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Secondary Privatization in Slovenia: Evolution of Ownership Structure and Company Performance Following Mass Privatization

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Preface

This volume contains the output of country research undertaken in Slovenia in 2000–2001 by a team directed by Andreja Bohm and Marko Simoneti under the international comparative project "Secondary Privatization: the Evolution of Ownership Structures of Privatized Enterprises". The project was supported by the European Union's Phare ACE* Programme 1997 (project P97-8201 R) and was coordinated by Barbara Błaszczyk from the Center for Social and Economic Research (CASE) in Warsaw, Poland. The Slovenian research was additionally co-financed by the research grant received by Central and Eastern European Privatization Network from the Ministry of Science and Technology, Republic of Slovenia (V5-9140-98).

The support of the ACE Programme made it possible to organize the cooperation of an international group of scholars (from the Czech Republic, France, Poland, Slovenia and the U.K.).

The entire project was devoted to the investigation of secondary ownership changes in enterprises privatized in special privatization schemes (i.e., mass privatization schemes and MEBOs**) in three Central European countries – the Czech Republic, Poland and Slovenia . Through a combination of different research methods, such as secondary analysis of previous research, analysis of legal and other regulatory instruments, original field research, statistical data base research and econometric analysis of individual enterprise data, the project aimed to investigate the scope, pace and trends in secondary ownership changes, the factors and barriers affecting them and the degree of ownership concentration resulting from them.

In presenting a clear picture of secondary privatization trends in Slovenia, the authors of this volume tried to evaluate the effectiveness of various privatization schemes in terms of their open-endedness (i.e., the degree to which they foster flexibility in adjustments of ownership structures) and in terms of achieving good corporate governance. Additionally, they formulate and examine hypotheses concerning the relationships between changes in the economic performance of enterprises and post-privatization changes in their ownership structures.

This report also includes a set of recommendations concerning necessary changes in the regulations and policies governing privatization and capital markets in Slovenia, designed to foster the development of privatized enterprises and to meet the requirements of the process of accession to the European Union.

We hope that the results of this research will be of great interest for everyone interested in the little-researched question of what has happened to companies after privatization in transition countries.

Barbara Błaszczyk

* "Action for Cooperation in the Field of Economics".

** Management-Employee Buyouts.

Part I.
Slovenia Mass Privatization and Barriers to Secondary Privatization[1]

Marko Simoneti and Andreja Böhm[2]

1.1. Introduction

After prolonged debates on the most adequate method for privatizing companies in Slovenia, a combined model was adopted, which in principle allowed for paid and non-equivalent (i.e. mass) privatization. The basic model of privatization (20% + 20% +20% + 40%) according to the Ownership Transformation Act (OTA) envisaged:

(1) transfer of 20 percent of shares to para-state funds: 10 percent to the pension fund and 10 percent to the restitution fund;

(2) transfer of 20 percent of shares to privately managed privatization funds in exchange for ownership certificates collected by them from citizens;

(3) exchange of 20 percent of shares at favorable terms for ownership certificates of internal owners (managers, current and former employees);

(4) optional use of 40 percent of shares:

(4i) for buy-outs at favorable terms by internal owners,

(4ii) in exchange for ownership certificates of citizens in public offerings,

(4iii) in exchange for ownership certificates collected by privatization funds or

(4iv) for purchases by strategic owners.

The fourth component contained optional elements, and could therefore lead to the emergence of various ownership structures, reflecting (in principle) the needs of individual companies. The legal principle of autonomy, by which managers and employees in companies were granted the right to prepare privatization plans, was a factor that critically determined the selection of privatization options.

The first characteristic of that selection was that companies practically did not opt for sales of shares to strategic owners (4iv). Of approx. 1,500 companies privatized under the OTA, only a few dozen acquired strategic owners. Thus primary privatization was a lost opportunity for numerous troubled companies requiring strategic investors for restructuring. Such companies are therefore forced to search for strategic investors that are capable and motivated to ensure restructuring in the next step, via secondary transactions with privatization shares (i.e. secondary privatization). Owners from mass privatization are largely transitional owners, playing a role of privatization agents in search of strategic investors.

The second characteristic of the selection of privatization options was that managers and employees in general exercised their priority buyout right to 40 percent of shares at favorable terms (4i) to the maximum extent allowed by their financial resources. Residual shares were either exchanged for certificates collected by privatization funds (4ii) or directly distributed to the citizens in public offerings (4ii). Thus, apart from privatization to insiders (i.e. internal privatization) and privatization to funds (i.e. external privatization), privatization to the citizens (i.e. public privatization) gained significance in large and capital intensive companies. The selection between external and public privatization was made on the basis of judgements as to which of the two options represented a lesser threat to internal owners. However, we must also take into account the fact that public offerings to the citizens could have not been successful in poorly performing companies, whereas privatization funds were forced to accept the shares of such companies.

In consequence, three typical groups of companies were formed according to the relative importance of the three forms of privatization and in view of the statutory rules that applied at the commencement of secondary privatization: (a) public companies quoted on the stock exchange as the

[1] This research was undertaken with support from the European Union's Phare ACE Program 1997, Project P97-8201 R "Secondary Privatization: The Evolution of Ownership structure of Privatized Companies", coordinated by Professor Barbara Błaszczyk, CASE Foundation, Warsaw". The content of the publication is the sole responsibility of the authors and it in no way represents the views of the Commission or its services. In addition the Slovenian research was supported by the research grant received by CEEPN from the Ministry of Science and Technology, Republic of Slovenia (V5-9140-98).

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result of combined internal, external and public privatization, (b) nonpublic internal companies not quoted on the stock exchange with employees holding majority stakes, and (c) nonpublic external companies not quoted on the stock exchange with employees and funds holding comparably large shareholdings.

The proponents of mass privatization argued that its main advantages were the speed at which large parts of economy would be transferred to the private sector and its contribution to starting of capital markets in countries in transition. [Lipton and Sachs (1990), Frydman et al. (1997)]. Mass privatization indeed involved a large part of the corporate (non-financial) sector in Slovenia[3] but was spread over five years. Unlike in similar programs implemented elsewhere, privatization was decentralized on both the supply and demand sides, and in principle a wide spectrum of options was made available in the privatization law. Nevertheless, in practice that model limited the selection of privatization methods on both sides. Of the 1,386 companies that underwent mass privatization, less than one tenth (albeit the largest ones) used public offerings and are quoted on the stock exchange. All public offerings were oversubscribed, some of them by several times. The majority of citizens, however, invested certificates in companies (as their current and former employees) and in privatization funds (all quoted on the stock exchange). Mass privatization was formally completed at the end of 1998 but has actually remained uncompleted on both the demand and supply sides. The portfolio of the state holding company (Slovenian Development Corporation-SDC) consisted of a few hundred companies that were excluded from mass privatization at its early stage, voluntarily for prior restructuring or compulsorily within the state-led rehabilitation of two dominant banks. On the other hand, substantial portions of certificates in the portfolios of privatization funds remained unused (the so-called privatization gap).

There was a wide agreement that success of mass privatization would ultimately depend on the speed and effectiveness of restructuring at the micro level. The argument that the ensuing concentration of diffuse ownership and consolidation of control would serve as a prelude to the entry of strategic investors to companies, enabling those companies to gain access to external financing to ensure restructuring, pointed to difficult trade-offs. Whereas mass privatization was state administered, it was argued that secondary privatization should be essentially market driven. For that reason the market would have to be appropriately regulated, and the questions arose whether the standard Western regulations were sufficient for the purpose or whether they would actually hinder the speed of secondary privatization and invite fraudulence in its course. The speed of secondary privatization threatened its transparency and fairness, and this, in turn, would obviously affect the speed and effectiveness of corporate restructuring. This required a high degree of sensitivity to the specific ownership and control structures of companies that had emerged from mass privatization in the actions of policy makers, legislators and regulators who were responsible for guiding, facilitating and promoting secondary privatization.

1.2. Review of the Empirical Evidence on Mass Privatization in Slovenia

Numerous empirical studies have focused on the effects of initial ownership and control structures, as well as their subsequent changes, on corporate restructuring and performance – and *vice versa* – in countries in transition (see Murrel and Djankov, 2000, for their synthesis). Different ownership and control structures of companies that reflect the specifics of mass privatization programs in individual countries impair meaningful international comparisons. Practical solutions for secondary privatization must be sought at the level of individual countries. International research, nevertheless, provides for comparisons that are of value in that search.

There is a growing body of empirical work in Slovenia that studies the effects of privatization (via the ownership and control structures emerging as a result of privatization) on corporate restructuring, finance and performance following privatization. Economists believe that optimal ownership and control structures will ultimately result from strategic management and restructuring, leading to an expansion of assets, employment and sales (i.e. revenue-generating restructuring) which in turn improves the performance of companies and increases their values in a long run. Faster adoption of hard budget constraints and strategies for expansion of markets is evidenced in companies that face competition on product markets (Pućko, 2000). Sales on foreign markets evidently force strategic restructuring (Prašnikar, Domadenik and Svejnar, 1999). Managers perceive competing companies as the most likely raiders, and most takeovers are indeed horizontal in Slovenia (Bešter, 1999). Hence competition on product markets heightens

[3] Mass privatization concerned only the commercial companies and involved a group of them that accounted for approx. 60 percent of the total corporate sector in the country in various terms at its commencement (1994) and roughly contributed over 40 percent of its labor force and value added and to over 30 percent of its assets and capital at the end of the process (1998). The respective figures illustrate that a lot of ownership restructuring in the country took place in other forms via nationalization, spontaneous privatization and private sector development, and corporate restructuring via asset (dis)investments and shrinking of labor force (Simoneti, Rojec and Rems, 2000).

the likelihood of both strategic management and restructuring and fast and effective secondary privatization.

Defensive restructuring (defined as consisting of labor force reductions, contraction of assets and moderate growth of sales revenues) is a distinguishing characteristic of companies that underwent mass privatization, as opposed to new private firms and subsidiaries that are closely held by their owners and/or controlled by their creditors. New private firms show accelerated growth of investments, sales revenues, profits, as well as operating cash flows, and they are generators of new jobs. Subsidiaries excluded from mass privatization show higher investments and an extraordinary growth of operating cash flows[4]. The fastest growth in every respect is seen in companies with foreign strategic investors. On the other hand, while the leaders in defensive restructuring are the state-held, non-privatized companies, the largest investments in assets are recorded in nationalized public utilities[5].

Specific components and forms of defensive restructuring are widely observed in companies that underwent mass privatization. In empirical research on the respective forms, intensity, speed and effects of corporate restructuring, companies are most commonly disaggregated with respect to the relative importance of external and internal ownership, implicitly assuming that there were two options of mass privatization.

'Employeeism' – defined as an antagonistic relation between employees (over-represented on supervisory boards and fighting for salary benefits) and managers (argued to behave like external owners [i.e., funds] attempting to maximize cash flows) – takes on different forms in companies privatized to internal and external owners. The latter do not exhibit the typical positive correlation between value added and investments but seem to evidence appropriation of depreciation resources for salary benefits, while the former show typical trade-offs between salaries and investment (Prašnikar and Svejnar, 1998). Larger layoffs occur in the group of companies with majority employee representation on supervisory boards than in the group with minority employee representation[6]. Nevertheless, differences between the two groups with respect to the effects of defensive restructuring and strategic restructuring (e.g., investments in human capital, R&D and market research) are insignificant (Prašnikar, Domadenik and Svejnar, 1999). The likelihood of strategic management would be heightened if managers were rewarded in share options (rather than in fixed salaries, as is the prevailing practice) for their contribution to performance improvement in the long run (Prašnikar, Ferligoj, Cirman and Valentinčič, 1999).

Multi-year surveys based on large samples of companies reveal that outsider-owned companies that used public offerings in privatization show superior initial performance in relation to all other companies, and the gap tends to widen over time. Larger operating cash flows and low indebtedness is a characteristic feature of the former. Moreover, their restructuring incurs lesser layoffs and yields higher productivity gains, whereas the growth of salaries is due to higher skills of their labor force.

Reliance on internal resources is a typical feature of defensive corporate restructuring. Access to external financing is constrained due to poor development of financial system. The latter, in turn, is often argued to result from the poor corporate governance that emerged from mass privatization and the ineffective ensuing ownership concentration. Illiquid capital markets, combined with diffuse ownership, do not provide for effective corporate governance, but instead drive the controversial concentration of ownership in the hands of funds that should be drastically reducing their stakes. In fact, these funds are emerging the largest shareholders in most companies quoted on the stock exchange (Gregorič, Prašnikar and Ribnikar, 2000). The capital market, which is doing a poor job of re-distributing ownership, precludes new issues of securities. Banks, in turn, decline credits due to information asymmetry, or – when they do grant them – price their credits too high because of a high information premium (Ribnikar, 2000).

The stock exchange is discredited with both investors and companies because of low transparency and speculative trading (largely due to various restrictions on investments in shares and large volumes of non-transferable shares), as well as low liquidity largely due to asymmetrical treatment of debt and equity securities and restrictions on foreign portfolio investments. Citizens who became shareholders in mass privatization thanks to their certificates maintain

[4] Various techniques of privatization (apart from those used in mass privatization) contained in the law provided for the financial and organizational restructuring of companies preceding privatization. This entailed breaking up large companies and groups of companies and free transfers of assets among (newly created) legally independent enterprises. As an unexpected outcome of such restructuring, a number of companies (approx. 400) were consequently indirectly privatized as subsidiaries of parent enterprises that were privatized according to the model of mass privatization. They accounted for some 20 percent of the total corporate sector in the country in 1998 (Simoneti, Rojec and Rems, 2000). It was not uncommon for employees of subsidiaries to take part in the privatization of parent companies as former employees.

[5] All public utilities and infrastructure objects of public interest were excluded from mass privatization and nationalized. In 1998 they accounted for approx. 20 percent of the total corporate sector in the country. Such nationalization occurred also in selected (large) companies that underwent mass privatization.

[6] This classification does not exactly correspond with majority internal and external ownership, but rather reflects the size of the labor force and the decision to avail of the legal provision that grants employees seats on supervisory boards in proportion to their numbers.

extremely low propensities to invest their (cash) savings in securities, greatly preferring bank deposits (Kleindienst and Simoneti, 1999). Managers of companies are more inclined to seek bank credits than to issue new securities on the stock exchange. On the other hand, the supervisory boards of companies (irrespective of the privatization option) tend to reject the managers' proposals for equity financing when they do arise, due to the limited financial resources of incumbent owners and their consequent loss of control (Simoneti and Jamnik, 2000).

With companies relying on internal resources and largely free from servicing debts, financial discipline is obviously lacking. Operating cash flows are not ploughed back for strategic investments but are used for short-term financial investments. Smaller financial investments are the most distinguishing characteristic of large companies with dominant owners in relation to companies without such owners; the latter show lower use of debt financing and higher salaries (Cirman and Konič 2000). Companies on the stock exchange show higher operating cash flows but smaller purchases of own shares than the non-quoted privatized companies (Simoneti and Jamnik, 2000). Regardless of whether shares are purchased on the public market or "troublesome" owners are directly bought out, such purchases of companies' own shares consolidate the control of incumbents from mass privatization.

Extensive data on the evolution of ownership structures and concentration after mass privatization in Slovenia are studied in this paper. These data reveal that since completion of privatization at the end of 1999 almost 40% of initial shareholders have already exited companies privatized through mass privatization. At the end of 1999 ownership concentration is relatively high: the five largest owners on average hold 61.5% percent of votes in "mass-privatized" companies. Moreover, in Slovenia para-state funds and privatization funds act as large shareholders, despite lacking the ability and motivation for proper corporate governance. On the other side, many small shareholders are company insiders who act as a homogeneous group in relation to external owners. It might well be that with concentration of ownership in the period 1994–99 the problem of managerial discretion was reduced, while the conflict of interest between internal and external owners was exacerbated.

The state and para-state funds are reducing their ownership stakes in the companies from mass privatization, while managers and strategic investors are increasing them. It is observed that both groups are accumulating their shares more intensively in companies which are not traded on the stock exchange and therefore have limited transparency. In addition, new strategic investors appearing through the end of 1999 were almost exclusively of domestic origin. Initial privatization (with free distribution of shares and limited foreign and strategic investors) is followed by non-transparent domestic consolidation of ownership, where domestic companies, managers and funds are the key players.

The relationship between changes in ownership and companies' performance after mass privatization is also studied in this paper. These empirical results are conclusive that secondary privatization had practically no positive effect on either economic efficiency or on financial performance in the period 1995–1999 in Slovenia. Breakdowns by individual privatization models, groups of companies, and individual years as well as for the whole period did not yield any different results. The problem of secondary privatization in Slovenia does not only concern its low transparency and relatively slow pace, but especially its failure to yield the expected positive effects on economic efficiency and financial performance.

