Organisation for Economic Co-operation and Development

Organisation de Coopération et de Développement Économiques

Hosted by
The Government of Lithuania

PRIVATISATION, GOVERNANCE AND RESTRUCTURING OF ENTERPRISES IN THE BALTICS
SUMMARY

by

Niels Mygind
Director
Centre for East European Studies
Copenhagen Business School
DENMARK

Seminar on
CORPORATE GOVERNANCE IN THE BALTICS
Vilnius, Lithuania
21-22 October, 1999

TABLE OF CONTENTS

1. INTRODUCTION*

1. The experience in Eastern Europe shows that there is a clear connection between the different methods of privatisation and resulting ownership structures in privatised enterprises. Ownership structure here refers to the distribution of ownership rights held by different groups of owners / stakeholders in relation to the enterprise. Different stakeholders - including managers, other employees, domestic persons, domestic non-financial enterprises, domestic financial enterprises and foreign enterprises - often have quite different objectives. In addition they possess different resources, such as capital, technological knowledge, management knowledge, and access to networks.

2. In this paper emphasis will be put on insider ownership which can be divided in management ownership and employee ownership when owned by a broad of employees. Both management and employee ownership have been important elements in the development of new ownership structures in the Baltic countries. At the same time insider ownership has been taken as an obstacle for restructuring of enterprises (Carlin and Landesman, 1997; Pohl et al., 1997, Frydman et al., 1997). We will also put emphasis on the development of foreign ownership which in contrast to insider ownership has been taken as a guarantee for restructuring because foreign investors have strong resources of capital, management and technological skills, as well as access to international supplier and distribution networks.

3. The rights in relation to the enterprise are not only derived from ownership of enterprise assets. In addition we need to take account of the role of legislation, giving other types of rights to different stakeholders. The development of legislation and enforcement of company code, rules on trade of ownership rights, bankruptcy legislation etc. often play important roles in influencing for the distribution of rights and thus for the development of corporate governance.

4. The ownership structure of a given enterprise is determined by the privatisation methods interacting with the specific conditions in the enterprise (size, capital-intensity etc) and the resources of the potential new owners. Privatisation will often favour a special group of stakeholders, and this group might or might not want to exchange these rights with another group of stakeholders. Such a change of ownership depends on the possibilities and conditions for trading - on the development of the market for ownership. The capital market plays an important role in this context. Some methods of privatisation can help to develop the stock exchange by developing the regulatory framework and by boosting the trading of vouchers and shares on the stock exchange.

5. The institutional framework, legislation on registration of ownership, the development of the stock exchange, the transparency and quality of information of enterprise performance are important elements behind the change of ownership after privatisation. Some groups who have acquired shares because of special preferential opportunities might want to change their portfolio. The possibilities of change thus depend on their preferred portfolio composition and on the possibilities for making this adjustment. This paper will include an analysis of the change in the distribution of ownership after privatisation.

* The views in this report are those of the authors and do not necessarily represent the opinions of the OECD or its Member countries. This report includes extracts (introduction, summary-sections, and conclusiions) from a larger paper with the same title to be published as an OECD-working paper.

6. The governance structure is a question about who takes the decisions and what are the incentives for different groups to supply their resources and effort in improving the efficiency of the enterprises. The test of how the governance structure is functioning is the economic performance of the enterprises. In the context of transitional economies it is of special interest to evaluate their progress in restructuring the enterprises - to develop new products, production methods and markets. In this paper we will not make a deep analysis of restructuring, but summarise the preliminary results on our data for the three Baltic countries.

2. OVERVIEW OVER PRIVATISATION AND INSTITUTIONS FOR CORPORATE GOVERNANCE

7. In this section we will summarise and compare the development of privatisation in the three Baltic countries and look at the institutional framework of corporate governance such as bankruptcy legislation, the role of the financial sector and the capital market. The results of privatisation in the Baltic countries are summarised in figure 2-1.

