms could be sold to outside investors. In the first stage of transition characterizing MEEC, IPOs were highly limited because capital markets were not completely developed and because only the best firms, with profitable perspectives and with a good reputation, could be listed in regulated markets. Moreover, this privatisation technique was not eligible for corporate restructuring since ownership was dispersed and this could not allow significant changing. Only a majority shareholder could make the difference, seeking for a greater efficiency compared to former managers. Poor performing firms, with lower profitable perspectives and requiring a significant restructuring process could not be listed.

In sum, IPOs through stock market were not the best solution for a quick and massive privatisation program even if they favoured the development of capital markets. In MEEC, direct sale to foreign investors had an important role during the privatisation process. Direct sales were adopted by Hungary and Estonia where about 20% and 50% was sold to foreign investors respectively (Estrin 2002). This method was also adopted by Latvia, Poland and Czech Republic after 1998.

2.3 Management-Employee Buy-Out (MEBO)

Slovenia, Poland and Hungary used *management-employee buy-out* the most. It consists in the give-away of the total amount of the shares or a significant stake of them to labour or managers of that firm. Main advantages are:

- it is easy and fast to implement (relatively to the shares to be privatized);
- manager and labour were more prone to MEBO compared with other privatisation methods, because MEBO allowed them to participate to possible future cash flows;
- a greater efficiency in contrasting agency problems.

There are also possible disadvantages, particularly in a transition scenario:

1. selling shares to managers or labour inhibits, if not eliminates, competition to the extent that more qualified and potential investors are not allowed to take part to the privatisation process. That's why this kind of ownership could be a second best for the economy as a whole, at the beginning at least (Gray, 1996);
2. the incumbents are not eligible to provide new managerial skills and new capital;
3. if insiders (managers and labour) own only a significant stake of the firm, a conflict of interest can occur between incumbent and outsiders. With an underdeveloped corporate law and in a situation of poor transparency towards foreign investors, as in transition countries, minorities may be unwilling to invest in those with significant insider ownership. Gray (1996) asserts that if manages and labour were given a 15-20% stake, they could deal with a majority shareholder and the privatisation program would be less likely to be resisted. Moreover managers and labour would be able to play a monitoring role over majority owners. Due to the low appeal in attracting new managerial skills and providing new capital suitable for corporate restructuring, MEBOs may work better for viable firms that can generate internal funds for a sustainable growth such as small firms in which employees may be more prone to wage cut in order to preserve the company. However, for large distressed firms with

major capital needs, MEBOs are unlikely to work in a proper way.

2.4 Mass Privatisation or Voucher Privatisation

Voucher privatisation was widely implemented in transition economies, while it was seldom used before being implemented in such countries. Vouchers were certificates or *coupon* issued by the government and given to citizens of age at very low prices or for free. Vouchers could be used as means to purchase assets, shares in companies undergoing a privatisation or stake in investment funds acquiring privatized firms. Vouchers were issued in the domestic currency or in points[3]. After being assigned, they could be normally exchanged for shares of privatized enterprises in proper auctions with different features among countries. Boyco et al. (1994) stress about the reasons why vouchers were issued in currency or in points. First of all, issuing vouchers in currency and not in points could cause inflationist effects. In fact, using vouchers as money in purchasing goods, a significant money availability could happen with a price rise as a consequence. Another aspect is that the currency issue could face with a discounted real market value of future negotiations compared to the facial value. This could sound as a fraud to the receivers. On the other hand, issuing vouchers in currency has some important political aspects. This form of issue resembles vouchers to securities and this strengthens citizens' perception of the governmental action. In the end, using vouchers as money in transactions makes perceive the privatisation process as nonreversible and more credible. Estrin and Stone (1996) report a table for 18 countries that adopted a mass privatisation program. In this paper we report an extract concerning the eight countries that joined the E.U. in table 2. Estrin and Stone point out the year in which the program started and the features of the main aspects for every country.