Mass privatization in Slovenia proved to be appropriate for several hundred relatively small and labor-intensive companies and for about one hundred well-performing, large, capital-intensive companies. In the former, a majority of shares was acquired by the employees, while the latter, using public offerings, were quoted on the stock exchange. Mass privatization, however, was inappropriate for relatively large and capital-intensive companies requiring substantial corporate restructuring, because they required strategic investors and/or access to external financing. Only around a hundred such companies (ones that were making losses and unable to service debts) were excluded from mass privatization. In the remaining several hundred companies with similar economic characteristics, stakes of comparable sizes went to employees and funds. There is a strong conflict of interest between insiders and outsiders, which is making the restructuring process very difficult in these companies.

Empirical research has exposed and evidenced various factors that prevent effective changes in ownership and control structures of companies conducive to their strategic management and restructuring. They stem from the legal and regulatory framework that makes up the corporate governance regime established with mass privatization and perpetuated in the post-privatization phase.

1.3. Legal, Institutional, Structural and Political Barriers to Secondary Privatization

There is a wide agreement in Slovenia that the ownership and control structures created in mass privatization are sub-optimal for strategic management and restructuring of companies and will have to undergo profound changes in secondary privatization. Their transitional nature stems essentially from the transitional nature of incumbent owners from mass privatization. They either will have to exit from companies to provide for the entry of strategic investors, or their ownership and control positions in companies will have to be adjusted. For the most part, secondary privatization actually concerns the consolidation of dispersed employees' ownership, transformation of privatization funds and improved governance of para-state funds. The following questions arise: Do the legal and regulatory conditions for fast, transparent and just secondary privatization (and for the exit or transformation of owners) exist? If they are lacking, does the political will to create them exist? And what are the main factors constraining post-privatization ownership changes? Specific constraints to its speed and effectiveness that are legacies of the Slovenian mass privatization are discussed below, with due consideration of the respective routes of secondary privatization in three ownership groups of companies which we label public, internal and external.

1.3.1. Postponed Transferability of Privatization Shares

Discussion on the issues of potential stock exchange collapse, inflation and the inequitable distribution of wealth began already during the drafting of the privatization law, as it was arbitrarily assumed that small shareholders would start selling shares promptly following privatization. The apprehension about the impossibility of creating sufficient demand in the short run led to the decision to postpone transferability of employees' shares from internal distribution for two years and from internal buyouts until credits were fully paid, i.e. up to five years.

In order to ensure transparent secondary privatization all tradable shares from mass privatization were to be issued in dematerialized form and their transaction concluded through the Clearing and Depository Company (CDD) using the services of stockbrokers authorized by the Securities Market Agency (SMA)[7]. The CDD keeps a central share register in which entries can be made only by their owners/members and the stockbrokers. Whereas the shares remain non-transferable until registered, it has been left to the discretion of companies (and privatization funds) how quickly or slowly to proceed. The compulsory two-month registration deadline after the completion of privatization (i.e., share distribution) by individual companies was widely disregarded. A number of companies avoided registration by having been taken private promptly after privatization by decisions made at shareholders' meetings.

The flaw of postponed transferability of shares resulted in a flourishing non-organized market. Its existence immediately after privatization certainly facilitated early concentration of ownership. Such concentration, however, was driven by inside information and information asymmetry concerning expected capital gains from share trading, and hefty premiums from selling controlling stakes. It proceeded at the cost of small shareholders in an environment of nearly total disregard of their rights due the regulatory absence of takeover rules.

A simple method for such trading was the purchase of future contracts on the shares from public offerings and internal privatization at low prices and the simultaneous collection of *in blanco* proxy authorization for several years[8]. The stockbrokers servicing the share trading on the stock exchange and maintaining a kind of organized quasi-public market for the shares of nonpublic companies were certainly in a position to accumulate shares promptly after completed privatization by individual companies. Managers clearly had an advantage on internal markets of companies in purchasing shares acquired by employees with certificates and large discounts for credits.

Postponed transferability of shares has had far-reaching adverse effects on secondary privatization and strategic corporate restructuring and management. Incumbent owners were given latitude to consolidate control and introduce ownership and control restrictions in companies' charters. Thereby separation of control between two incumbent blocks of owners has been entrenched. Speculative share trading and control acquisitions have discredited the securities market with investors and companies and postponed development of the primary market in the longer run.

1.3.2. Trading with Privatization Shares on the Stock Exchange

Public companies (and privatization funds) are required to be quoted on the Ljubljana Stock Exchange (LSE). The process of quotation gained momentum only at the end of 1998 following public appeals of the SMA and the exertion of pressure on the governing bodies of companies by shareholders observing price differentials on the organized and non-organized markets.

The prices determined by the secondary trading on the stock exchange rose quickly in relation to the prices on the non-organized market. The shares of larger and well performing companies have been quite liquid and traded at fairly stable price levels. The shares of smaller (and more poorly performing) companies have been less liquid, and their prices quite volatile (Stock Exchange Focus, 2000). Price instability on the stock exchange was contributed to by blocks of shares coming onto the stock exchange at stag-

[7] This requirement applies to joint stock companies with 50 and more shareholders (which was the prevailing legal form of privatized companies, since the scheme of mass privatization did not provide for collective employee acquisitions), as well as to privatization funds.

[8] Such in blanco long-term proxy authorizations were later prohibited.

gered times due to postponed transferability of employees while other blocks of shares in the same companies were still being traded on the non-organized market. As a result, the concentration of shares was quicker and higher in smaller companies and in the companies with relatively large volumes of nontransferable employee shares[9].

The initial stock exchange boom was mostly due to foreign portfolio investors. Due to concerns about their potential destabilizing effects, the Bank of Slovenia (BOS) introduced restrictions on them in 1997. In that year such investments accounted for 12 percent of stock market capitalization and were concentrated in a small number of companies that had the most liquid shares and contributed 60 percent of total market turnover in 1997 (Stock Exchange Focus, 2000). Foreign portfolio investors were required to open custodian accounts with authorized domestic banks and could trade shares quoted on the LSE only among themselves over several years or sell them to domestic investors with a high exit commission. Such restrictions have been considerably relaxed since their introduction but effectively caused the withdrawal of foreign investors. This, in turn, led to falling liquidity and prices on the LSE[10]. Foreign investors have only recently begun to re-appear.

The initial liquidity on the stock exchange was also due to enthusiastic domestic investors, including privatized companies making financial investments by purchasing shares of other companies as well as their own shares. But after experiencing (accounting) losses due to the falling prices they, too, became disillusioned with investing in corporate securities.

Some other factors have inhibited development of the capital market. Relatively risk free debt securities with high interest rates issued by the state, BOS and commercial banks are more attractive to investors than riskier corporate securities. Dividends and interests are asymmetrically treated: interest is not taxed while dividends are taxed[11]. Moreover, a relatively high tax is charged on capital gains if securities are sold less than 3 years after purchase.

Moreover, as the result of the illiquid stock market and the restrictions on outward portfolio investments the development of domestic institutional investors has been slow. Having recently been allowed to invest 10 percent of their portfolios abroad, domestic mutual funds are gaining in importance. Some management companies of privatization funds consider establishing mutual funds abroad to avoid restrictions on outward portfolio investments[12]. Pension funds are only now emerging but are legally bound to yield guaranteed returns on pension policies tied to the returns of the state securities; they are not likely to play a role in deepening of the corporate securities market.

1.3.3. Market for Corporate Control

Takeover, merger, and acquisition activity has been on the rise since the completion of privatization by individual companies. Two parallel processes have driven it: (a) reintegration of businesses that had earlier been broken up[13], with a view toward increased competitiveness on product markets, and (b) concentration of ownership by shareholders with short-term financial interests or to gain control over companies[14].

The takeover act was delayed for several years despite severe pressures for its passage, as companies resisted quotation and registration of shares in the absence of clear rules for concentration of ownership and for proxy voting. It was enacted at the end of 1997 after an extended period of controversial debates[15], and after substantial ownership changes had already occurred and ownership and voting restrictions had already been introduced in companies' statutes.

The act entrusted the SMA and antimonopoly commission[16] to oversee the control acquisitions in companies

[9] Since the entry into the central share register until the beginning of the last quarter of 1998 the number of shareholders decreased much more in smaller public companies (by up to 82 percent) than in larger ones (between 20–40 percent on average) (Lahovnik, 1999). The lowest concentration has been observed for a large company that directly restituted shares to a large number of former small shareholders and had completed internal distribution at an early stage of privatization process, as a result of which the employees' shares were all transferable at the time of quotation (Stock Exchange Focus, 2000).

[10] Some companies are considering issuing global depository receipts on foreign exchanges to counteract the low prices of their shares on the LSE.

[11] Interest on bank deposits and on debt securities is not taxed.

[12] For the time being, foreign mutual funds are not allowed to issue coupons in Slovenia, and hence domestic investors cannot invest in their coupons abroad.

[13] Such reintegration entails, for example, reversals of spin-offs undertaken in pre-privatization leading to the reconstitution of groups of companies, but such reversals may as well be postponed until control of parent companies is consolidated.

[14] The managers perceive the shareholders as likely raiders – especially competing companies and business partners, followed by privatization and state funds (Bešter, 1999).

[15] Simoneti (1997a) proposed a dual approach to the regulation of market for corporate control of public and nonpublic companies. Whereas standard rules of ownership concentration should be adopted only for public companies, looser but clear rules should be adopted for nonpublic companies, with emphasis on the rules for voting on legal changes at shareholders' meetings.

[16] The antimonopoly commission has frequently proved its narrow and short-term view on competition, limiting its considerations to domestic market share and domestic competitors and failing to apprehend the need for strengthening international competitiveness given the accelerated opening of the economy.

with more than one billion tolars' worth of equity capital and over 500 shareholders. All such companies have to report on every 5 percent acquisition by individual and related shareholders. Non-reported acquisitions do not confer control or yield dividends. Moreover, two thresholds of 25 and 40 percent respectively were set for mandatory bids and the shareholders that had already accumulated large stakes were obliged *ex post* to such bids in further acquisitions. In addition, mandatory bids at the two thresholds are obligatory for voting coalitions, irrespective of the value of equity capital of companies or the number of their shareholders.

In order to facilitate transparency of control acquisitions, a batch market was introduced on the stock exchange in 1997. At the time of writing, batch deals already account for over one half of the total turnover of the stock exchange. The stockbrokers that lost businesses from share trading soon saw a new opportunity in servicing takeovers. They act on behalf of both raiders and defenders. Being allowed to trade on their own account, they carefully orchestrate control acquisitions among several (formally unrelated) persons. There are no limitations for applications of batch deals on the stock exchange and settlement time is longer than for regular share trading. To counteract the negative effects on prices in regular share trading the stock exchange is contemplating the introduction of limits on the price differentials and size of batches that can be applied on a daily basis.

Takeover rules are promoted as a means of protection of small shareholders in secondary privatization. In view of the dispersed ownership resulting from mass privatization, such rules have been applied to all companies with tradable shares. This policy, however, hinders the process of taking private nonpublic companies. It is not possible to protect the rights of small shareholders in companies not quoted on the stock exchange with takeover rules, as possibilities for exit at fair prices are so limited in such companies. It is unreasonable to insist on such rules on voting coalitions when two blocks of owners share control, especially in the case of external companies. On the other hand, legally non-related persons acting in de facto coalitions have accumulated in disguised ways large volumes of shares, not all of them with voting rights. Nevertheless, the passivity of small shareholders and rules requiring simple majority votes make them controlling shareholders at shareholders' meetings. More control over acquisitions of formally unrelated persons is required.

1.3.4. Disclosure of Information on Companies

Due to the unsettled conditions on the securities market and Slovenian discretionary accounting standards it is difficult to value companies objectively. Book values and profits reflect diverse accounting practices that tend to be pursued in the short-term interests of shareholders rather than with a view toward the long-term development needs of the companies. Hence, standard valuation indicators such as price-earning ratios and market-to-book values are quite unreliable[17]. The issue is compounded in nonpublic companies, which are not subject to the same reporting requirements as companies quoted on the stock exchange.

Poor performance could be argued to be a factor that speeds up secondary privatization. Nevertheless, companies can manipulate performance indicators by availing of their historical legacies, as performance and high book values can be maintained in the short run with defensive restructuring and accounting adjustments. The Slovenian accounting profession maintains a conservative approach to the accounting standards that preserve historical book values from mass privatization rather than promoting the discovery of market prices reflecting future cash flows that would demonstrate the true capabilities of companies to service shareholders and potential investors.

In order to allow for the allocation of long-term reserves created in mass privatization (equal to the accounting difference between book values of assets and their values established by formal valuation using the discounted future cash flow method), significant discretion in decisions on depreciation is granted. Consequently, discretion is also given in decisions on salaries. Moreover, accounting standards allow for keeping book values of companies high by upward adjustments of values of capital and assets for inflation[18]. But the high levels of equity capital from mass privatization and the upward adjustments of its value yield small returns. Managers are slowly beginning to understand the role of dividends in corporate governance and finance. They face a trade-off between decreasing the value of capital to allow for payment of dividends and maintaining the high value of capital. While book values can be kept up by accounting decisions, to decrease them it is necessary for shareholders to formally agree *ex-ante* on the revaluation of the assets. An alternative way to decrease book values while maintaining the value of shares is re-purchase and annulment of shares traded on the market, but this increases the threat of hostile takeovers.

[17] The general lack of liquidity and overall fall of prices has promoted a lively discussion (albeit with no solid arguments offered) about whether the prices on the LSE are over- or undervalued in relation to the (accounting) performances of companies.

[18] Possible differences between adjustments in the values of assets and capital represent extraordinary (accounting) revenues (losses) that can be used for depreciation.

1.3.5. Supervisory Boards

Supervisory boards represent the most important vehicle for gaining reliable information on companies and controlling managers. Their role in secondary privatization may actually be central[19]. Initially, a frequent motive behind ownership consolidation was to gain representation on supervisory boards. All major decisions on mergers and acquisitions, takeovers, issuing of debt and equity and adjustments of asset values, as well as concerning sales of capital and assets, must be approved by these boards. As a result, supervisory boards represent the main constraint to secondary privatization via access to external financing and sales to strategic investors which affect the control positions of incumbents.

The first supervisory boards, which replaced the former workers' councils (and continued serving in the early post-privatization period), were appointed by managers in the course of privatization. The ability of such boards to control managers was widely questioned. As a result of incumbents' consolidation of ownership and voting powers, the membership of supervisory boards has begun changing fast, and the increased frequency of meetings demonstrates their activism.

The presence of incumbent owners on supervisory boards, however, is controversial. There is a major information asymmetry between managerial supervisory board members and other members that lack understanding of accounting and financial issues.

Another controversy over supervisory boards concerns the representation of employees on two grounds: due to their role as owners and due to legislation mandating certain levels of supervisory board representation based on the size of labor force. In companies with 500 and more employees, one third of seats on the supervisory board are reserved for employees, and in companies with 1000 or more employees they can occupy two thirds of seats. In addition, a labor director (i.e., a member of the executive board representing employees) is required by the law for the companies with more than 500 employees. There is a general understanding that the latter requirements refer to public companies, but they are also applied in nonpublic external companies. Such companies have both large labor forces and large employee shares, and there is extensive block voting at shareholder meetings by employees.

Such legal provisions clearly preserve the level of influence of employees from the pre-privatization era, as a result of which employees are in position to resist layoffs[20] and to claim salary raises and related benefits. While representative of funds may deter the self-dealing of managers and employee expropriation of residual income and profits, there is also a risk that funds, as large-scale traders with short-term financial interests, will themselves abuse internal information and control for self-dealing and other forms of overreaching.

Efforts to streamline the role of the supervisory boards in order to speed up secondary privatization need to include more balanced legal provisions for employee representation, enhancement of the professional capacities of their members and mechanisms for ensuring a focus on the long-term development of the companies by linking remuneration to the contribution of the boards to the performance in the long run. The association of supervisory board presidents proposes the introduction of licensing requirements that would impose guild norms on members' behavior (while the legal personal liability of individual members obviously fails to serve its purpose)[21].

1.3.6. Financing of Companies and Secondary Privatization

Secondary privatization is taking place in an environment of scarce external financial resources and therefore represents an opportunity cost for strategic restructuring. This is because the internal resources of companies are not ploughed back into their development but are used to make financial investments, as well as to attempt (or defend against) takeovers and to buy out "troublesome" owners. The large scale of purchasing of own shares is evidence of the importance of such actions in enterprise activity. After the barter deals used by funds on internal markets, it has been the most important technique of secondary privatization, paradoxically consolidating control of incumbents. Moreover, secondary privatization incurs high transaction costs due to poor information disclosure (due to peculiar accounting standards) and taxes and brokerage commissions (due to over-regulation of capital markets). At the same time ineffective ownership concentration of privatization funds and trading with pension coupons detract investments in companies[22].

[19] The emerging network of domestic companies linked through ownership and supervisory board membership in Slovenia was studied by Pahor, Ferligoj and Prašnikar (2000).

[20] The largest layoffs actually occurred in the course of privatization when employees massively availed of state-sponsored schemes for early retirement. This, however, did not preclude their participation in privatization of companies as former employees (who had the same rights to acquire shares on a privileged basis as current employees). Such early retirement schemes were later abolished, and thus later layoffs occur as a result of decisions made in relation to company restructuring.