8. There have been important differences in the political development in the three countries which have meant that they have chosen different paths of changing the ownership structure from a planned system to a market system based on private ownership (see Mygind 1994, 1995, 1996). In Estonia and Latvia, the nationalist-oriented policies in relation to the large Russian speaking minority meant that the period supporting broad employee take-overs of enter-prices was very short. Before independence employee take-overs implied that control was taken away from central authorities in Moscow to the Baltic Republics. When this goal was accomplished the next goal was to strengthen the position of the titular population and to find the most efficient ownership structure. In Lithuania with only a negligible Russian speaking minority, the workers and employees in general had a much stronger political role. Therefore, the early ideas of insider-take-overs were further developed in the early years of transition with the implementation of the LIPSP program. At the same time, there was strong resistance against selling out Lithuania to foreign investors and Lithuanians feared Russian take-overs in the form of Russian FDI into Lithuania. Thus, the Lithuanian policies for a long period was quite restrictive toward FDI in sharp contrast to Estonia implementing very liberal rules for foreign capital opening up for inflow of especially Finnish and Swedish investors.

9. In all three countries there was in the second half of the 1980´s the first movements in the direction of private enterprises in the form of new co-operatives, individual firms and in the end of the period leasing and joint ventures. This development was strongest in Estonia functioning to a high degree as a lab for market reforms in USSR. The “small state enterprises” with semi-private spin offs from state owned enterprises is part of this development. Also in Latvia a fast development of new-co-operatives made an early start of private entrepreneurship.

Figure 2-1. Overview over privatisation of enterprises, 1989-98

	Estonia	**Latvia**	**Lithuania**
early	Small SOEs and new coops, Mostly owned by management. Soviet leasing, 12 empl. owned Estonian leasing 200 management owned	new co-operatives mostly owned by management Soviet leasing to employees	New co-operatives Mostly owned by management Soviet leasing, 60 empl. owned, 1990-91, Employee-shares, 2-3% of assets
small	Dec 1990 law: insider advantages 80% of 450 employee owned, Advantages limited May 1992 And cut away June 1993 Most privatised by end of 1992	legislation November 1991 partly by local municipalities, below 10 employees, auction bidders >16 years residency trade, catering, service 85% privatised 1994 mainly by management some to other employees.	LIPSP vouchers and cash quotas can be used in auctions, Conditions: employment cannot be reduced more than 30% and same activity 3 years. 1992 1993 1994 1995 sold 57% 70% 76% 100% no advantages for employees
large	1989: 7 peoples enterprises 1991: 7 SOE experiments most employee owned 1992: EPA Treuhandmodel. advantage: outsiders, foreigners tenders based on price, and investment- and job-guarantees by the end of 1998: 483 enterprises for 4.7 bill EEK (400 mill USD) 4.6 bill EEK invest. guarantees 56000 job guarantees peak of privatisation 1994 most privatised 1995 nearly all by end of 1998 by ....17 bln EEK vouchers distributed to .... Public offering of minority shares for vouchers started autumn 1994, by the end of 97: 39 holdings for 2.3 bln EEK (most vouchers for housing) end 1998 only few utilities left	1991, 6 SOE sold to insiders 1992-94 decentral privatisat. by sector ministries ca. 50 firms privatised 78 corporatised 234 leased, mainly to insiders May 1994 centralised at LPA by the end of 1998: 1009 tender privatisations for 190 mill LVL (350 mill USD) 244 mill LVL debt taken over 127 mill LVLinvestguarantee 47735 job guarantees peak of privatisation 1997 most privatised 1997 nearly all by the end of 1998 by Jan. 1996 3 bln LVL vouchers distributed to 2,4 mill 97% of the population Aug. 1994 voucher market 1995-98 82 public offerings 1 bln LVL vouchers (most vouchers for housing) end 1998 only few utilities and large enterprises left	Sept. 1991, LIPSP privatisation Sale of shares through Vouchers and cash quotas, Dec. 1991, Investment Funds, the share employees can buy at preferential terms increased 1991:10%,1992:30%,1993:50% 1992 1993 1994 1995 sold 38% 62% 75% 99% of LIPSP 2926 enterprises, tenders of min. shares utilities, 46 SOE "hard currency sale", peak of privatisation 1992 most medium and large firms privatised by end of 1994 remaining shares and very large quite slow process 1996 Lit. Privatisation Agency privatisation for cash founding ministries and municipalities slow down process 1998 Centralisation of process in State Property Fund, remaining privatisations faster including some of largest firms end 1998 some utilities and large enterprises left.