The form in which vouchers were issued. Vouchers were bearer or registered, they could also be tradable or nontradable (bearer ones were always tradable, registered ones could be or not). In sum, vouchers could be bearer and tradable (B), registered and tradable (T), registered and nontradable, except between relatives or on the death of the owner (N);

offering strategy: continuously (C) or in waves (W). In the first case, a small number of firms (fewer than 200) was privatized every three months. The latter involved the simultaneous offer of 25% of firms included in the privatisation program in subsequent waves every three months from each other;

kind of intermediaries involved in the process: mass privatisation allowed to transfer property rights, but no features were set for future capital markets. In some schemes of privatisation, for instance, citizens were allowed to choose (A) if to convert vouchers in shares or in stake of *Privatisation Investment Funds (PIFs)*, although the latter was not particularly encouraged. Other schemes encouraged (E) this conversion in favour of intermediaries development. More, other schemes were compulsory to citizens to exchange vouchers for *PIFs* stakes (C), because they could not convert vouchers in shares.

Privatisation Investment Funds (PIFs) intermediaries independence: privatisation schemes should establish if funds had to be managed by independent and separate companies (I) or if they should be self-managed (S). Boyco et al. (1994) discuss about vouchers tradability pointing out advantages and disadvantages. The main issue in disadvantage of a free tradability is that vouchers are neither cash nor securities. They are what make privatisation work, that's why vouchers should not be traded until they are converted into shares. In addition, many citizens owning vouchers were experiencing serious economic problems and they were likely prone to give vouchers away (if tradable). Such a situation could cause an offer being able to depress the market value below the real one. On the other hand, upper classes would have probably been the acquirer in order to take an economic advantage by buying undervalued vouchers. A topic in advantage of tradability is that poor people could quickly sell their vouchers to buy consumables. Therefore, these people would have considered such a privatisation as an aid for their hard economic situation and they would have fostered the political assent. Other advantages of the voucher privatisation were that voucher market would have favoured the development of future capital markets. Voucher collecting, on the other hand, would have encouraged the raising of stakeholders with management skill in order to improve the future corporate governance. The main advantage with voucher privatisation was that it ended up with problems related to direct selling of firms, nontransparency conditions, lack of capital to sell firms to domestic investors, valuation assets difficulties in selling firms to outside investors. Moreover, in the extent that voucher privatisation is faster to implement, ties between firms and the state drop. These ties were the main obstacle to corporate restructuring; they also caused the increase of the fiscal pressure over people. In addition, voucher privatisation favoured investments in shares, the development of institutional investors and capital markets. In sum, according to Coffee (1996)[4], voucher privatisation had three advantages: it required a very short time to be implemented because free transfers needed no negotiations; it gave out citizens assets widely and democratically, not only to whom had financial resources; it avoided political controversies concerning the selling to foreign investors.

Table 2. Methods of voucher privatisation in MEEC

Country and year in which distribution of vouchers began	Share issued in waves (W) or continuously (C)?	Vouchers: bearer(B), registered and tradable (T), registered and not tradable (N)?	Investments in PIFs: Allowed (A), encouraged (E) or compulsory (Co)?	Independent fund managers (I) or self-managed funds (S)?
Czech Republic (1992)	W	N	E	I
Slovak Republic (1992)	W	N	E	S
Poland (1995)	W	T	Co[3]	I
Slovenia (1994)	C	N	A	I
Estonia (1993)	C	T[1]	A[2]	I
Latvia (1994)	C	T	A[2]	
Lithuania (1993)	C	N	A[2]	I

[1]Vouchers were nontradable in Estonia at the outset of the program, but cash trading was legalized in the spring of 1994.
[2] In Estonia, Lithuania and Latvia vouchers could also be exchanged for apartments or land.
[3] Polish citizens were given vouchers that could be exchanged for shares in PIFs.
Source: Estrin S. and R. Stone (1996), "*A taxonomy of Mass Privatisations*", *Transition Newsletter*, Volume 7, N. 11-12, 1996.

On the other hand, negative aspects of the voucher privatisation lie in having favoured the raising of a highly dispersed ownership with a consequent relapse over the corporate governance (Jensen and Meckling, 1976). This problem was sometimes treated trying to involve investment funds in the mass privatisation process (Poland), and it was at times treated trying to encourage the spontaneous raise of such intermediaries (Czech Republic and Slovakia). In this latter case, citizens could let their vouchers for fund's stakes. This process turned into the raise of an ownership structure often concentrated in the funds' hands[5].