[21] Such personal liabilities are difficult to enforce even in countries with sophisticated courts.

[22] There are various other examples of the opportunity cost of secondary privatization for strategic restructuring, e.g. public companies' being forced to simultaneous (expensive) quotation on foreign markets in order to maintain the prices on the LSE rather than for the purpose of raising fresh financing.

Financial institutions did not play any significant role in mass privatization, either by leveraging employees' buyouts (as they were directly leveraged by the state) or by acquiring equity stakes themselves. Banks were given a choice to convert non-performing debts of companies to equity. This technique of privatization, used mostly in the state-led rehabilitation of two dominant banks and in the financial restructuring of the SDC companies, was widely opposed by banks. On the other hand, both banks and insurance companies were encouraged to establish privatization fund management companies. Thus, while themselves being partly owned by non-financial companies[23], banks and insurance companies in turn became the indirect owners of such companies in mass privatization.

Such cross-ownership structures within and between the financial and corporate sectors clearly gives rise to an array of conflicts of interests, including, for example, the threat of soft financing of companies and restriction of competition within the financial sector (and even its re-integration)[24]. Banks are reluctant to finance companies that are poorly governed and lack financial discipline or to support secondary privatization. Their engagement in the financing of companies and secondary privatization depends on improved governance of companies and their owners. To that end, there is a realistic possibility for incumbent owners to leverage each other in secondary privatization by converting their equity securities from mass privatization into debt securities.

1.3.7. Employee Ownership

The extent of employee ownership which emerged from mass privatization is widely viewed in Slovenia as close to optimal. Such views are partly linked to the tradition of labor self-management under socialism, but the three mass privatization models actually varied the extent of employee ownership to suit the economic characteristics of companies. Problems stem from continuing dispersion, postponed transferability of employees' shares, their unsettled liabilities from privatization and extensive representation on supervisory boards.

Employees took part in mass privatization as individuals, with no limitations on their liability to pay off credits received from the state for financing share acquisitions. Nevertheless, collectively they have an interest in making regular payments, as failure to do so will reactivate the role of the state in corporate governance. They have conflicting objectives: maximization of salary benefits in the short run and employment security in the long run. They are legally granted a majority of seats on the supervisory boards and often combine their votes with the votes of small shareholders from public offerings in assemblies[25]. They are thus in a position to appropriate value added for salary benefits at the expense of depreciation and profits, as well as to vote down sales to strategic investors or the use of external financing if it is supported by funds and/or managers.

Employee ownership is expected to decline in relative and absolute terms in consequence of sales of their shares from privatization and expansion of capital financed from external sources or without their participation. Alternatively, employee ownership could be expanded in secondary privatization if the funds agreed to leverage purchases of their shares by the employees. Employee ownership could be made a permanent feature in optimal sizes through collective ownership schemes with clearly defined rules for entry and exit, minimum size of individual ownership and profit sharing. Nevertheless, employees who wish to do so must be given the opportunity to exit at fair prices (Simoneti, 1997).

There is a legal basis for the establishment of collective employee ownership schemes, but few companies have availed of it in practice. The state has not offered any inducements to promote such schemes (e.g., tax benefits for paying salaries in shares). Moreover, as long as the control structures are not consolidated managers and funds are unlikely to support them. Collective employee ownership schemes, however, offer a systemic solution for speeding up the secondary privatization of nonpublic companies. Performance-based compensation payable in the company's shares purchased on secondary markets (or possibly leveraged new share issues, with credits offered to employees by banks and guaranteed by the schemes) would help employees identify with the objectives of companies. This would, in

[23] The law on the privatization of insurance companies has been challenged in the constitutional court, as it does not grant priority property claims to investors (including privatized companies). The argument in this respect is that the insurance companies did not take advantage of the opportunity to convert into mutual insurance schemes, which would have formally guaranteed their participants the right to claim shares at the time of their privatization, in compensation for earlier retained profits.

[24] In the course of mass privatization two dominant banks were nationalized after they had been successfully rehabilitated through the issuing of state bonds. Prior to this nationalization there had been a major breakup of monopolized banks, with the newly spun-off banks partly owned by the "mother" banks and also, in large part, by (privatized) companies. Both banks are acquiring stakes of their daughters on the market in an attempt to reconstitute bank groups. This will have a direct effect on transformation of privatization funds via mergers, but may also require the selling of management companies in order to make the re-integration of financial institutions possible at all.

[25] Small shareholders from public offerings were often related in various ways to employees and/or companies, as kin, business partners or residents in the regions where the companies were located. They were encouraged to invest certificates in semi-closed subscriptions organized by companies.

turn, increase the likelihood of both accessing external debt financing and exit of funds, by heightening the interest of strategic investors in such companies. Alternatively, funds could be appropriately encouraged to exit from governing bodies of companies by converting equity to debt securities or using other schemes of seller financing of companies or employees' schemes (Simoneti, 1997).

1.3.8. Transformation of Privatization Funds[26]

Privatization funds were intended as a corporate governance correction to extensive employee ownership and expected to help companies to find strategic investors. They were not intended to be active owners, as their borrowing power is limited[27], and they cannot raise financing on the capital market where they are quoted. As closed-ended investment funds with practically no restrictions on the concentration of ownership in companies but with severe limits on concentration of their own ownership, they are transitional features. By law, they are obliged to transform into regular investment funds or ordinary joint stock companies (i.e., financial holdings) by mid-2002.

The role of privatization funds in corporate governance and secondary privatization is controversial for various reasons. The most important is the gap from mass privatization[28]. This gap, which at the completion of privatization process in 1998 represented close to 60 percent of their portfolios and at present still accounts for some 30 percent of them[29], has constrained the needed restructuring of portfolios. Even worse, it gives the state a convenient excuse to postpone both the privatization of nationalized property[30] and the adoption of rules on transformation of privatization funds. In the meantime, transformation has occurred in a non-transparent manner, with fund managers becoming directly and indirectly the controlling shareholders of privatization funds. The momentum for effectively regulating the transformation of the funds has been wasted, and the drafting of regulation has been made more cumbersome by the developments that have taken place during these delays.

The quotation of privatization funds was postponed for a couple years because of this gap. The initial price on the LSE was set between 20 and 30 percent of the NAV, which was 2–3 times higher than the prices on the non-organized market beforehand (Stock Exchange Focus, 2000). The market valuation has effectively turned all privatization funds into takeover targets, although formally the stakes of individual shareholders cannot exceed 5 percent, and privatization funds cannot hold shares one in another. As a result, their managers have incentives to engage in non-transparent acquisitions of fund shares through legally unrelated persons (but allegedly related to them informally).

On the other hand, privatization funds have relatively high obligations to their managers: management fees are high and calculated on the basis of the NAV, reflecting the book values of non-tradable securities dominating the portfolios of privatization funds[31]. Managers have no incentives to engage in corporate restructuring at their own cost (reduced profits) as benefits would accrue to the funds' shareholders in the short run. Fees are partly payable in fund shares, and fund managers' stakes in the funds have become significant as a result of this factor alone.

The funds' portfolios have been adjusted through barter deals on the internal market of privatization and para-state funds, purchases and sales of shares on the organized and non-organized public markets and internal markets of companies, as well as by mergers and splits of funds managed by the same companies. Via such mergers, the number of privatization funds has decreased from the original 78 to 46. Restructuring of portfolios with respect to combinations of tradable and non-tradable securities and unused certificates has taken various directions. In some cases certificates represent up to 80 percent of the portfolio, in other cases tradable securities are dominant. Such reorganizations have been affected through voting at shareholders' meetings. Most differentials in prices (i.e., variations in the rate of discount of the NAV) can be explained by the structures and sizes of portfolios. Traded with large discounts, the shares of "empty" funds (i.e. those with large portions of unused certificates) are currently (paradoxically) one of the most liquid securities on the stock exchange.

[26] The issue of the governance of privatization funds and the necessity of their transformation in Poland, Slovenia and Czech Republic was extensively studied in Simoneti, Estrin, Böhm (eds.) (1999).

[27] Their borrowing can amount to not more than 10 percent of the NAV of their portfolio and is subject to approval of supervisory boards and SMA; it has been largely used for payment of management fees and for making financial investments on the stock exchange.

[28] The privatization gap refers to the unused certificates in portfolios of privatization funds at the formal completion of mass privatization process in 1998 (although its existence was predicted much earlier). It had various origins, among them the systemic flaw inherent in the model of mass privatization based on the book values of social capital on the supply side and certificates denominated in tolars on the demand side. Incorrect calculations of the total value of social capital available made by the state in designing the model of mass privatization also contributed to the gap.

[29] In the meantime further transfers of SDC property, para-state funds and conversion of unused certificates into pension coupons have reduced the privatization gap by half.

[30] All public utilities and dominant banks were nationalized in the course of mass privatization. Moreover, dominant insurance companies are partially non-privatized, but the extent of residual state capital in them is a subject of controversial legal disputes.

[31] Book values are regularly adjusted for inflation, while the market prices of quoted shares vary due to changed liquidity on capital market rather than companies' performances.

Possible routes of transformation depend on the quality of assets that will be allocated for filling up the gap. In view of the current ownership structure of funds and the structure of their portfolios, as well as the scenarios being considered for filling up the gap, the most realistic route is a financial holding company or venture capital fund. A few funds have already followed it, and others are considering it.

The SMA and managers of privatization funds prefer the route of regular closed-ended investment funds, a form that in practice protects small shareholders poorly. Although the form of mutual funds is more appropriate for that purpose, legislators have until recently not considered such transformation as possible (desired). It has actually been discouraged in various ways in practice, for example by accounting standards requiring that capital losses (but not capital gains) from changes in market prices of quoted securities be entered on the accounts, while the NAVs can be kept high by keeping investments in non-quoted securities. In both cases substantial sales of shares of nonpublic companies and dispersion of ownership of funds will need to occur. Adjustments of portfolios will be difficult if the current restriction on the funds' investments abroad persist until they are transformed. An indirect way of resolving the problem of the required adjustment of ownership may be to allow the funds to invest in one another.

Disallowing or hindering transformation into mutual funds has actually invited fraudulence on the part of privatization fund managers, in the form of disguised sales of tradable securities to formally unrelated persons in order to start up cash mutual funds. Due to developments in practice so far, direct transformation of privatization funds into mutual funds has become practically impossible. Even the opportunity to introduce regulation like that in the Czech Republic may have been wasted.

1.3.9. Residual State Property[32]

An important source of barriers to the evolution of optimal ownership structures is the combination of significant direct, and widespread indirect, residual state property in privatized companies. The state is the single largest direct and indirect residual shareholder of privatized companies. Although its shares were intended to be temporary, the state has not demonstrated much will to exit, but instead takes an active stance in governing bodies[33]. It thus is in position to affect secondary privatization directly through share trading, sales and purchases on secondary markets, as well as through voting in the governing bodies. Its role in secondary privatization goes even further: it is in a position to actually re-nationalize privatized property or use it in its economic policy[34]. Its direct role in secondary privatization and as an agent of privatization (clearly favoring para-state funds) is certainly in conflict with its role of regulator, legislator and policy maker, as well as with its authority to approve takeovers and purchases made by foreign strategic investors. Substantial anecdotal evidence suggests that state representatives tend to oppose sales of controlling stakes to foreign strategic investors and hinder mergers and acquisitions.

The Slovenian Development Company (SDC) is in principle a silent residual owner, but its voting powers are activated whenever employees fail to pay credits, as well as in sales and other decisions that alter control structures or change the legal status of companies[35]. It finds it difficult to sell its residual stakes in portfolio companies to strategic investors or to negotiate debt settlements with banks, due to large employee stakes and poor performance. The privatization funds, in turn, resist accepting them at book values, the scenario for filling up the gap most strongly promoted by the state[36].

The para-state funds were intended as temporary owners of companies, but the deadlines for their winding up are vaguely defined, and the values and dynamics of their long- and short-term financial obligations are not known. Expecting to maintain the value of their portfolios in the long run, they are reluctant to divest their portfolios. They were not meant as active portfolio traders, which makes them dependent on the profits of companies to meet their short-term financial obligations. Neither were they meant to play an active role in corporate governance and to be important agents of secondary privatization, i.e. to concentrate ownership with the aim of selling it to strategic investors. In principle such sales would have to be pursued with public tenders, which is not practical and would actually be counterproductive in the case of quoted securities. There are no

[32] The problems of residual state property in Poland, Hungary, Slovenia and Czech Republic were extensively covered in Andreja Böhm (1999).

[33] Two para-state funds are each represented on over 100 supervisory boards and vote at a larger number of shareholder meetings. Moreover, representatives of branch ministries often sit on the same boards and vote in the same shareholder meetings. Changes in the government lead to replacements of the state representatives on supervisory boards and in the management of the state funds and the SDC that via them extend to such changes in companies. Moreover, anticipated changes in the government prompt sales of the para-state funds' shares in certain privatized companies to preclude control of the new government over them.

[34] For example, aid to companies are sometimes conditioned on sales of their shares in other companies.

[35] This provision essentially threatens the external companies.

[36] Currently there are debates on whether the gap should be filled up by privatization of the SDC or by privatization of its portfolio companies, which would obviously affect the price of each privatization route. Moreover, it would have different effects on the transformation of privatization funds and on secondary privatization, directly and indirectly.

limits on the size of their stakes in companies, and their investment policies change whenever the government changes. Although they are essentially financial investors, they make appointments to the supervisory boards of companies, whereby they can exercise influence on policies regarding, for example, dividend payments and control changes.

With considerable assistance from the state, both funds have substantially adjusted their portfolios and decreased the numbers of portfolio companies to a fraction of their original number. The state sells its residual stakes in public companies to them and by various measures helps them to exit from nonpublic companies[37]. As the funds' financial obligations represent implicit state debt, the state has a legitimate ground to keep control over them and assist them to consolidate their portfolios with shares in public companies[38]. Moreover, both funds are likely beneficiaries in the privatization of financial institutions and public utilities. Transfer of their shares in nonpublic companies to privatization funds contribute to secondary privatization, albeit with no immediate effects.

The restitution fund was originally intended to financially compensate former owners with bonds redeemable in 15 years. Its life span is thus formally determined by the maturity of the bonds. Their issuance proceeds slowly, in pace with the (slow) settlement of restitution claims in the regular courts. They are traded on the stock exchange and must be serviced, which imposes some discipline on the managers of that fund. The total financial obligations of the fund are not known, and the state keeps making new commitments to victims of war and the previous regime. This gives rise to the threat of another gap emerging, which prompts considerations of new transfers of shares to the restitution fund in the privatization of financial institutions.

The pension fund was originally created to sell its portfolio in order to cover the growing deficit on the pension account arising from the transition to a funded pension system. Pension reform has been postponed for several years, and the extent and dynamics of the deficit have not been established. In the meantime, the fund has been used to cover the deficit in the regular state budget with arbitrarily defined advances to the pension account to finance its regular obligations[39]. The pension fund has also established a separate fund that issued pension coupons to the employees of the state institutions claiming compensation for unpaid salaries and to the privatization fund shareholders who decided to convert their unused certificates into such coupons. These coupons can be used to open pension policies with the state pension fund in two years. In the interim coupons are traded on the stock exchange[40]. The new task of managing this second pension fund with private participants essentially makes it a permanent institution, as state-guaranteed returns on pension policies make it impossible for participants to shift to private pension funds unless those guarantees are rescinded.

The resultant situation implies conflicts of interest that may lead to eventual cross-dealings between the two funds and moral hazard on the part of its managers (or the state) at the cost of private participants. This must be prevented by establishing Chinese walls between the two funds. Moreover, the pension fund from mass privatization should issue debt securities (possibly with different maturities) to the state, in order to clearly define the term structure of its obligations. Such an arrangement would also provide for the conversion of the para-state funds' portfolio equity to debt holdings, allowing for their immediate exit from the governing bodies of companies. This would improve financial discipline in both para-state funds and companies. The privatization of public utilities and financial institutions via transfers of blocks of portfolio shares (or bonds) to the state funds would deepen the stock market only if public offerings are used and portfolio shares (bonds) of the state funds are quoted on the stock exchange. To exit from companies, both funds, nevertheless, should be encouraged to start investing in state securities, which is also in line with their basic mission to service the state budget and to preempt its deficit in future.

1.3.10. Strategic Investors

There appears to be a general scarcity of strategic investors, who are the desired owners of public and nonpublic companies. Mass privatization was effectively closed to cash purchases by strategic investors. There were scattered cases of concentrated acquisition of shares (i.e., acquisition of stakes of over 10 percent) with certificates and at discounted prices for credits. In the first phase of secondary privatization, characterized by lumpy demand and fragmented supply, such strategic investors (apart from those that participated in mass privatization) interested in large blocks of shares were excluded too. As long as incumbent

[37] For example, the shares owned by both para-state funds in nonpublic companies were partially transferred to privatization funds as a way of filing up the gap.