10. In 1989 both in Estonia and Lithuania new economic reform programs were defined and implementation started and in both countries plans for privatisation were developed. In Estonia the idea of employee-controlled "people enterprises" was only implemented in a limited number of cases because of the change in policies related to the dissolution of the USSR. The insider bias in legislation continued until spring 1992 in small privatisation, but the bulk of privatisation was without

preferences for insiders. In Latvia most advantages for insiders in small privatisation were also taken away in 1992 although there were more scope for continuation of some insider advantages in the following years.

11. In Lithuania the comprehensive LIPSP program implemented already in September 1991 meant that insiders got a strong role in the privatisation of not only the small, but also most of the medium and larger enterprises. The LIPSP program was to a high degree based on vouchers. The largest enterprises including most utilities were only to a limited extent included in the LIPSP privatisation.

12. All three countries have had large voucher schemes involving most of the residents. However, in both Estonia and Latvia the bulk of vouchers were related to the privatisation of land and housing. In Lithuania 65% of the vouchers were used in enterprise privatisation, in Estonia 26% and in Latvia 42%. In Estonia and Latvia most of these vouchers went to broad public offerings of minority holdings after sale of the majority to a core investor. However, in both these countries a core investor could also finance a big share of the down payment by vouchers in the tender privatisation, figure 2-2.

Figure 2-2 - The use of vouchers for privatisation in the Baltics

Nominal value mill local currency	**Estonia**	**Latvia**	**Lithuania**
Mainly core owners, tender/LIPSP*	1160 (9)	165 (5)	6805 (65)
Public offering – minority holdings	2300 (17)	****1120 (37)	0 (0)
Housing - land – agriculture	6280 (47)	596 (20)	2973 (28)
not used (end year)	(1998)3730**(28)	(1998) 878 (38)	(1995) 726 (7)
Total distributed	13470 (100)	3032 (100)	10504 (100)
USD per capita ***	660	2028	706

*incl. small privatisation (less than 10% of the amount), **incl. compensation fund, ***1994 exchange rates
****Ministry of Economy includes also cases when majority of shares have been sold, but not to a core investor.

13. In Lithuania, vouchers could only be used in the LIPSP-program. Often majority share holdings were bought mainly for vouchers. Although the LIPSP privatisation resulted in a more diversified ownership structure, than the tender privatisation in Estonia and Latvia, we estimate that in most cases a core group of owners, most often insiders, acquired a majority of shares. Therefore, this type of privatisation is categorised together with tenders on figure 2-3. In the later stages of privatisation minority share holdings were sold for cash. In this way Lithuania had a complete opposite way of using vouchers for majority/minority shares compared to the two other Baltic countries.

14. Because of the limited role of vouchers in enterprise privatisation in Estonia and Latvia investment funds played only a limited role in these countries. In Lithuania around 3-400 investment funds were started in relation to the LIPSP-program. Most of them were used as leverage for a group of insiders to take control with their companies, but a few developed to investment funds representing a high number of investors and with a diversified portfolio in a large number of companies. However, when the regulation was tightened in 1997 most of the investment funds were dissolved.

Figure 2-3 - Different types of privatisation of large enterprises end 1998 - Preliminary

mill local currency	leasing mainly insiders	Mainly Insider buy-outs	tender core-investor	of which minority publ. offer	Restitution Liquidated /other	Still State Owned**	total
Estonia							
firms %	100* 16	7 1	483 75	39 (overlap)	40* 6	10* 1	640* 100
Price	? -	? -	6875 67	2300 22	100* 1	? 9*	10300* 100
Latvia							
Firms	237 18	6 0	1009 75	82 (overlap)	?	100* 7	1350* 100
Price	37 -	? -	434 27	953 60	?	? 13*	1600* 100
Lithuania							
Firms %	60 2	2940 89	100* 3	300 (overlap)	?	200* 6	3300* 100
Price	? -	4000* 42	2500* 26	100* 1	?	? 30*	9600* 100

Price = price for the share privatised incl. nominal value of vouchers, (for Estonia incl. debt taken over). Vouchers counted as nominal value (if market value, price for e.g. public offerings in Latvia would be only 10% of the nominal value. * Estimate. ** Firms, majority state owned, value, including minority state shares.