3. Different Methods in Different Countries

3.1 Czech Republic

In 1989, when the Velvet Revolution ended the communist dominion, Czechoslovakian productive enterprises were almost entirely owned by the state[6]. After the communism breakdown, prices were rarely liberalized, there was a low tolerance to private firms, a strong and independent trade union was lacking even in decision making processes inside enterprises. Economic reformers were scared by a possible communism return, that's why they adopted a faster approach toward privatisations. In fact they believed that only a massive and quick transfer of state-owned assets could have created owners being able to encourage the necessary market reforms. In 1990-1991 a wide restitution program concerning agricultural lands and real estates expropriated during the communism was implemented. From 1991 to 1993 small and medium firms were privatized through public auctions, while from 1992 to 1994 the mass privatisation of middle-large firms took place, the so called voucher plan.

Czechoslovakian Government thought the mass privatisation in two waves. The separation of Czech Republic from Slovakia happened in January 1993; the latter did not take part to the second wave of the privatisation. The program involved about 70% of Czechoslovakia's state-owned firms, this process was implemented through the combination of different methods. Voucher privatisation was the most important from a quantitative point of view. During the first wave, 1491 were involved (988 Czech and 503 Slovakian) with a face value of CZK 299 billions. The second wave involved 861 firms (Czech only) with a face value of CZK 155 billions (Cermack, 1997). In Czech Republic, the government organized the mass privatisation: it also prepared and published a detailed list of the firms to be privatized during the first and the second stage. Managers of the firm (with other interested buyers) could suggest privatisation projects based on the combination of different techniques (vouchers included). It all aimed to a valuation and to an approval by specific governmental institutions. Voucher privatisation was one of the most adopted methods and in many cases it involved a high per cent of firms' capital. Unlike Poland and Slovenia, where the stake of capital to be privatized through voucher privatisation was established in advance for every enterprise (60% in Poland, 20-40% in Slovenia), in Czech Republic firms themselves suggested the preferred combination among the various privatisation methods. In addition, they also suggested the stake of shares to be privatized through vouchers. During the first wave, 39,7% of firms used vouchers as the only privatisation methods as well (Kotrba et al., 1999). Moreover, vouchers were used to sell an average of 81% of privatized firms' shares. (Coffee, 1996).

The objective was to create a more concentrated ownership in comparison with public companies that would foster from a direct conversion of vouchers into shares. With regard to this question, the *Investment Privatisation Funds* (IPFs) were encouraged to rise. These were investment funds in which vouchers could be exchanged for fund's stakes in order to diversify the portfolio risk.

In fact vouchers could be used to buy firms' shares or funds' stakes. In their turn, funds could buy sharing in firms through vouchers given by the citizens. Independent agents, legal persons or individuals, such as merchant banks, private companies, new intermediaries or already existing ones, created these funds spontaneously. The government established only the basic regulation structure according to the "bottom-up" approach. At first, in Czech Republic investment funds could be set up as limited companies only. In this way they were considered as closed investment funds. On 28th April, 1992, an act about financial intermediaries and investment funds authorized the open investment funds and variable asset funds rise. Unlikely closed investment funds which were set up as limited companies, in the latter citizens did not own voting rights. Many domestic banks collected most of closed funds' shares in order to control them and turning them into holding companies. A concentration of fund ownership over a small number of firms and a parallel concentration of such funds and holding companies (through M&A and buy-outs) led to the so called third wave of privatisation. At the end of the third wave, bank holding companies owned the majority in the main privatized firms. In 1996, the prime-minister Vaclav Klaus claimed that transition had been more or less completed and that the country should be viewed as an ordinary European country undergoing ordinary economic and political problems. At the time, almost economic indicators supported this judgment. In fact, after an initial shock due to the transition, the country was experiencing a low inflation period and a strong GDP growth (2,2% in 1993 and 4,7% in 1994). Nevertheless, the economic growth slowed down at the end of the upcoming years and it turned into recession in 1997-1998. It all happened together with a strong bank crisis in 1997-1998 due to the features of the undergone privatisation process. The voucher privatisation created ineffective corporate governance and an inadequate corporate restructuring for the following reasons:

- A lot of investment funds were owned by large national banks in which Czech state maintained a majority or a control stake. This inhibited their performance;
- Investment funds did not pull the plug on poorly performing firms, because that would have forced the funds' bank owner to write down the loans they made to these firms;
- The state-influenced, weakly managed and inexperienced banks tended to extend credit to high-risk, unpromising privatized firms and to persistently roll over credits rather than push firms into bankruptcy;
- The bankruptcy framework was weak and the process lengthy, further diminishing financial market discipline;
- The lack of prudential regulation and enforcement mechanism in the capital markets opened the door to a variety of highly dubious and some overtly illegal actions that enriched fund managers at the expense of minority shareholders and harmed firms' financial health, this technique is well known as tunneling (Johnson et al., 2000).

For further widening about voucher privatisation in Czech Republic see Coffee (1996), Classens (1997) and Shafik (1995).

3.2 Slovak Republic

Up to the separation from Czech Republic (January 1993), Slovak Republic followed the same privatisation pattern described in the previous paragraph, including the first mass privatisation wave through vouchers too[7].

The ownership structure characterizing Czech Republic took place in Slovak Republic too. In fact, in this country the first top 12 foreign trading companies became financial societies owning large control stakes in 146 industrial companies. (Pohl et al., 1997). In 1993 Meciar government came into power and decided to drop this privatisation technique. The government was convinced that such a privatisation method would have led to unstable governance and that it would have favoured investment funds rather than citizens. According to that, Slovak Republic implemented the second privatisation stage using traditional schemes such as direct selling. Up to 1997, direct selling involved non-strategic small and medium firms only; this technique was not always implemented according to fair principles and transparency conditions, in favour of some groups linked to the previous *Nomenklatura*.

Though ownership was more concentrated, Slovak firms governance privatized through direct selling was not significantly better than one privatized through vouchers during the first stage, as altogether supported by Slovak firms poor performances during the second half of the 90s (World Bank, 2002). The Slovak experience related to direct selling led to the conclusion that concentrated ownership is a necessary but not sufficient condition for effective corporate governance. Since 1998 Czech Republic have changed its strategy by looking at foreign investors for the main national firms give-aways, even in strategic industries such as telecommunications , transports and energy.

3.3 Poland

Poland used several techniques for privatisations. Amongst 2966 privatized firms at the end of 1998, 699 were dissolved and their assets liquidated, 240 were privatized through direct selling or initial public offerings, 512 were transferred to *National Investment Funds* and associated to a voucher system, 1515 were privatized through the so called liquidation privatisation. This method can be realized in three ways: selling of assets, contribution of assets to companies and leasing of assets to labour (Kozarzewsky and Woodwars, 2001). The latter involved about 66% among 1515 firms and that means about one third of all privatized firms, in particular small and middle ones. According to this technique, at least 50% of the employees of the state enterprise being liquidated must form a company to lease the assets of the enterprise at a preferential interest rate. In addition, no foreign investors were allowed to participate in the absence of special permission from the privatisation ministry. For this reason such companies were commonly referred as *employee-owned companies*. Mass privatisation through vouchers (called *certificate of ownership*) and investment funds (known as *NIFs, National Investment Funds*) was conceived in 1991 and approved in 1993. A long political debate followed; it concerned the implementation of such a scheme that ended in 1997. Moreover, this polish privatisation program was poorer than Czech and Slovak ones. In fact it involved 512 middle-large firms only, these companies represented a modest 10% of the polish industrial sector sales. That means an overall book value of 7 billions zloty, that is US$2,8 billions (Lawniczak and Szyszko, 1996). By a ministerial decree, the firms selected for the mass privatisation were included in the so called *National Investment Funds Programme* and their shares were transferred to 15 *NIFs*, that were state owned at first, in these proportions: 33% was transferred to a lead fund (called *lead NIF* for that enterprise), another 27% in equal proportion to other 14 funds, 15% was given to enterprise employees and the remaining 25% to the State Treasury (Uvalic et al., 1999). In 1995 citizens were given the *certificates of ownership*. Every certificate was capable to be exchanged for a stake of each investment fund; these funds owned an overall 60% of firms' capital (33%+27%). Certificates were listed at the stock exchange in July 1996. In April 1997 *NIFs* were listed at the Warsaw stock exchange; since May, certificates were capable to be exchanged for *NIFs'* stakes up to the end of 1998. Polish citizens were given 85% of funds' stakes through the conversion of the certificates at the end of the conversion process. At the beginning of 1999, the state owned the remaining 15%, this per cent decreased to 13,1% at the beginning of 2001. Funds' stakes were mainly acquired by institutional investors that owned around 46% of *NIFs'* stakes in January 2001. Among these, about 26% was owned by foreigners, 13% by domestic investors (Polish banks mainly) and 6% was a cross-ownership by other *NIFs* (Blaszczyk et al., 2001). The whole process was directly organized by the government: the funds creation, the funds' managers appointment, the allocation of single firms' majority stakes allocation among different funds, compensation schemes and other details (*top-down approach*). At the end of 1997, Poland was the MEEC with the lowest per cent of its economy privatized. Since 1998, this process has grown faster and direct selling of most important domestic enterprises and banks to strategic foreigners has taken place. The 1997-2001 period revenues were four times larger than 1990-1996 period ones.