[38] For example, the residual state stakes in two oil companies were sold to the state funds at an 11 percent premium price, albeit not via public tender, which is obligatory in sales of state property.

[39] Recently, when facing problems with budget liquidity, the government resorted to the pension fund for advance payment of its obligations.

[40] These coupons represent highly speculative and liquid security on the stock exchange.

owners resist selling to strategic investors, the latter are discouraged from purchases and investments in view of continued free rider problems, unreliable information on companies' performances and values, and the requirement to make mandatory bids.

The liquidation of companies has been the most frequent vehicle for entry of strategic investors. But government protection of non-performing companies considered too big to fail (and with a concern for maintaining employment in backward regions) has postponed the entry of strategic investors to nonpublic external companies even by this method.

Privatization funds were not intended as strategic investors, but to mediate sales to such investors. Their transformation into holdings makes them reluctant to perform that intended mission. The transformation of privatization funds, however, is still transitory as far as the ownership of companies is concerned. Transformation to mutual funds, in combination with the ESOPs and conversion of the para-state funds' equity to debt, would speed the entry of strategic investors with long-term interests in the companies.

Foreign strategic investors are generally recognized as an important source of corporate strategic restructuring, but at the same time there is hostility against them, motivated by unjustified fears of their prime interest in prosperous companies and not in those needing restructuring[41]. Foreigners were excluded from mass privatization in any form. While there are no legal restrictions on foreign strategic investments and on repatriation of profits, any sales of privatized companies to foreigners that involve over 10 percent of companies' capital must be approved by the state. Moreover, there are administrative barriers to the entry of such investors. The majority of the management team must be Slovenian citizens, and foreigners soon become frustrated by lengthy procedures for obtaining various permits from the local bureaucracy.

1.3.11. Political Economy of Privatization

Mass privatization was intended as a just and egalitarian distribution to employees and the population at large. Various restrictions on ownership concentration and control consolidation have been introduced to prevent non-egalitarian redistribution in secondary privatization. Yet, despite (and because of) these restrictions the first phase of secondary privatization was largely non-egalitarian. What is worse, the increasingly tangled web of links among politics, companies and their owners created or strengthened in the secondary privatization process threaten regulatory capture and politicization in the next phase of ownership transformation. Early entry of strategic investors and creditors with long-term interests in companies and the transparent taking private of companies and privatization funds may not be in the immediate interest of various parties, including the state, employees, managers of companies and privatization funds, as well as the operators and regulators of the securities market. Thus, secondary privatization may actually proceed slowly due to political economy considerations.

Secondary privatization has been definitely state-led, and there may have been a political, as well as an economic, agenda behind it. In drafting and pursuing the latter the state is self-captured by the former, which frequently changed in the course of the year 2000. In the absence of an effective market for corporate control political parties have been given latitude to create their fiefdoms in the market for political control. Economic policy based on administrative restrictions and selective protectionism restrains market competition and opens up the economy to the intervention of politics. Such state policy (and state representation on the supervisory boards of companies and financial institutions) in turn makes the state vulnerable and open to pressures of various kinds. Companies and their owners lobby for its aid and protectionism. Influential rent-bearers and rent-seekers of various types (some of them allegedly linked with political parties) pressure for regulatory and legal solutions that help them preserve rents or protect investments from secondary privatization. Political parties expect pecuniary and political rents in return for such favors, and these rents are obtained at the direct or indirect expense of companies.

The main direct beneficiaries of the first phase of secondary privatization are clearly companies' managers and sophisticated financial investors, notably stockbrokers and managers of privatization funds. Its indirect beneficiaries are stockbrokers, operators and supervisors of securities markets (including the SMA, CDC and LSE), charging various fees to the shareholders of companies and privatization funds. They also have vested financial interests in preempting early taking private of companies and privatization funds, and are in position to influence the regulatory process.

Influential professional circles around the SMA, BOS and the Association of Accountants clearly lack sensitivity to, and understanding of, the problems in the corporate governance and finance regime. Favoring specific segments of economy or persisting in flawed assumptions in their regulatory endeavors, they are not able to develop a holistic

[41] A survey of managers of privatized companies confirmed that they do not perceive foreigners as likely raiders. Foreign strategic investors are interested in technology and skill-intensive branches but prefer to invest in de novo private firms whereas in other branches they opt for establishing branches in Slovenia rather than entering the product market via investments in privatized companies or their takeovers (Bešter, 1999).

view on the type of the regime that would suit the Slovenian economy after mass privatization and would promote competition throughout it.

The legislative process, as well as privatization and other economic and social reforms deemed necessary to facilitate market-led secondary privatization, have encountered severe political constraints. The most recent governments were difficult coalitions of political parties with diverse views on the transitional issues and management of the economy. Parliament was blocked by the bipolar structure of the political party spectrum. Accession to the EU has given the legislative process a push forward, but unsettled legacies from mass privatization and structural imbalances constraining competition will make it difficult to enforce the laws that fully comply with the EU directives. The anticipated opening up of the economy with the accession to the EU requires its re-integration in post-privatization that would require addressing a number of transitional issues, notably the conflict of interests between internal and external owners, ownership by company managers, ownership of privatization fund management companies, and exit of para-state funds from companies.

1.4. Conclusions

In post-independence, Slovenian economic policy has concentrated more on achieving macroeconomic stability and keeping internal and external balances than on setting up the conditions for competition on product and financial markets by pursuing institutional and microeconomic reforms. The financial sector has been favored against the corporate sector and the banks have been favored against the emerging capital market. The social sector reforms have been long delayed. Foreign capital inflows (and capital outflows), however, have been formally and informally discouraged.

Factors that prevent fast, transparent and effective secondary privatization stem from the legal and regulatory framework of capital markets and companies, i.e. the corporate governance and finance regime[42] that was established in mass privatization and is perpetuated in post-privatization due to the slow legislative and regulatory process. The legal and regulatory framework adopted to guide secondary privatization postpones transferability of large volumes of shares and applies standard rules for ownership concentration and consolidation of control to all privatized companies with tradable shares, although only a small number of them are quoted on the stock exchange. Introduced on the basis of flawed assumptions and assumed to protect small shareholders, such restrictions and rules hinder the orderly taking private of companies and privatization funds. They are flagrantly abused in practice, while voice is evidently captured to take private companies and privatization funds. Rules for voting on legal changes and reorganizations which under given conditions may provide better protection to small investors, however, have not been established. As many companies (as well as privatization funds) ought to (will) be taken private, a systemic solution to that effect is required.

The regulatory and legislative process lacks sensitivity regarding the specific ownership and governance deficiencies concerning the three ownership groups of companies and awareness of the need to regulate and facilitate different routes of secondary privatization. To that effect, different forms of consolidation of diffuse employee ownership and different routes of transformation of privatization funds ought to be allowed, regulated and facilitated. Moreover, secondary privatization depends directly on the manner of privatization of residual state property (including the exit of para-state funds as owners or financial investors from companies), and indirectly on the manner of privatization of public utilities and financial institutions. The empirical evidence shows that the first phase of secondary privatization has been characterized by limited (foreign) competition, lack of transparency and low speed, and suggests new anomalies stemming from it. Delayed tackling of transitional issues in Slovenia has wasted the momentum for fast and orderly secondary privatization and made search for better ownership solutions even more cumbersome.

[42] The corporate governance and finance regime that emerged from mass privatization combines the Anglo-Saxon type of securities market regulation with the German two-tier governance and codetermination system. But the essential ingredients of the two systems are lacking: the reliable information disclosure of the Anglo-Saxon system and the financial discipline imposed on managers and owners by the presence of banks (and strategic investors) on supervisory boards in the German system. This raises the question of the internal coherence of the regime, i.e. the effectiveness of exit and voice in corporate governance and in secondary privatization.

Part II.
Secondary Privatization in Slovenia: Evolution in Ownership Structure and Concentration after Mass Privatization

Marko Simoneti, Andreja Böhm, Marko Rems and Matija Rojec[43]

2.1. Introduction

The ownership structures and statuses of companies, and consequently their distribution into the public, internal and external categories, have to undergo profound changes after mass privatization. We argue that to improve performance of privatized companies, it is necessary (i) to enable transitional owners to exit in order to accomplish higher concentration of ownership, (ii) to expand the share of strategic owners, and (iii) to reduce conflicts of interests between funds and internal owners.

2.1.1. Exit of Transitional Owners and Concentration of Ownership

Any mass privatization creates individual or institutional shareholders that do not wish to remain shareholders in the long run because of their patrimonial status or because they cannot afford it. In many Slovenian companies the group of initial shareholders that wish to sell at the first convenient opportunity includes former employees, privatization funds and para-state funds. Moreover, these unstable and dispersed ownership structures do not give sufficient power and incentives to smaller shareholders to actively monitor managers or to commence all-encompassing restructuring. Significant changes in performance cannot be expected even in internal companies that are already under the control of internal owners until ownership becomes more concentrated in the hands of those individuals that are decisive for the success of the companies. The managers generally expand their stakes in such companies by acquisition of the stakes of former employees and various funds. From the point of view of economic efficiency it is desirable for the process of concentration to occur faster. From the point of view of social fairness it is essential that this occur transparently and on markets that are accessible by as broad a circle of domestic and foreign buyers as possible.

2.1.2. Entry of Strategic Owners

Concentration of ownership after mass privatization is also important as a means for entry of strategic investors to the Slovenian privatized companies. Dispersed ownership structures make the entry of strategic investors, who generally wish to acquire controlling stakes, quite difficult. Domestic and foreign strategic owners were practically excluded from primary privatization, while many companies require new strategic alliances in order to survive or to prosper. Takeovers of companies that are quoted on the stock exchange are regulated by a special act that enables the purchase of controlling stakes from a number of small owners. The procedure is very complex and relatively costly for new strategic partners, but it is at least transparent and guarantees equal protection to all sellers of shares from mass privatization. The situation is quite different in nonpublic, internal and external, companies where the views of internal owners and funds regarding the need, ways and conditions for the entry of new strategic owners are frequently opposed. Hence, in such cases transactions are less transparent, and benefits from them less equitably distributed while blockages in decision making are frequent due to conflicts of interests between internal owners and funds.

2.1.3. Conflicts of Interests between Internal Owners and Funds

There is a strong conflict of interests between internal and external owners in all three groups of companies that have emerged from mass privatization. In addition to profits, the internal owners have an interest in keeping jobs and long-term development of companies. On the other hand, funds primarily pursue financial interests and are essentially interested in profits and opportunities to exit profitably from their investments by sale of shares. Important distinctions also arise between privately managed privatization funds and para-state funds in decision making on strategic matters of companies. The relations within the group of internal owners

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are not always idyllic either, as the interests of managers, current and former employees are objectively different. Moreover, new coalitions of owners are being formed in individual companies in post-privatization, while the ones created at the time of privatization are dismantled. Such instability and conflicts in relations among the main groups of owners do not contribute to the successful operation of companies.

Conflicts between the advocates of internal and external ownership, which delayed the adoption of the privatization law in Slovenia for three years, were reflected in each single company by the privatization model adopted under the OTA. The conflicts between the interests of internal and external owners are being alleviated with different intensity and in different ways due to different institutional rules applying to different forms (e.g., public vs. nonpublic companies) and due to differences in the initial ownership structures with respect to the controlling groups of owners (e.g., internal vs. external companies).

The fewest conflicts between internal and external owners exist in the group of public companies, which do not need fast entry of strategic investors, as they perform relatively better than others. Here the ability to protect their ownership rights is in principle equal for all shareholders. Public companies are traded on the stock exchange. The respective shares represent liquid financial investments for owners, and there are no strong reasons for the existence of conflicting interests of internal and external owners in the long run.

The situation is different in nonpublic companies, where both internal and external owners attempt to gain control over companies. Battles occur concerning the conditions for exit of one of the two groups from the company. Those fights, however, should not significantly influence the operations of companies, if they only concern the question of redistribution of benefits between internal and external owners. The conflicts are of a different nature in nonpublic companies, in which control must be acquired by new strategic investors to ensure their long-term development. Here fights between internal and external owners occur on the issue of who will sell to strategic investors, and to what extent the interests of internal owners and funds will be observed in such sales. Blockages occur in decision making, since none of the parties succeeds in prevailing completely over the other. The changes required for improved operation of the companies are postponed. Slow resolution of conflicts of interests between internal owners and funds with respect to the entry of strategic investors can have an especially negative effect, as this is not only a question of redistribution of existing benefits between internal and external owners.

This section analyzes how intensive the changes in ownership structure and concentration in companies privatized as public, internal and external are in the period from completed privatization until the end of 1999. First, the initial ownership structure and concentration is presented. Second, changes in concentration are analyzed. Third, changes in ownership structure are presented and a transformation matrix is constructed, showing how privatized companies shifted to other groups as a result of changes in ownership structure in the post-privatization phase. Finally, we present an overall assessment of post-privatization ownership consolidation in Slovenia.

2.2. The Outcomes of Primary (Mass) Privatization

2.2.1. Ownership Structure and Concentration at the Time of Completion of Privatization

Table 2.1: Initial ownership concentration in companies privatized as public (P), internal (I) and external (E)

		C1	C5	C10	H	Number of shareholders
Public	Average	16.0%	43.0%	50.0%	5.7%	6,898
	St deviation	6.9%	11.5%	11.4%	3.4%	17,122
	Minimum	3.8%	14.4%	27.6%	1.3%	6
	Maximum	38.0%	99.6%	100.0%	25.0%	95,464
Internal	Average	17.2%	42.6%	47.8%	5.8%	440
	St deviation	4.2%	5.4%	6.6%	1.6%	762
	Average	7.3%	27.6%	31.7%	2.0%	67
	Maximum	26.2%	57.8%	72.9%	9.9%	7,410
External	Average	24.2%	61.4%	67.7%	11.3%	481
	St deviation	7.0%	10.1%	9.6%	4.9%	662
	Minimum	10.4%	40.3%	48.0%	4.7%	38
	Maximum	67.0%	98.6%	98.7%	46.9%	5,485
All companies	**Average**	**19.1%**	**49.0%**	**55.2%**	**7.6%**	**2,606**
	St deviation	**6.0%**	**9.0%**	**9.2%**	**3.3%**	**6,182**
	Minimum	**7.2%**	**27.5%**	**35.8%**	**2.7%**	**37**
	Maximum	**43.7%**	**85.3%**	**90.5%**	**27.3%**	**36,120**

Table 2.1 shows the levels of ownership concentration in public, internal and external companies at the completion of privatization. The average number of shareholders amounted to 6,898 in public companies, whereas it was below 500 in both internal and external companies. Differences in the number of shareholders result from different numbers of individuals taking part in privatization. These persons are employees in internal and external companies, and employees and small shareholders in public companies.

The larger number of shareholders in public companies does not automatically mean lower concentration of ownership, as the measures of concentration are strongly affected by the stakes of the funds in companies. Table 2.2 shows the concentration of ownership by the stake of the largest owner (C1), and cumulative stakes of the five largest owners (C5) and of the ten largest owners (C10), as well as the H index (maximum = 100 percent). All calculated measures of concentration show that the ownership concentration is significantly higher in external companies than in internal and public companies as a result of larger fund stakes.

Therefore, in comparison with all companies from mass privatization the main characteristics of public companies are a large number of shareholders and lower concentration; of internal companies a smaller number of shareholders and lower concentration, and of external companies a smaller number of shareholders and higher concentration (see Figure 2.1).

capabilities and incentives for effective corporate governance were questionable because of their institutional forms.

It should be pointed out that the upper measures of concentration calculated on the basis of the stakes of individual owners obscure the fact that smaller owners are forming coalitions to promote their own interests. The actual concentration was, therefore, even higher at the completion of privatization. This holds especially for those companies that are not actively traded on the stock exchange. After mass privatization in Slovenia active trading has involved only a fraction of companies in which the shareholders exercise their rights essentially via voting. It is decisive in that respect that homogenous and stable groups of owners that will control 50 percent of the shares of companies are formed in the long run. Two homogenous groups of internal and external owners with conflicting interests were formed in all companies soon after mass privatization. The problem of establishing effective corporate governance after mass privatization does not result so much from dispersion of ownership but from concentration of ownership by groups of owners with conflicting interests. The analysis of changes of ownership structures and ownership concentration by homogenous groups of owners allows us to monitor that fight for control over Slovenian companies. It should be taken into account that some coalitions are only temporary (e.g. former and current employees), and that new ownership coalitions (e.g. managers and privatization funds) are being formed in the course of secondary privatization.

Figure 2.1: The number of shareholders and ownership concentration at the time of completion of privatization

		Ownership concentration	
		Lower	Higher
Number of shareholders	Lower	Internal	External
	Higher	Public	

It can be concluded that mass privatization in Slovenia set up ab initio relatively concentrated ownership structures in companies. Thus, 5 shareholders on average controlled approx. 50 percent of capital in all companies (see C5 in all companies), which is in principle conducive to the establishment of effective corporate governance. On the other hand, there were no strategic investors among the large shareholders. In all companies the large shareholders were the two para-state funds and privatization funds, which pursued their own interests in corporate governance, while their

Data on the ownership stakes of individual groups of owners are not available from public records and therefore have been collected with a special questionnaire survey. Table 2.2 shows average ownership stakes of individual groups of owners at the completion of primary privatization for a sample of 183 companies.

Internal owners held majorities in internal companies. The degree of concentration expressed by the H index (calculated for groups of owners!)[44] is the highest in these companies; the fight for control over companies had been tem-

[44] The H index of concentration calculated by groups of owners lies on the interval (100%, 100%/n), n signifying the number of groups. Thus, the H-5 index lies on the interval (100%, 20%), and H-10 index on the interval (100%, 10%).

Table 2.2: Ownership structures at time of completed privatization

Group of owners	All companies	Public	Internal	External
State	**7.75%**	**6.78%**	**2.02%**	**11.92%**
Restitution and pension fund	21.60%	20.49%	21.28%	22.19%
PIF-I (privatization funds)	19.38%	17.65%	14.88%	22.99%
ALL Funds	**40.98%**	**38.14%**	**36.17%**	**45.18%**
Internal owners – managers of companies	3.86%	1.40%	4.98%	3.95%
Internal owners – current employees	29.23%	21.88%	38.08%	25.80%
Internal owners – former employees	11.05%	7.48%	14.60%	9.89%
ALL Internal	**44.14%**	**30.77%**	**57.66%**	**39.65%**
Financial investors – domestic	4.80%	22.37%	0.63%	1.61%
Financial investors – foreign	0.03%	0.08%	0.00%	0.02%
ALL Financial	**4.83%**	**22.45%**	**0.63%**	**1.64%**
Strategic investors – domestic	2.00%	1.86%	3.55%	1.01%
Strategic investors - foreign	0.30%	0.00%	0.00%	0.60%
ALL Strategic	**2.30%**	**1.86%**	**3.55%**	**1.61%**
TOTAL (all groups)	**100.00%**	**100.00%**	**100.00%**	**100.00%**
Sum of squares, H-5	37.17%	29.55%	46.49%	37.60%
Sum of squares, H –10	19.21%	18.18%	23.79%	19.46%

porarily resolved in favor of internal owners. By taking into account alliances of owners into homogenous groups, the concentration of ownership is essentially higher in each group as shown by data disaggregated by individual types of owners. As long as the coalition between managers and former and current employees does not fall apart, it can be expected that the stake of strategic investors will increase and the stake of funds will fall in the long run.

The level of concentration by individual groups of owners is the lowest in public companies, in which none of the groups acquired 50 percent of shares. Both funds and internal owners are confronted with the fact that neither of them will come to control 50 percent of votes in public companies, as the stake of small financial shareholders is over 20 percent. Strategic investors can enter public companies only via public bid for purchase of all shares under the same conditions. Conflicts among internal and external owners are less pronounced for that reason alone.

The fight for control is most pronounced in external companies, where none of the groups of owners holds 50 percent of shares: internal owners on average hold approx. 40 percent and funds 45 percent. Concentration of shares by internal owners and funds maintaining conflicting interests puts both groups in a comparably convenient initial position to take over control or to block strategic changes in companies.

Table 2.2 also shows the ownership structure at the completion of privatization obtained by breaking up the main 5 groups of owners into a larger number of smaller groups (i.e. 10). They were established by separating the ownership of para-state and privatization funds, breaking up internal owners into managers and former and current employees and distinguishing between foreign and domestic strategic investors. Data concerning all companies in Table 2.2 clearly show the distinguishable main characteristics of mass privatization in Slovenia:

(1) the stake of strategic investors at the completion of privatization is minor (stake of 2.3 percent in the column of all companies);
(2) foreign (financial and strategic) investors were virtually totally excluded from mass privatization (stake of 0.33 percent in the column of all companies);
(3) the state and para-state funds jointly held a stake of approx. 30 percent (7.7 percent is held directly by the state and 21.6 percent indirectly via para-state funds);
(4) financial investors that acquired shares in privatization via public offerings represent an important group in the small number of companies quoted on the stock exchange (public companies);
(5) the main groups of owners from privatization on average gained equal stakes, but internal owners prevail in internal companies and funds and the state prevail in external companies;
(6) funds do not represent a homogenous group, as there are differences between the para-state funds and privatization funds, which acquired approximately equal stakes in companies;
(7) internal owners consist of former employees (11.05 percent), current employees (29.23 percent) and managers of companies (3.86 percent). They act as a

homogenous group especially at the beginning of privatization. It can, however, be expected that former employees that have acquired considerable stakes will regard their shares as essentially financial investments. Managers and employees can also pursue quite opposite interests in strategic decisions of companies. It can be reasonably anticipated that the coalition of internal owners will not remain very stable in the long run. Importantly, the role of companies' managers and their decision-making powers are greater than their ownership stakes suggest.

2.3. Secondary Privatization: Changes in Ownership Concentration after Privatization

Through the end of 1999 the number of shareholders from mass privatization in companies had been on average fallen by almost 40 percent (at that time, the number of shareholders was 62.3% of the initial number of owners, as shown in Table 2.3). As one would expect, the number of shareholders fell fastest in public companies, as numerous

Table 2.3: Changes in ownership concentration since completed privatization through the end of 1999 in companies privatized as public (P), internal (I) and external (E)

		Changes in percentage points				No. of shareholders
		C1	C5	C10	H	(completed privatization = 100)
Public	Average	9.4	13.2	14.5	7.8	60.7
	St deviation	11.8	5.6	3.8	14.6	
	Minimum	1.2	4.5	2.5	-0.1	
	Maximum	59.9	-1.1	-1.3	70.7	
Internal	Average	14.9	18.4	19.4	12.0	70.5
	St deviation	14.9	14.8	12.7	16.4	
	Minimum	1.6	2.0	5.8	0.6	
	Maximum	73.8	42.2	27.1	90.1	
External	Average	10.3	5.8	5.7	9.0	76.5
	St deviation	12.4	7.0	5.9	13.7	
	Minimum	-1.1	-9.1	-6.6	-1.8	
	Maximum	33.0	1.4	1.3	53.1	
All	**Average**	**11.5**	**12.5**	**13.2**	**9.6**	**62.3**
	St deviation	**13.0**	**9.1**	**7.5**	**14.9**	
	Minimum	**0.6**	**-0.9**	**0.6**	**-0.4**	
	Maximum	**55.5**	**14.1**	**9.1**	**71.3**	

Table 2.4: Ownership concentration at the end of 1999 in companies privatized as public (P), internal (I) and external (E)

		C1	C5	C10	H	No. of shareholders
Public	Average	25.4%	56.3%	64.5%	13.5%	4,190
	St deviation	18.6%	17.0%	15.2%	18.0%	10,132
	Minimum	5.0%	18.9%	30.1%	1.2%	53
	Maximum	97.8%	98.4%	98.7%	95.7%	58,446
Internal	Average	32.2%	61.1%	67.2%	17.8%	310
	St deviation	19.0%	20.1%	19.3%	17.9%	626
	Minimum	9.0%	29.6%	37.6%	2.7%	1
	Maximum	100.0%	100.0%	100.0%	100.0%	5,864
External	Average	34.5%	67.1%	73.5%	20.2%	368
	St deviation	19.3%	17.0%	15.5%	18.6%	566
	Minimum	9.3%	31.3%	41.4%	2.8%	1
	Maximum	100.0%	100.0%	100.0%	100.0%	4,536
All companies	**Average**	**30.7%**	**61.5%**	**68.4%**	**17.2%**	**1,622**
	St deviation	**19.0%**	**18.1%**	**16.7%**	**18.2%**	**3,775**
	Minimum	**7.8%**	**26.6%**	**36.4%**	**2.2%**	**18**
	Maximum	**99.3%**	**99.5%**	**99.6%**	**98.6%**	**22,949**

citizens entered those companies at the time of privatization with the aim of fast sale. Moreover, the sale of shares on the stock exchange is simpler and more transparent than the sale of shares of internal and external companies, which are not quoted on the stock exchange.

Through the end of 1999 ownership concentration had strengthened in all groups of companies. Changes expressed in percentage points by individual measures of concentration are shown in Table 2.3. It is interesting to note that the increase in ownership concentration was the most intensive in internal companies. In those companies internal owners as a group had already acquired majority stakes in primary privatization, and in the ensuing period the stake of the largest owner (C1) increased by 14.9 percentage points, the cumulative stake of the 5 largest owners (C5) increased by 18.4 percentage points and the H-index by 12 percentage points.

Table 2.4 reveals that through the end of 1999 the ownership concentration in internal companies had come close to the ownership concentration in external companies. Ownership concentration in public companies had been lower at the time of completed privatization and proceeded with a relatively slower pace. It is an interesting finding that the fast decline in the number of shareholders in the companies privatized by public offerings was not directly related to fast ownership concentration in those companies.

Two explanations can be given regarding that finding. Concentration is either very difficult to accomplish in public companies or is not needed in such companies. Large shareholders find it difficult to increase their stakes due to restrictive takeover rules that apply to the companies on the stock exchange. It is also possible that because of the possibility of selling shares on the stock exchange, the funds as essentially financial investors have no interest in increasing their stakes. Moreover, there is less need for the entry of strategic owners into public companies. On the other hand, concentration rules are simpler in nonpublic companies, and the concentration of ownership and votes is the only realistic way of protecting the interests of the owners who by their nature are essentially financial investors in such companies.

Another interesting finding is reflected in Table 2.4. At the end of 1999, ownership concentration was relatively high in all companies from mass privatization. The five largest owners on average held 61.5 percent of votes in all companies. The respective stake was the lowest in all companies privatized as public, but, nevertheless, it amounted to as much as 56.3 percent of votes even here. From the point of view of ensuring equal rights to large and small shareholders, such high concentration rates may be controversial in the companies that intend to remain on the stock exchange in the long run. Moreover, in Slovenia large shareholders in public companies tend to be related to the state (directly or indirectly via para-state funds and via privatization funds managed by state-owned banks and insurance companies). Therefore, the issue of large minority shareholders in public companies requires additional attention.

Figure 2.2 shows the stakes of the largest owner (C1) in the range from the smallest ones to the largest ones in three groups of companies (public, internal and external). The point (x,y) on a given curve signifies that in x percent of companies the stake of the largest owner is equal to or smaller than y percent. With increased concentration the curve rises more rapidly towards the level at which the value of C1 is equal to 100 percent. It can be observed from the shifts of the curves in 1999 that concentration measured by C1 increased in all three categories of companies, but increased the most in internal companies. At the end of 1999, concentration measured in this way was significantly higher in companies privatized as internal and external than in those privatized as public. The figure can also be read by relating the selected y to the corresponding x. Thus, at the end of 1999 the largest owner had a majority stake (i.e., y is over 50 percent) in only 4 percent of public companies and in approx. 20 percent of internal and external companies. This is further proof that privatization in Slovenia through public offering of shares has not been, so far, a means of providing for the entry of strategic investors, normally interested in majority stakes.

Figure 2.3 presents the cumulative stakes of the five largest owners (C5) in the three groups of companies. The shifts of curve lines document increases in concentration that had occurred through the end of 1999. This was the highest in internal companies. The curve lines for C5 show that the stake of the five largest owners was also relatively large in public companies on the stock exchange. For the reasons explained above, this is negative as far as the protection of the rights of smaller shareholders is concerned. It should be emphasized that the measures of concentration presented here are calculated on the basis of stakes held by *individual* shareholders. Considering that internal shareholders actually behave as a homogenous group in most companies, the real concentration rates could be seen as even higher in those companies. Like large para-state funds and privatization funds, the organized internal owners also represent a continuous threat to the equal treatment of small external shareholders in public companies.

2.4. Secondary Privatization: Changes in Ownership Structure after Privatization

Table 2.5 presents data on the average changes in ownership structure in the sample of 183 public, internal and

Figure 2.2: The stake of the largest owner (C1) from the smallest to the largest at the time of completed privatization and the end of 1999

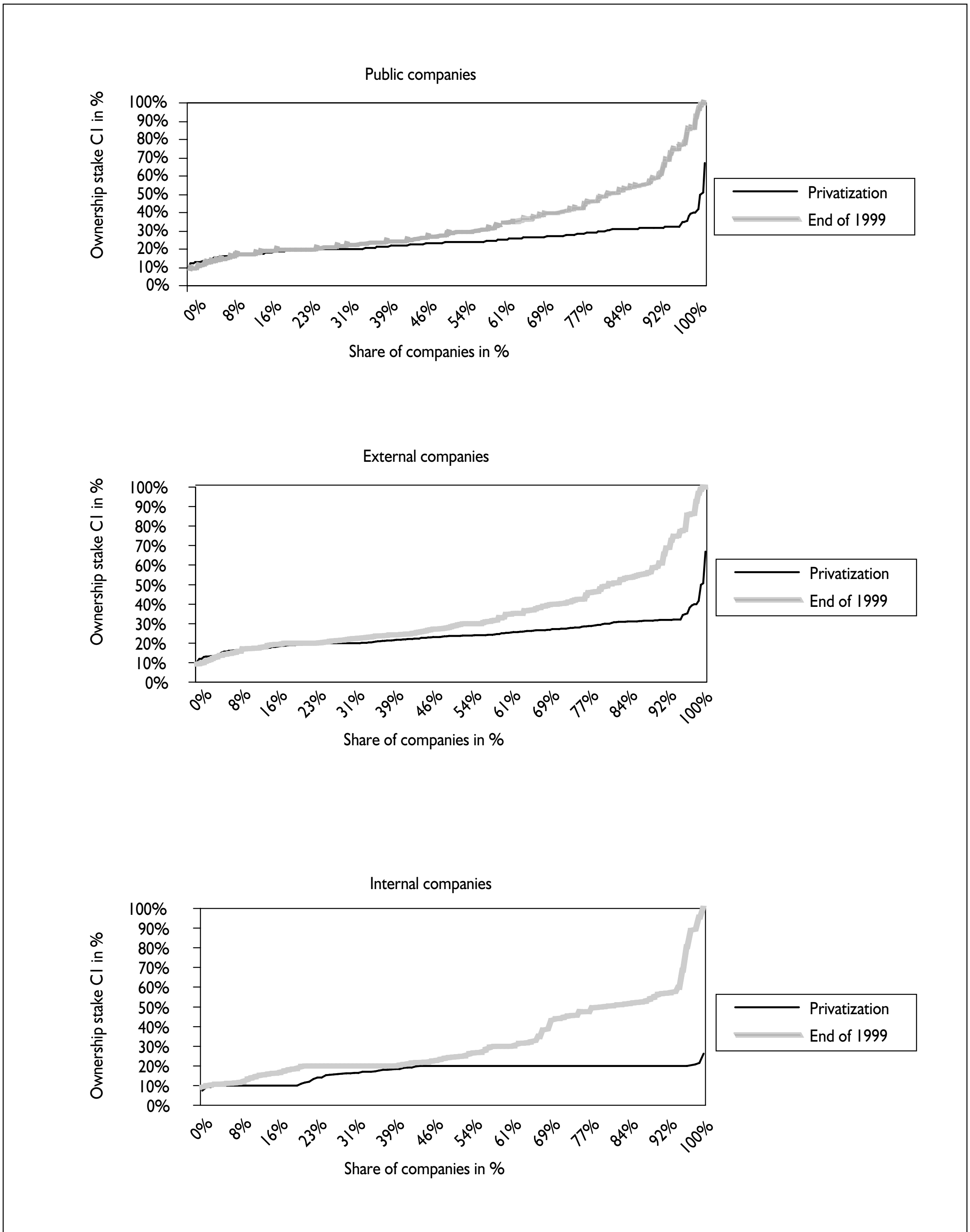
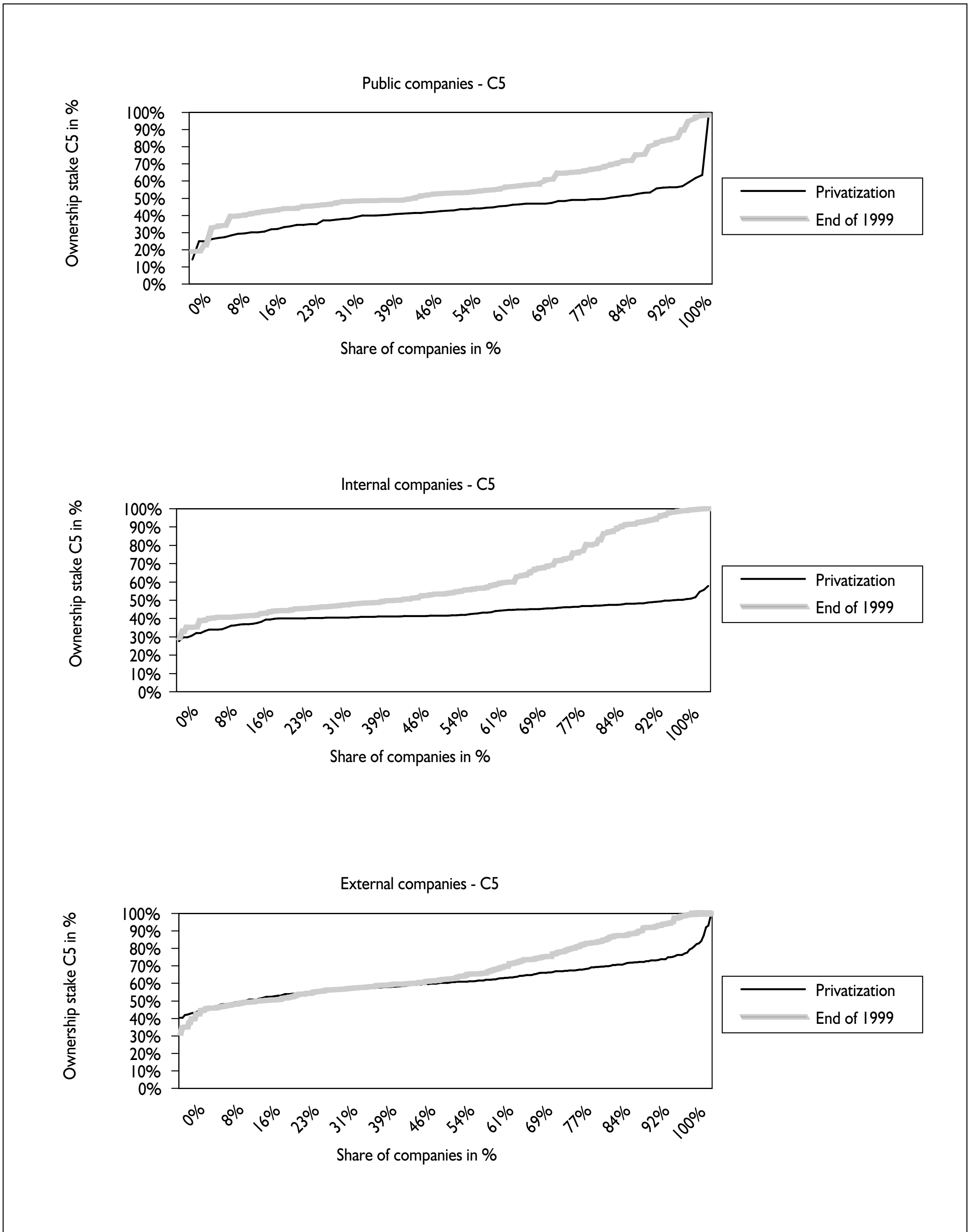