3.4 Hungary

Since 1968 in Hungary the Communist Party has rapidly reformed. It introduced market mechanisms in a new model of centralized planning. This was a more pragmatic communist regime, in fact it abandoned the central plan. The regime encouraged an increasing rate of private-owned firms, it reformed the taxation policy, and it reformed the bank sector, trading with foreigners and the corporate governance during those years preceding the political change. When this changing happened, the new leading elite did not consider the communism as a threat. Instead, the real problem was represented by the inefficient managerial group leading hundreds of more independent firms (but stated-owned formally). Transferring the ownership to people through the mass privatisation and leaving the original management in its place was not the right solution for Hungary. This country was one of the most in debt of the region and for this reason, one of the main privatisation objective was to maximize the revenues. The country tried to achieve this purpose through direct selling with competitive auctions where foreigners could take part to. At that moment, none of other MEEC government (except for Estonia), allowed foreigners to participate to the privatisation process in such a wide way. This choice was considered as daring. Actually, this strategy revealed to be the right one and it was one of the reasons of the growth of the country during the 90s. In facts strategic outside investors provided Hungarian banks and enterprises with new capital and new skills necessary to a real development. In the middle of the 90s, Hungary had sold its banks to strategic foreigners, it had also adopted a convincing bank and bankruptcy regulation. The good trend of Hungarian economy demonstrates that a fair bank and bankruptcy regulation is as necessary as a fair governance to encourage an effective corporate restructuring. In Hungary the restitution of expropriated properties was realized through vouchers with which assets could be acquired. Firms privatisation can be divided into three stages. In the first one, 1990-1994, the most attractive firms were given trying to involve the small domestic investors as much as possible. In 1990, 1859 companies were identified as being privatized even if only more than one third had been privatized in 1994, its worth was US$ 2,8 billions. From 1995 to 1997, large firms of strategic sectors (energy, chemical, bank, etc.) were privatized mainly through direct selling to foreigners. In 1997 the country employed IPOs.