Figure 2.3: The stakes of five largest owners (C5) from the smallest to the largest at time of completed privatization and the end of 1999



external companies. The table will be initially interpreted by groups of owners (i.e., by rows), and then by groups of companies (i.e., by columns).

The table presents in bold print the changes in ownership structures by the 5 main ownership groups on average: the state and funds are decreasing their stakes, while internal, financial and strategic owners are increasing theirs[45]. The stakes of funds decreased the most (-11.5 percent points), especially in companies that are not quoted on the stock exchange (internal: -9.47 percent points; external: -14.3 percent points). The largest increases in stakes are recorded for strategic owners (+8.62 percent points). Internal owners are on average increasing their stakes (+3.3 percent points), albeit with large differences among groups of companies. The stake of internal owners is falling in public companies (-6.78 percent points), which can be explained by their acceptance of the fact that acquisition of majority stakes is unattainable due to the size of companies, as well as by the ease of selling shares on the stock exchange. The increase in the stake of internal owners is the most intensive in external companies (+10.22 percent points), but the fight for acquisition of majority stakes still goes on.

Internal owners are reducing their stake in internal companies, although on average keeping the majority. In contrast to expectations, the stake of financial investors in public companies quoted on stock exchange is not expanded. Financial investors enter internal and external companies (approx. + 4 percent points). This is probably related to their struggle to gain control over companies and to temporary buyouts of shares via brokers by the groups of shareholders attempting to acquire majority stakes.

Table 2.5 also shows changes in ownership structures disaggregated by 10 groups of owners, thereby giving an insight into the differences in behavior within broader groups of owners. The funds are evidently behaving as sellers of shares from privatization, notably para-state funds (-9.02 percent points), which are forced to divest parts of their portfolios to meet their current obligations. At the same time, privatization funds are adjusting their portfolios by reinvesting proceeds from share sales into the shares of other companies from privatization.

The role of managers is strengthened (+5.17 percent points) within the group of internal owners, while the stake of employees is reduced (-2.19 percent points). The managers' stakes are on the rise with the fastest pace in external companies (+7.16 percent points) and with a relatively slow pace in public companies (+1.45 percent points). The stakes of former employees are surprisingly stable. It may be that former employees have limited possibilities to sell shares in nonpublic companies or that in Slovenia the retired continue feeling associated to the companies in which they were once employed.

Practically all financial investors that expanded their stakes were domestic. The same holds true for strategic investors accumulating their stakes in privatized companies. Primary mass privatization precluded participation of strategic investors, as well as of foreigners. By the end of 1999 secondary privatization had opened up the way for the entry of the first strategic investors, who were almost

Table 2.5: Changes in ownership structures from completion of privatization to end of 1999 (%)

Group of owners	All companies	Public	Internal	External
State	**-4.69**	**-3.98**	**-1.47**	**-7.09**
Restitution and pension funds	-9.02	-6.49	-9.16	-9.78
PIF-I (privatization funds	-2.13	1.37	-0.31	-4.54
ALL Funds	**-11.15**	**-5.13**	**-9.47**	**-14.32**
Internal owners – managers of companies	5.17	1.45	4.09	7.16
Internal owners – current employees	-2.19	-6.54	-4.52	0.85
Internal owners – former employees	0.35	-1.69	-1.39	2.21
ALL Internal	**3.33**	**-6.78**	**-1.82**	**10.22**
Financial investors – domestic	3.73	1.71	3.92	4.29
Financial investors - foreign	0.15	0.06	0.30	0.09
ALL Financial	**3.88**	**1.77**	**4.22**	**4.38**
Strategic investors – domestic	7.90	13.68	8.01	5.85
Strategic investors – foreign	0.72	0.44	0.52	0.96
ALL Strategic	**8.62**	**14.12**	**8.53**	**6.81**
AAD – 5	6.33	6.36	5.10	8.56
AAD – 10	3.60	3.74	3.37	4.28

[45] Similar trends were observed in some earlier studies by Bešter (1999), Simoneti, Rems and Rojec (1999) and Gregorič, Prašnikar and Ribnikar (2000).

exclusively of domestic origin. More intensive entry of foreign financial and strategic investors to privatized companies can be expected only when direct and indirect restrictions on foreign investments are abolished in the course of accession to the EU.

To demonstrate the intensity of changes in ownership structure by groups of companies, average absolute differences (AAD) have been calculated as average differences in structural stakes at the time of completed privatization and at the end of 1999. For example, AAD-5 was calculated on the basis of structural stakes for 5 groups of owners[46]. Its value of 6.33 for all companies signifies that structural stakes of individual groups of owners changed on average by 6.33 percentage points (up or down). AAD-10 was calculated on the basis of structural stakes for 10 groups of owners[46]. Table 2.6 reveals that AAD-5 and AAD-10 are the highest for the group of companies privatized as external companies. It has already been argued that in this group, the initial ownership structure was the most problematic and the need for ownership changes the most pressing. Data indicate that changes in ownership structure do actually take place with the fastest pace precisely in that group. The analysis of performance of companies in this period should reveal whether those changes are sufficiently fast and effective.

2.5. Post-privatization Trasformation Matrix of Companies

Companies in the public, internal or external groups at the time of privatization shifted to other groups as the result of changes in ownership structures in the post-privatization period. Table 2.6 shows shifts of companies among the groups for a sample of 426 companies from mass privatization for which data on initial and final ownership structures[47] are available. Companies on the diagonal in the shaded area are those which remained in the same group. Companies outside the diagonal are those in which major changes in ownership structures occurred which led to their shift to other groups. Between 1995 and 1999 the incumbent owners from mass privatization played the role of owners in the companies on the diagonal and the role of sellers to other owners in the companies outside the diagonal. The transformation matrix is supplemented by the number of companies, which did not exist any more at the end of 1999 as the result of liquidation or transformation by mergers.

Public companies were already performing relatively well at the time of completed privatization, and therefore liquidations involved only internal (14) and external (27) companies. Five external companies ceased existing due to mergers, and two of them were re-nationalized. Apart from 5 external companies there were practically no shifts to foreign companies, i.e. companies controlled by foreign strategic investors. There were, however, relatively frequent shifts to companies owned by domestic strategic owners. It is interesting to note that domestic strategic investors are acquiring the largest ownership stakes in all three groups of companies from privatization, in public, internal and external companies. A few external companies (9) and even fewer internal ones (4) have opted for quotation on the stock exchange, thereby becoming public companies. Opposite cases (changing public joint stock companies into internal or external companies) were not recorded in the sample during the observed period. Companies privatized as public companies largely stayed on as public, whereas the dynamics of shifting of internal and external companies to other groups was quite fast[48].

[46] The AAD-5 and AAD-10 are not directly comparable as the indicator AAD lies on the interval (0%, 200%/n), which depends on the number of groups of owners (n).

[47] I.e. at the completion of privatization by individual companies irrespective of specific years (initial) and at the end of 1999 (final).

[48] A large number of internal companies became external companies. Those shifts were partly due to the methodological reasons. Ownership data were obtained from the Clearing and Depository Company (CDC), which at the end of 1999 did not dispose of ownership data on all privatized joint stock companies. It is very likely that the missing companies mostly involved the companies still controlled by internal owners that had no interest in entering the shareholders' books onto the central share register. The CDD does not include smaller companies established as limited liability companies and mostly controlled by internal owners throughout the observed period. Moreover, the 'internal to internal cell' in the transformation matrix is underestimated due to the establishment of proxy companies by insiders. Those are established by internal owners who invest their shares in a special legal entity (similar to the American ESOP) that manages the created block of shares on their behalf. By formal criteria of this study, the proxy company should be treated as a domestic strategic owner, since its shareholding is larger than 10 percent. The respective companies should have been appropriately treated as internal companies as they involve a stable form of organizing internal owners. The matrix gives corrections for proxy companies in parentheses. By adding proxy companies the number of internal companies is enlarged by 13, and in consequence the number of external companies is reduced by 6 and the number of enterprises with dominant domestic strategic owner is reduced by 7. Due to incomplete ownership data maintained by the CDC, the transformation matrix does not enable, so far, a complete presentation of ownership transformation for all privatized companies. Nevertheless, for the sample of 426 companies it provides a reliable approximation of the distribution of those companies that have changed their type in secondary privatization (i.e., the cells outside the diagonal) and of those ones that have not done so (i.e. the cells on the diagonal). This distribution could serve as a basis for generating dummy variables in empirical analysis of the relationship between the change in performance and the change in ownership type.

Table 2.6: Transformation matrix from completion of privatization to the end of 1999

	Registered in CDD by the end of 1999										
	Type of company	Public	Internal	External	Strategic domestic	Strategic foreign	State	Total in CDD	Liquidated	Merged	All
At time of completed privatization	Public	65	0	0	14	0	1	80			80
	Internal	4	(+8) 49	(-4) 42	(-4) 28	0	0	123	14		137
	External	9	(+5) 39	(-2) 128	(-3) 40	5	2	223	27	5	255
	All	78	(+13) 88	(-6) 170	(-7) 82	5	3	426	41	5	472

Table 2.7: Transformation matrix from completion of privatization to the end of 1999 in percentage points; n=426

		Registered in CDD by the end of 1999						
	Type of company	Public	Internal	External	Strategic domestic	Strategic foreign	State	**Total in CDD**
At time of completed privatization	Public	81%	0%	0%	18%	0%	1%	**100%**
	Internal	3%	40%	34%	23%	0%	0%	**100%**
	External	4%	17%	57%	18%	2%	1%	**100%**
	Total	**18%**	**21%**	**40%**	**19%**	**1%**	**1%**	**100%**

		Registered in CDD by the end of 1999						
	Type of company	Public	Internal	External	Strategic domestic	Strategic foreign	State	**Total in CDD**
At time of completed privatization	Public	83%	0%	0%	17%	0%	33%	**19%**
	Internal	5%	56%	25%	34%	0%	0%	**29%**
	External	12%	44%	75%	49%	100%	67%	**52%**
	Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Table 2.7 presents the distribution by initial and final types of the companies included in the transformation matrix. The rows, which add up to 100 percent, show changes in ownership types of companies privatized as public, internal or external. For example, the smallest changes in that respect can be clearly observed for public companies, as 80 percent of them remained in the same category. The columns that add up to 100 percent show the breakdown of privatization models for companies in each ownership category at the end of 1999 (i.e., what percentage of the companies in each category in 1999 were in each of the various categories at the time of privatization). Thus, for example, all foreign strategic companies and almost 50 percent of domestic strategic companies originated from companies privatized as external.

2.6. Conclusions

In Part II, we examined the data on evolution of ownership structures and concentration after mass privatization in Slovenia. Companies are grouped according to the prevailing privatization model into public, internal and external. Public companies are traded on the stock exchange; in nonpublic internal companies internal owners dominate over external owners (mostly privatization funds and para-state funds), while in nonpublic external companies the situation is reversed. Internal and external companies are not traded on the stock exchange. Therefore, the consolidation of ownership in these two groups is less transparent than in public ones.

Data reveal that since the completion of privatization by the end of 1999, almost 40% of initial shareholders have already exited companies privatized through mass privatization. Ownership concentration was strengthened in all groups of companies, but most intensively in internal companies. At the end of 1999 ownership concentration is relatively high in all groups of companies: the five largest owners on average hold 61.5% percent of votes in companies from mass privatization. It seems that the principal-agent relationship between managers and shareholders is less of a problem than the conflict between large and small shareholders. Moreover, in Slovenia large shareholders include para-state funds and privatization funds, both lacking the ability and motivation for proper corporate governance. On the other hand, many small shareholders are company insiders who act as a homogeneous group in relation to external owners. It might well be that with concentration of ownership in the 1994–1999 period, the problem of managerial discretion was reduced, while the conflict of interest between internal and external owners has become worse.

Small shareholders, the state and para-state funds are reducing their ownership stakes in the companies from mass privatization, while managers and strategic investors are increasing them. It is observed that both groups are accumulating their shares more intensively in companies not traded on the stock exchange. Therefore, transactions are made on informal markets with limited competition and transparency. In addition, new strategic investors appearing through the end of 1999 were almost exclusively of domestic origin. Initial privatization, with free distribution of shares and limited foreign and strategic investors, is followed by non-transparent domestic consolidation of ownership, where domestic companies, managers and funds are the key players. A more intensive entry of foreign portfolio and strategic investors in privatized companies can be expected only later, in the course of Slovenia's accession to the EU. On the basis of available data, the overall assessment of the post-privatization ownership consolidation in Slovenia is that the major problems are rather the quality and transparency of the process than its speed.

Part III. Secondary Privatization in Slovenia: Company Performance and Ownership Changes after Mass Privatization (1995–99)

Marko Simoneti, Jože P. Damijan, Boris Majcen and Matija Rojec[49]

3.1. Introduction

In the case of mass privatization it is expected that many 'true' owners will enter companies only in secondary privatization. Hence, initial owners from privatization have two roles: some will continue to be owners, others are only intermediaries of privatization that should help companies to find 'true' owners that in turn should take care of restructuring of companies. Both roles are important in mass privatization. Therefore, it will be attempted to empirically verify for Slovenia how effectively individual groups of owners from mass privatization – insiders, funds and small shareholders – perform their roles of owner in the post-privatization period or agent/seller in the secondary privatization.

The difference between the owner effect and agent/seller effect in mass privatization is not well understood in the economic literature and economic policies of countries in transition. Privatization models were adopted in those countries on the basis of political acceptability and the need for fast privatization of the entire enterprise sector. Initial ownership structures were intended to be transitional, with optimal ownership structures emerging gradually as a result of secondary transactions. In this sense the success of mass privatization can be judged mainly by the agent/seller effect. Thus, the recognition that privatization funds are not good owners should not be surprising, as ownership was not their intended role. It is more important whether privatization funds are good and fast sellers.

A traditional approach to examining the ownership effects or relations between ownership type and performance of companies prevails in the literature. Recent extensive surveys of empirical studies on corporate restructuring after privatization for most of the countries in transition can be found in Djankov and Murrell (2000) or Havrylyshyn and McGettingen (1999). There is also a growing body of empirical work in Slovenia that studies the effects of privatization models and emerging ownership and control structures on corporate performance. The main findings are published in the collection of papers edited by Prašnikar (1999, 2000), Borak (1995) and Simoneti (2000). We will argue that the success of mass privatization should be judged by other, non-traditional, criteria as well. Mass privatization is considered successful if temporary owners sell fast and successfully to other owners (in Slovenia, primarily to strategic investors). The success of secondary sales is, therefore, not to be evaluated by the achieved price but by how successfully companies perform after the sale to new owners. Positive effects of mass privatization are thus not shown by companies remaining under control of initial owners but by the companies that have already gone through secondary privatization.

3.2. Methodology and Data

Data from financial accounts in the period 1995–1999 are available for 426 companies from mass privatization in Slovenia and allow us to perform analyses of owner effects and agent/seller effects. Companies are grouped according to the prevailing privatization model into public, internal and external, as defined earlier in Part I.

The transformation matrix presented in Section 2.5 was constructed by taking into account the initial and final categorization of companies. It provides for distribution of 426 companies privatized as public (P), internal (I) and external (E) into the companies that remained in the same category (PP, II, EE) and the companies outside the diagonal that changed their ownership type in the course of secondary privatization (PS, IS, ES; the first letter refers to the initial ownership type):

P = PP + PS : (80 = 65 + 15)
I = II + IS : (123 = 42 + 81)
E = EE + ES :(223 = 128 + 95)

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Legend:
P = Public; PP = Public/Public; PS = Public/Secondary
I = Internal; II = Internal/Internal; IS = Internal/Secondary
E = External; EE = External/External; ES = External/Secondary

The changes in performance of P, I and E companies indicate the effectiveness of individual privatization models. Nevertheless, both the owner effect and the agent/seller effect are present here due to changes in ownership structures and shifts to other ownership groups of companies. Changes in performance of PP, II and EE companies reflect primarily the owner effect, whereas changes in performance of PS, IS and ES reflect primarily the agent/seller effect.

The first part of the analysis is performed at the aggregate level, comparing the weighted mean values of performance indicators of individual groups of companies in the initial and final year. The results of such analyses are most strongly affected by the events occurring in large companies, which is interesting from the point of view of current economic policy but may be problematic from the methodological one. In aggregate analyses it is not possible to isolate the numerous factors besides the ownership structure that affect the performance of companies. Moreover, the possibilities for exclusion of the effect of initial differences in performance (the problem of selection bias) are limited. Therefore, the aggregate analyses basically serve to formulate the main hypotheses on owner effects and agent/seller effects for individual groups of companies. Those hypotheses were tested with econometric methods in the second part using panel data for individual companies.

For the performance of companies we used indicators reflecting economic efficiency and indicators reflecting financial performance. We attempted to investigate separately how change in ownership affects the generation of output and its distribution among the key participants. Is the change in economic efficiency reflected also in the change of financial performance of companies? In aggregate analyses the economic efficiency was analyzed via the growth in labor force, sales and assets, and especially through the growth in productivity, whereas the financial performance was analyzed through the share of EBIT (operating profit), EBITDA (operating profit increased by depreciation), and net profits in sale revenues. EBITDA reflects the operating cash flows which are at the disposal of companies' investors (creditors and owners) after the payment of material and labor costs. In econometric analyses of the panel data, economic efficiency was analyzed via the growth of total factor productivity (TFP), and the financial performance was evaluated with the same indicators as in the aggregate analysis.

3.3. Aggregate Analysis and Main Hypotheses

The main problem in our aggregate analyses concerns the exclusion of initial differences in performance among the companies privatized as public, internal and external. The most straightforward solution that at least partially excludes the influence of selection bias is not to focus the analysis directly on the values of indicators but on the changes in their values. Thus the tables that follow give only changes in weighted mean values of indicators in the period between the initial year (1995) and the final year (1999) for all groups of companies.

3.3.1. The Privatization Model Effect

Table 3.1 documents changes in average indicators of performance and operation of companies grouped by initial ownership structure at privatization – public (P), internal (I), or external (E). Here, the presentation of individual privatization models' effects does not separate the owner

Table 3.1: Changes in indicators of companies privatized as public (P), internal (N) and external (E), 1995–1999, n = 426

Changes in average indicators of operation	Public	Internal	External
	Index 1999/1995 (1995=100)		
Number of employees	93.4	92.7	94.8
Assets in 000 SIT	106.2	107.8	110.8
Sales in 000 SIT	115.1	105.6	107.2
Assets per employee in 000 SIT	113.7	116.3	116.9
Sales to assets	108.4	98.0	96.8
Sales per employee in 000 SIT	123.2	113.9	113.1
	Differences in percentage points		
EBITDA to sales	1.7	0.7	0.8
EBIT to sales	2.2	0.0	-0.5
Net profit to sales	6.1	-0.1	0.7

effect from the agent/seller effect. Labor force reductions and expansion of assets occurred in all groups. Sales increased by 15 percent in public companies, by only 5.6 percent in internal companies and by 7.2 percent in external companies. Labor productivity (measured as sales per employee) also increased most in public companies (+23.2 percent) and substantially less in internal and external companies (+13 percent). Asset productivity (measured as the ratio of sales to assets) increased only in companies privatized as public. The financial indicators of the greatest interest for true corporate investors (EBITDA, EBIT, and the ratio of net profit to sales) also show positive changes only in companies privatized as public. It is a well known fact that the best performing companies went public at the time of privatization[50]. It is shown here that those companies as a group also show the greatest progress in economic and financial performance. We go on to attempt to establish whether that progress was due to good owners or good agent/sellers.

3.3.2. The owner effect

Table 3.2 documents changes in the group of companies that at the beginning and at the end of observed period belonged to the same type of companies: PP, II, EE. The owner effect is observed in these groups of companies. Sales expanded most in the PP companies, while employment was reduced in all groups. Labor productivity increased significantly more in PP companies than in the II and EE companies. According to the indicators of changes in economic efficiency, the PP companies were thus doing better than the II and EE companies. The PP companies also had significantly better financial performance. The table allows us to conclude that shareholders of public companies are good long-term owners, while internal owners and funds in non-public companies follow with a large lag in that respect.

3.3.3.The Agent/Seller Effect (Secondary Privatization)

Table 3.2: Changes in indicators of companies that operated as public (PP), internal (II) or external (EE) in the period 1995–1999, n = 242

Changes in average indicators of operation	Public	Internal	External
	Index 1999/1995 (1995=100)		
Number of employees	93.3	93.2	94.0
Assets in 000 SIT	106.6	102.5	104.0
Sales in 000 SIT	119.7	102.2	107.3
Assets per employee in 000 SIT	114.3	109.7	110.6
Sales to assets	112.3	99.7	103.2
Sales per employee in 000 SIT	128.3	109.6	114.2
	Differences in percentage points		
EBITDA to sales	2.1	1.1	-0.2
EBIT to sales	2.7	0.7	-2.1
Net profit to sales	7.5	-0.8	0.3

Table 3.3: Changes in indicators of companies that changed ownership type between 1995 and 1999 in secondary privatization: PS, IS and ES companies, n=184

Changes in average indicators of performance	Public	Internal	External
	Index 1999/1995 (1995=100)		
Number of employees	94.0	92.5	95.8
Assets in 000 SIT	103.6	110.3	118.0
Sales in 000 SIT	92.6	107.3	107.1
Assets per employee in 000 SIT	110.2	119.2	111.8
Sales to assets	89.5	97.3	90.8
Sales per employee in 000 SIT	98.5	116.0	111.8
	Differences in percentage points		
EBITDA to sales	-0.2	0.4	2.1
EBIT to sales	0.4	-0.5	1.8
Net profit to sales	0.0	0.3	1.3

[50] See the selection bias analysis in the next section.

Table 3.4: Changes in indicators of companies that were acquired by strategic investors between and 1995 1999 in secondary privatization, n=87

Changes in average indicators of operation	Public	Internal	External
	Index 1999/1995		
Number of employees	90.1	86.3	95.1
Assets in 000 SIT	101.7	109.6	107.5
Sales in 000 SIT	91.3	96.6	103.8
Assets per employee in 000 SIT	112.9	126.1	113.0
Sales to assets	89.8	88.2	96.2
Sales per employee in 000 SIT	101.3	111.9	109.2
	Differences in percentage points		
EBITDA to sales	-0.1	0.9	1.3
EBIT to sales	0.7	-0.3	0.7
Net profit to sales	0.1	1.0	1.1

Table 3.3 gives data for the groups of companies in which individual companies shifted to other categories (PS, IS, ES) by the end of 1999 as the result of significant ownership changes in secondary privatization. Signs of significant growth of sales and assets are observed especially in companies sold by internal owners and by external owners, i.e. funds. Those two groups of companies also performed well according to the indicators of labor productivity growth. The IS and ES companies differed with respect to the indicators of financial performance. The ES companies on average documented larger progress in EBITDA, EBIT and net profit to sales than the IS companies. On the other hand, the PS companies did not manifest any positive shifts with respect to the indicators of economic efficiency and financial performance. The overview of changes in average indicators suggests that the best sellers are the owners of companies privatized as external.

Therefore, on the basis of these data the conclusion could be that para-state funds and privatization funds are relatively good agents/sellers and are followed by internal owners. The same findings have been derived from the analyses of sales to strategic owners only (see Table 3.4). The IS and ES companies stand out in terms of productivity increases and the ES companies especially in terms of improved financial performance.

The aggregate overview of average indicators by individual groups of companies presented in Tables 3.1 to 3.4 allow us to formulate the following main hypotheses regarding mass privatization in Slovenia:

(1) Of the privatization models the public privatization was relatively the most successful. Its success is reflected in growth of both economic efficiency and financial performance of companies.
(2) The positive owner effect on productivity and financial performance is especially strong in companies privatized as public and is weak in the companies that underwent internal or external privatization.
(3) The positive agent/seller effect on performance is relatively strongest in companies privatized as external and internal.
(4) The success of public privatization thus originates essentially from the owner effect, which prevailed over the modest effect of changed ownership. In this privatization the initial choice was already fairly selective and, for the most part, appropriate owners already emerged in primary privatization.
(5) The poor results from internal and external privatization stem from the prevalence of modest owner effects over positive agent/seller effects. Here the initial selection of companies was less selective and other owners are required in secondary privatization. Secondary privatization is therefore urgent and is moving in the right direction, but not fast enough. Due to blockages and numerous institutional barriers[51], the funds and internal owners have accepted to play a role of long-term owners but perform it poorly.

3.4. Empirical Testing of Hypotheses

The hypotheses that concern strategic issues of key importance for directing the secondary privatization in Slovenia have been formulated based on the comparison of average values of various performance indicators for public, internal and external companies. These hypotheses appear logical and are in line with developments in a few large and well-known Slovenian companies. Next, they are tested by econometric methods employing panel data on operation of 426 companies between 1995–99. All companies are grouped in one of the main categories: PP, PS, II, IS, EE and ES.

[51] These barriers have been discussed extensively above.

Table 3.5: Initial indicators of companies privatized as public (P), internal (I) and external (E), 1995, n = 426

Average indicators of operation of companies	1995		
	Public	**Internal**	**External**
Number of employees	448	287	234
Assets in 000 SIT	9,766,208	1,879,742	2,897,793
Sales in 000 SIT	6,917,831	2,197,563	2,797,208
Value added in 000 SIT	1,519,486	683,861	605,286
Asset per employee in 000 SIT	31,220	8,779	14,841
Sales per employee in 000 SIT	13,214	10,331	12,557
Sales to assets	0.71	1.17	0.97
Labor cost per employee in 000 SIT	2,954	2,630	2,781
Share of capital in assets	71.3%	60.8%	65.4%
Share of export in sales	27.7%	24.1%	21.5%
Value added per employee	2.933	2.736	2.740
Value added to assets	20.5%	42.7%	27.9%
Labor cost to sales	28.2%	35.9%	31.4%
Value added to sales	26.7%	35.9%	29.7%
EBITDA to sales	6.5%	4.1%	3.8%
EBIT to sales	-1.7%	-0.5%	-1.9%
Net profit to sales	0.8%	0.5%	-0.1%
Number of companies	*80*	*123*	*223*

3.4.1. Selection Bias Problem

The analysis has to take into account the fact that the initial breakdown of companies into groups of public, internal and external companies is not independent of the initial differences in companies' performances (i.e. the so-called selection bias). At the time of selection of privatization models, the performance of the companies influenced the ownership structure and not vice versa. There was a strong bias in selection of privatization methods in Slovenia due to the principle of autonomy of companies in the selection of privatization models.

Table 3.5 presents the breakdown of a sample of companies participating in a survey. The sample included 80 companies privatized as public, 123 companies privatized as internal and 223 companies privatized as external. The basic hypothesis is that internal ownership depends on the financial capability of employees to exercise their rights to buy out majority stakes and on their willingness to engage in such buyouts (determined by the companies' performance).

Public companies are by far the largest in terms of labor force, sales and assets. Internal owners could not acquire majority stakes because of the large size of those companies. There were also obvious differences in capital intensity. Public companies disposed of the largest assets per employee, followed immediately by external companies, with internal companies bringing up the rear. The financial capacity of internal owners to acquire large stakes in companies was also dependent on the companies' indebtedness, which was the largest in internal companies and the smallest in public companies. The fact that the ratio of value added to assets is significantly larger in internal companies than in external and public companies indicates the capacity of internal owners to buy out companies from the resources generated by respective companies. According to the performance indicators (EBITDA, EBIT and net profit to sales) internal owners acquired majorities in average performing companies, while the best performing ones were quoted on the stock exchange and the poorly performing ones – not suitable for public offerings to small shareholders – were privatized as external companies. Detailed econometric analysis of the selection mechanism has further confirmed this analysis of mean values for individual groups of companies.

The evaluation of the selection mechanism in primary privatization was performed with the Heckman (1979) two-step method. In the first phase, a multinominal logit model (see more in Greene, 1997) was used to evaluate the optional multiple selection of companies among the three dominant privatization models (public, internal and external) on the basis of their indicators in 1994. In the second phase of evaluation, the Amemiya (1984) procedure served to calculate appropriate correction factors (the so called 'inverse Mills ratios', i.e. lambda) on the basis of the probability (likelihood) of selection of a given privatization model. In further evaluation of the effectiveness of the individual privatization model and of owners, the bias effects due to the selected privatization model were eliminated by inclusion of these correction factors in order to obtain unbiased estimates of regression coefficients. The selection of one of the three models of privatization in primary privatization was not random, but depended on the companies' pre-privatization performance. Any evaluation of individual models of privatization is therefore biased, if the non-random selec-

Table 3.6: Evaluation of the selection mechanism in primary privatization by multinomial logit model (base group=internal privatization; data for 1994)

Variable	Coef.	z-stat.
Parameters of selection of public privatization		
a	****6.51E-07**	4.099
l	***-0.003**	-2.245
a_l	***5.68E-05**	2.174
c_a	****0.034**	2.882
ebitda_s	***-0.054**	-2.462
s_l	-2.65E-05	-1.297
ex_s	0.003	0.348
Cons	***-2.783**	-2.274
Sector dummies	Yes	
Parameters of selection of external privatization		
a	****5.78E-07**	3.67
l	****-0.003**	-2.749
a_l	4.27E-05	1.68
c_a	***0.018**	2.052
ebitda_s	****-0.054**	-2.963
s_l	-2.1E-05	-1.497
ex_s	***-0.016**	-2.132
Cons	-1.861	-1.773
Sector dummies	Yes	
Number of obs	391	
LR $chi^2(60)$	186.45	
Prob > chi^2	0.000	
Pseudo R^2	0.233	

** and * indicate statistical significance of coefficients at 1 and 5 percent respectively; Dependent variable: ownership (ownership = 1, 2, 3)

tion mechanism for the three privatization models is not explicitly taken into account[52].

The likelihood of the selection of public privatization (see Table 3.6) is significantly related in a positive way to assets (a), capital intensity (a_l) and share of capital in assets (c_a), whereas the relationship with employment (l) and, interestingly, with performance (EBITDA-s) is negative. Pre-privatization characteristics are similarly related to the likelihood of the selection of external privatization, except for the significant negative relation to export orientation (ex_s), which is considered a good proxy variable for the long-term perspective of the company.

On the other hand, these results signify that the likelihood of the selection of the internal privatization model is negatively related to the size of assets and capital intensity and positively to the number of employees, performance of company (ebitda_s, ex_s) and also to indebtedness. In general, indebtedness is not problematic in internal companies that perform relatively successfully. We believe higher indebtedness plays a role of financial leverage that helps internal owners to gain the controlling stakes with relatively small resources. In-depth analysis of selection mechanisms in primary privatization thus shows that internal owners behaved quite rationally in selection of the privatization model, taking into account their financial capabilities to acquire control, as well as performance of the companies.

3.4.2. Economic Efficiency

To study changes in economic efficiency, a total factor productivity growth model was used. The evaluation of the marginal production function was performed by regressing the changes in employed capital and labor on changes in

[52] Only a few of the earliest empirical studies of the effects of privatization on company performance in Slovenia have explicitly taken the selection bias problem into account: Dubey and Vodopivec (1995) and Smith et al. (1997).