3.5 Slovenia

Yugoslavia had a different industrial organisation, in fact most of firms were not state-owned but they were formally community-owned. The community appointed managers through the Labour Councils. That's why the ownership structure had to change before a development of a market economy could happen. A 1992 act, implemented in the second half of 1993, stated the following capital allocation: 20% to a *Development Fund*, 10% to a *Restitution Fund*, another 10% to a *Pension Fund*, 20% to labour and the remaining 40% to insiders (labour and managers) through a MEBO at preferential terms, or given to individuals through direct sale, IPOs, vouchers. Stakes given to the *Development Fund* were secondly set to an auction to investment funds that had collected vouchers assigned to privates in exchange for their stakes. Labour's vouchers could be freely exchanged for the 20% stake assigned to workers. The self-managing tradition and the preferential terms for workers to buy the 40% of the firm capital (a 50% discount and deferred payment) encouraged the privatisation of such stakes through MEBOs and that's why in September 1996 about 71% of the firms were owned by workers[8]. In Slovenia the government decides which sectors were to be excluded from privatisation, while all the other enterprises were automatically included in the general privatisation program. The privatisation program involved 1543 companies representing about 41% of GDP, 40% of revenues and 50% of employment. Among these 1543, at the end of 1994, 90% of the firms to be privatized submitted their privatisation plan to the proper organisms, but at the end of 1996, only 58% (900) completed the privatisation process (Jaklin and Heric, 1997). Such a program completed in 1998 only.

3.5 Estonia, Latvia and Lithuania

In Estonia the privatization process started with the *Privatisation Act* in 1992. The main objective was to attract foreign capitals and the most used privatization method was the direct sale through auction together with IPOs for minority stakes of larger companies. The mass voucher privatization had a marginal role, though it had some peculiarities for what concerns assigning criterions (years of employment and past expropriations were taken into account) and the conditions of use (vouchers could be exchanged for stocks, investments funds, to buy houses, lands, etc). At the end of 1995 almost 90% of the state-owned firms had been privatized. At the end of 2000 about 1100 small-middle firms and 500 middle-large firms had been privatized. The process was completed with the *Estonian Privatization Agency* liquidation in 2001[9]. In Latvia in 1991 the restitution of expropriated properties and the privatization of shops and craft made activities took place. In 1992 the privatization of middle-large enterprise started but it lacked of interest until the creation of the *Latvian Privatization Agency* in 1994. Latvian privatizations involved many methods: direct sales, IPOs, public auctions and vouchers. In Lithuania there was a three stages privatization process. During the first stage, 1991, small assets were privatized mainly through vouchers or public auctions. In the second stage, 1995, the *Privatization of State-Owned and Municipal Porperty Act* tried to boost the privatization process and to encourage the selling to foreign strategic capitals, even if public auctions and IPOs were mainly used instead of the direct sale. The third stage started in 1997 with a new act about privatizations that established the *State Property Fund* that was liable for the future steps of the privatization process. After that, a giveaway of 1432 firms happened. At the end of 2000, about 70% of GDP was due to the private sector[10].

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Endnotes

[1] Shafik (1995) points out that in 1989 Czechoslovak government owned 98% of all activities. Such similar percents were the common run in many countries.
[2] In fact privatisations of banks and other financial intermediaries were sometimes different: their development needed foreign strategic investors with fresh capitals and skills. See also Coletti et al. (2003).
[3] Estonia, Latvia, Lithuania, Poland and Slovenia used their own currency to determine vouchers' prices. On the contrary, Czech Republic and Slovak Republic used points (Castater, 2002).
[4] For further investigations see: Coffee, C. John Jr. (1996), "Inventing a Corporate Monitor for Transitional Economies: The uncertain Lessons from Czech and Polish Experiences", in Hopt et al. (1996) *Comparative Corporate Governance*, Oxford University Press.
[5] Pohl et al. (1997) pointed out that five main stakeholders of 706 enterprises ……
[6] 86% of GDP was due to state-sector, 10% was due to cooperative sector and only 4% to private sector (Coffee, 1996).
[7] In Slovak Republic, privatisations on a small scale started on February 14th, 1991 and it was completed at the end of 1992. In such a period, 9676 small firms were set on auction whose worth was CSK 14,5 billions.
[8] Data reported by www.privatizationbarometer.net, Fondazione Mattei on July 27th, 2004.
[9] For further widening see Vensel V. e Wihlborg C. (2001) edited by *Estonia on the threshold of the European Union – Financial Sectors and Enterprise Restructuring in the changing economic environment*, Uhiselu, Tallin TU.
[10] Data reported by www.privatizationbarometer.net, Fondazione Mattei on July 27th, 2004.