Table 3.7: Economic efficiency – TFP growth: Selection bias and the privatization model effects (the combined effect of owners and sellers)

	without correction		with correction	
	Coef.	**t-stat.**	**Coef.**	**t-stat.**
Assets	****0.269**	9.667	****0.296**	10.641
Labor	****0.682**	33.009	****0.669**	32.765
I	0.000	-0.018	***-0.149**	-2.321
E	-0.012	-1.084	****-0.186**	-2.565
lamp2			***0.100**	2.344
lamp3			***0.112**	2.469
Cons.	***0.043**	2.333	****0.239**	3.369
Time dummies	Yes		yes	
Sector dummies	Yes		yes	
Adj.R2	0.489		0.508	
F-stat.	53.32		51.33	
Observations	1564		1564	

** and * indicate statistical significance of coefficients at 1 and 5 per cent respectively
Dependent variable: lp_d (growth of production); reference = P (public companies)

production with additional dummy variables for different ownership groups of companies and additional time and sector dummies. The model using annual data for the period of 1995–1999 is estimated on the differences of logarithms (the estimated coefficients thus represent growth rates). Before turning to the estimation results, different appropriate econometric techniques for estimating the models should be addressed. As we are dealing with panel data OLS estimates may give biased and inconsistent estimates of the consecutive models. These models may suffer from probable correlation between the productivity effects and the output variable. As there are no suitable firm-specific instruments to control for this problem, one should use one of the two panel data techniques (random or fixed effects) that do explicitly take firm-specific effects into account[53]. However, neither of these two techniques, though preferable to OLS, is absolutely accurate for the purposes of our estimations. The fixed effects model (FEM) assumes constant TFP growth over time for a single firm. In the present context, this is an inappropriate assumption, as the aim is to examine the impact of different factors on changes in TFP growth. On the other hand, the major disadvantage of the random effects model (REM) is the assumption that changes in TFP growth at the firm level are random and only reflected in the error term, i.e. uncorrelated over time. We perform estimations using the OLS, REM and FEM techniques. The Hausman (1978) test shows that FEM provides a better specification of our models than REM. However, as argued above, FEM is not a proper specification in our case due to the assumption of the firm's constant TFP growth over time. In addition, as the consecutive models are estimated in first differences, fixed effects are leveled out. On the other hand, due to estimating models in first differences, the Hausman test found no significant differences between OLS and REM estimations. We therefore report only OLS estimations that provide biased, though more efficient estimations than REM and FEM specifications.

The first model in Table 3.7 does not take into account the possible biases of parameters that may be due to the initial selection bias of sample. In this case variables for both internal and external privatization are insignificant.

The second model in Table 3.7 includes correction factors for the initial selection bias of the sample. Both correction parameters are significant, meaning that the selection bias has significant effects on the parameters of the model. With elimination of that bias both regression coefficients for internal and external privatization become significant. The estimated values of the coefficients allow us to conclude that the growth of TFP is typically higher in public privatization than in internal and external privatization. In other words, in the period between 1995–1999 companies privatized internally and externally show an average annual growth rate which 15 and 19 percent lower, respectively, than the respective rate of companies privatized publicly.

These results thus confirm our hypotheses concerning mass privatization in Slovenia formulated on the basis of aggregate data: public privatization is the best from the point of view of the economic efficiency of companies. In the next step we attempt to investigate the relative importance of owner effects and agent/seller effects.

[53] For discussion on use of different panel data techniques refer to Hsiao (1986), Baltagi (1995), and Greene (2000).

Table 3.8: Economic efficiency – TFP growth: Owner effect vs. agent/seller effect

	Coef.	t-stat.	Coef.	t-stat.
Assets	****0.294**	10.554	****0.296**	10.587
Labor	****0.670**	32.737	****0.669**	32.755
Diagonal	0.002	0.252		
II			***-0.143**	-2.163
IS			***-0.136**	-2.085
PS			-0.025	-1.097
EE			***-0.176**	-2.403
ES			***-0.175**	-2.392
Lamp1	0.165	1.683		
Lamp2	0.168	1.718	***0.090**	2.039
Lamp3	0.157	1.633	***0.102**	2.202
Cons.	***0.270**	1.948	***0.223**	3.092
Time dummies	yes		yes	
Sector dummies	yes		yes	
Adj.R2	0.508		0.499	
F-stat.	50.98		48.63	
Observations	1564		1564	

** and * indicate statistical significance of coefficients with 1 and 5 percents respectively, reference = PP (public diagonal companies)
II = Internal/Internal; IS = Internal/Secondary; PS = Public/Secondary; EE = External/External; ES = External/Secondary

The first model in Table 3.8 compares TFP growth in companies that have not changed ownership (i.e. diagonal companies) in secondary privatization to that in companies that have (off-diagonal companies). The insignificant estimated regression coefficient for diagonal companies show that TFP growth in diagonal companies in general is not different from off-diagonal public companies; hence, differences between owner effects and seller/agent effects are not significant. This means that, at this level of ownership aggregation, secondary privatization in itself (without distinguishing among initial types of ownership) has no additional positive effect on the economic efficiency of companies.

The second model in Table 3.8 evaluates the owner and agent/seller effects in secondary privatization on the basis of more disaggregated ownership, taking diagonal public companies as the reference. The evaluation of the model (after taking into account the selection bias) again shows that diagonal internal and external companies grow at a typically slower rate than diagonal public companies, meaning that owners of public companies are better owners than the owners of internal and external companies. Expressed in figures, we found that among the companies that did not undergo secondary privatization in the period between 1995–1999, internal and external companies recorded average annual growth rates which were lower by 14 percent and 18 percent, respectively, than in the case of public companies.

On the other hand, the estimates of the parameters show that there is no significant difference in the economic efficiency of privatized companies when we take into account the fact that owner effects play a role in diagonal companies and agent/seller effects play a role in off-diagonal companies. This is demonstrated by the lack of a significant difference between the coefficients for off-diagonal public companies and diagonal public companies, as well as the lack of significant differences between the coefficients for owner and agent effects when comparing internal (II vs. IS) and external (EE vs. ES) companies. These results actually mean that the expected positive effects of changes in ownership structures in secondary privatization on economic efficiency cannot be observed for any of the mass privatization models in Slovenia. Thus, the analysis of individual data has not succeeded in confirming the third, fourth and fifth hypothesis formulated on the basis of the aggregate analysis.

The results in Tables 3.9 and 3.10 even more strongly confirm the results in Table 3.7.

The model in Table 3.9 separately evaluates the owner effect and the agent/seller effect in secondary privatization for each privatization model. The results reveal that there are no significant differences in the economic efficiency of privatized companies in any of the three privatization models, given that the owner effect appears in diagonal companies and agent/seller effect in off-diagonal companies.

The model in Table 3.10 disaggregates sales of companies in such a way as to distinguish sales to strategic (domestic and foreign) investors from the sales to other new owners in secondary privatization. The results reiterate that there are no significant differences among privatization models with respect to owner and agent/seller effects on

Table 3.9: Economic efficiency – TFP growth: Owner effect vs. agent/seller effect separated for individual privatization model

	Public		Internal		External	
	Coef.	**t-stat.**	**Coef.**	**t-stat.**	**Coef.**	**t-stat.**
Assets	0.088	0.965	****0.276**	6.175	****0.402**	10.897
Labor	****0.928**	31.810	****0.472**	13.316	****0.375**	9.006
Diagonal	0.038	1.414	-0.009	-0.661	-0.002	-0.185
Lamp	-0.115	-1.623	0.152	1.796	-0.057	-0.686
Cons.	0.077	1.507	-0.059	-0.921	-0.099	-1.166
Time dummies	Yes		Yes		Yes	
Sector dummies	Yes		Yes		Yes	
Adj.R2	0.817		0.424		0.298	
F-stat.	62.32		13.17		12.61	
Observations	304		464		796	

** and * indicate statistical significance of coefficients at 1 and 5 percent respectively, reference = non-diagonal companies

Table 3.10: Economic efficiency - TFP growth:
Owner effect vs. seller effect separated for individual privatization model, taking into account sales to strategic investors only

	Public		Internal		External	
	Coef.	**t-stat.**	**Coef.**	**t-stat.**	**Coef.**	**t-stat.**
Assets	0.084	0.908	****0.275**	6.116	****0.395**	10.678
Labor	****0.930**	31.500	****0.471**	13.258	****0.375**	9.018
Diagonal	-0.024	-0.149	-0.009	-0.315	0.046	1.122
Strategic	-0.034	-0.383	-0.018	-0.900	-0.034	-1.911
Lamp	-0.127	-1.462	0.150	1.710	-0.101	-1.191
Cons.	0.138	0.850	-0.058	-0.909	0.042	0.550
Time dummies	Yes		Yes		Yes	
Sector dummies	Yes		Yes		Yes	
Adj.R2	0.815		0.422		0.300	
F-stat.	56.77		12.29		11.99	
Observations	304		464		796	

** and * indicate statistical significance of coefficients at 1 and 5 percent respectively, reference = non-strategic non-diagonal companies

the economic efficiency of companies. The companies sold to strategic investors do not show higher economic efficiency than the companies sold to non-strategic owners or the diagonal companies that did not undergo secondary privatization.

3.4.3. Financial Performance

We used a simple multiple regression model to analyze the influence of primary and secondary privatization on financial performance:

$$Y = \alpha + \beta . X + \gamma . O + \varepsilon$$

where Y is the measure of financial performance, X includes various factors not related to the ownership structure which are thought to have an impact on financial performance, and O represents dummy variables for different ownership groups of companies from transformation matrix (PP, II, EE, PS, IS, ES). In contrast with the TFP analytical framework, here we do not have a solid underlying theory about what factors determine the financial performance of companies. We believe that for Slovenia in the 1995–1999 period it makes sense to include on the right side of equation the following independent variables.

- The size of the company, as a proxy for the importance of the company to policy makers and for its monopolistic market position, is represented by *sales*.
- Whether the company is already at the stage of active (strategic) restructuring via business expansion or still in the phase of defensive restructuring via business contraction is represented by *changes in labor force and assets.*
- Because of the high sensitivity of financial results to interest rates and foreign exchange policy, the *indebtedness and export orientation* of the companies figure as independent variables.
- Sector dummy variables reflect the differences in economic conditions among branches.
- Time variables are included in order to capture changes in general business conditions (trade liberalization,

imposition of hard budget constraints, labor market reform) over the course of the years.

- The problem of initial differences in financial performance is resolved in the same manner as in the TFP model by inclusion of special correction factors (lambda), which ensure unbiased estimates of regression coefficients.

The shares of EBITDA and net profit in sales revenues serve as the measure of financial performance. Returns to sales are used for a simple reason, as this is a more reliable measure than returns to assets or to equity, since the accounting data on assets and equity are significantly less reliable in Slovenian companies. Net profit is a much narrower category, which (in addition to depreciation) takes into account payment of interest and taxes, as well as extraordinary revenues and expenditures, which, in Slovenia, include compulsory value adjustments mandated by the accounting standards. Net profit is therefore a good measure of financial performance for owners, as it reflects the structure of financing. On the other hand, in Slovenia it also reflects various factors which are not directly related to the core business of companies and is therefore essentially less reliable than EBITDA. The correlation matrix also points to both indicators of returns to sales (ebitda_s and pf_s) being typically positively correlated, although the rate of correlation is significantly lower than one (i.e. 0.39).

The first model in Table 3.11 tests the influence of the privatization model on the financial performance of companies in the period 1996–1999; the second model tests it in the period 1998–1999 and yields better estimates. The models were estimated using OLS.

Both correction parameters for the selection of privatization model are significant, meaning that the selection bias has a significant influence on the financial performance (as in the TFP analytical framework). In 1989–1999 both regression coefficients are significant for internal and external privatization. It follows from the negative values of these coefficients that firms privatized to internal and external owners have worse financial performance than publicly privatized firms. A comparable result has been obtained in examining TFP growth, but for the whole period 1995–1999. These results may suggest that privatization model effects show up first in economic parameters and only later in financial parameters. This would be contrary to the prevailing view that in privatized companies the new owners first take care of financial restructuring, whereas a longer period of time is required for the changes in productivity to show.

This model is used to test if there are significant differences between owner effects and seller effects by different privatization models with public diagonal companies serving as the reference. The estimated parameters show that there are no statistically significant differences in the financial performance of privatized companies if we take into account the fact that the owner effect is present in diagonal companies and the seller effect is present in off-diagonal companies. There are no significant differences between the owner effect and seller effect coefficients in internal companies (II vs. IS) and external companies (EE vs. ES), but all these coefficients are significantly negative, meaning that in all four categories (II, IS, EE, ES) financial performance is much poorer than in public diagonal companies. These results mean that in the examined period we do not observe the expected positive effects of changed ownership on the financial performance of internally and externally privatized companies. The same findings have been obtained on the basis of the model that used net profit as the measure of financial performance (see Table 3.13).

Table 3.11: Financial performance (EBITDA to sales ratio): The privatization model effect (combined owner and seller effect)

	1996-99		1998-99	
	Coefficient	**t-stat**	**Coefficient**	**t-stat**
Sales	1.89E-07	1.127	3.76E-07	1.295
Capital/assets	****0.139**	11.757	****0.156**	9.454
Δ labor	1.178	0.980	2.219	1.150
Δ assets	16.890	1.356	****19.446**	7.719
Export/sales	****0.044**	3.656	***0.039**	2.152
I	***-9.432**	-2.438	****-17.915**	-3.128
E	-4.589	-0.994	***-13.831**	-2.010
Lamp 2	***6.435**	2.507	****11.733**	3.087
Lamp 3	2.775	0.963	***8.507**	1.984
Cons	5.597	1.438	***15.417**	2.280
Time dummies	Yes		Yes	
Sector dummies	Yes		Yes	
Adj. R2	0.263		0.2894	
F-stat	15.61		10.64	
Observations	1564		782	

** and * indicate statistical significance of coefficients at 1 and 5 percents respectively; dependent variable: EBITDA_s (EBITDA to sales); reference = P (companies privatized as public).

Table 3.12: Financial performance (EBITDA to sales ratio): Owner effect vs. seller effect

	Between 1998-99	
	Coefficient	**t-stat**
Sales	3.45E-07	1.186
Capital/assets	****0.154**	9.390
Δ labor	2.234	1.157
Δ assets	****18.936**	7.448
Export/sales	***0.037**	2.075
II	****-18.252**	-3.098
IS	****-18.419**	-3.166
PS	0.108	0.054
EE	***-14.604**	-2.101
ES	-13.061	-1.878
Lamp 2	****12.003**	3.060
Lamp 3	***8.598**	1.969
Cons	***15.820**	2.299
Time dummies	Yes	
Sector dummies	Yes	
Adj. R2	0.289	
F-stat	9.82	
Observations	782	

** and * indicate statistical significance of coefficients at 1 and 5 percent respectively; dependent variable: EBITDA_s (EBITDA to sales); reference = PP (diagonal public companies).

Table 3.13: Financial performance (profit to sales ratio): Owner effect vs. seller effect

	Between 1995-99	
	Coefficient	**t-stat**
Sales	2.44E-09	0.980
capital/assets	****0.0012**	7.271
Δ labor	-0.0098	-0.551
Δ assets	****0.2182**	8.990
export/sales	****-0.0009**	-5.408
II	****-0.5370**	-9.126
IS	****-0.5296**	-9.109
PS	0.0082	0.414
EE	****-0.7920**	-11.467
ES	****-0.7638**	-11.047
Lamp 2	****0.3392**	8.661
Lamp 3	****0.4777**	10.995
Cons	****0.7398**	10.714
Time variables	Yes	
Sector variables	Yes	
Adj. R2	0.225	
F-stat	12.94	
Observations	1564	

** and * indicate statistical significance of coefficients at 1 and 5 percent respectively; dependent variable: profit to sales; reference = PP (diagonal public companies)

These results are in line with the general hypothesis that internal and external privatization yield poorer results than public privatization as far as financial performance is concerned. The poorer results of internal and external privatization in the 1995–1999 period are related to the poorer effects of both ownership and changed ownership. Putting it simply, internal owners and funds seem to be relatively poor both as owners and as sellers. In mass privatization, the absence of positive effects of secondary privatization on financial performance is even more troubling than the poor ownership effects of these temporary owners.

3.5. Conclusions

The econometric results presented here show conclusively that secondary privatization has had practically no positive effect, either on economic efficiency or on financial performance, in the 1995–1999 period in Slovenia. The analyses by individual privatization models, individual years and for the whole period did not render any different results. This confirms that something is very wrong with secondary privatization in Slovenia and that certain rules of the game must be promptly changed and various institutional barriers promptly abolished. The problem of secondary privatization in Slovenia does not only concern its relatively slow pace but especially its failure to yield the expected positive effects on economic efficiency and financial performance.

The aggregate analyses still allowed the possibility that the problem of secondary privatization in Slovenia was essentially related to its slowness, as the aggregate effects of changed ownership were positive. This suggested that the positive effects of changed ownership would prevail in the future as a result of accelerated secondary privatization of internal and external companies. The econometric analysis of individual data, however, revealed that such positive effects on economic efficiency and financial performance could not be confirmed in the observed period. This means that improvements cannot be expected only from acceleration of secondary privatization. The prime problem of secondary privatization is its quality; slowness is only a secondary problem.

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