15. The timing of privatisation was quite similar for the small privatisation, but quite different between the three countries for the large privatisation. In all three countries, the majority of small enterprises were privatised already in the early years of transition 1992-93. However, for the medium and large enterprises there have been marked differences. With the implementation of the LIPSP-program, Lithuania had the peak of privatisation already in 1993. Larger enterprises were privatised by 1994. Note, however, that in most companies some shares remained state owned, and especially in some very large companies only around 10% of the shares were privatised, so in total only around 50% of the capital were privatised in the involved companies. In Estonia the privatisation through EPA had the highest momentum by 1994. By 1995 larger enterprises were privatised. In Latvia the privatisation through LPA gained momentum in 1995-96 to peak in 1997, and large privatisation was nearly accomplished by the end of 1998.

16. Looking at the largest enterprises in utilities and infrastructure Estonia has been the fastest followed by Latvia. Here Lithuania has been relatively slow. This has also been the case for the sale of residual state share holdings in companies already included in the LIPSP privatisation. So while being fastest in the first round Lithuania is slowest in the last round of privatisation, but after 2-3 years of hesitation and slow action from the end of LIPSP in June 1995 the privatisation gained momentum in 1998.

17. In all three countries, foreign investors played only a minor role in the privatisation of small enterprises. The advantages for insiders crowded out the possibilities for outsiders especially foreign investors. After 1992, they had some possibilities in Estonia. That was to some extent also the case in Latvia. However, for Lithuania the foreigners had a very weak position in the LIPSP-privatisation.

18. Estonia was the first country to use privatisation for the promotion of foreign investment in relation to large privatisation. In the tender process foreign capital had a strong position because of their access to capital, management skills, and international business networks. Already from 1993 foreigners took over some of the largest enterprises under privatisation. By the end of 1998 foreigners had taken over approximately one third of enterprise assets included in large privatisation - in the years 1996-98 the foreigners paid 56% of the price paid for privatisation. Latvia started the same process in the autumn of 1994 and the foreign share of purchase was 34% for the years 1995-1997. In Lithuania the LIPSP-privatisation gave very little room for foreigners, and only 4 enterprises out of 46 were taken over by foreign investors in the privatisation for hard currency up to 1995. After LIPSP followed the period of stagnation and not before 1998 did foreign capital start to play an important role in privatisation in Lithuania. However, just the single foreign investment in Lithuanian Telecom of more than 2 bln Litas imply that privatisation revenue makes up a very big part of total FDI-stock in Lithuania, see figure 2-4.

Figure 2-4. The role of foreign investors in large privatisation in the Baltics

mill local currency units	**Estonia**	**Latvia**	**Lithuania**
FDI accumulated end 1998* per capita Local/USD	20623 (100) 13568 /1130$	846 (100) 344/615 $	6501 (100) 1757/437 $
Purchase of privatised firms % total privatisation revenue	1439 (7.0) 31%	111 (13)	2250 (35)
debt taken over % of total large privatisation	495 (2.4) 23%	150? (18)	
Investment guarantees % of total large privatisation	2364 (11.5) 51%	87 (10)	900? (14)

* Estonia 1993-1998, Latvia and Lithuania, stock of FDI end of 1998, Lithuania dominated by foreign investment in Telecom (purchase price 2040 mill Litas, investment guarantees 884 mill Litas)

19. The methods of privatisation have had a great impact on the ownership structure in the Baltic countries. However, privatisation can only be considered to be the initial stage of developing the ownership and corporate governance system. Especially in the cases where special groups have been given specific advantages to acquire the assets, it can be expected that they have not got the preferred portfolio-combination through the privatisation process. Many new owners will be interested in selling their shares and some other groups might want to take-over. Quite intense trading in the period after privatisation is expected. However, in the transitional economies the system for trading shares - the market for ownership - is not highly developed and lack of transparency, uncertainty about registration and implementation of ownership rights might be an important barrier for the post-privatisation dynamics.

20. The most important institutions for the dynamics of ownership are:
- Competition on the product market
- Bankruptcy procedures, securing the take-over by creditors in case of default
- Legislation on registration, transfer, and enforcement of ownership rights
- The development of the financial system for supply of loans to enterprises
- The development of the stock exchange and a market for ownership of firms

21. The legislation on bankruptcy procedures was developed quite early in Estonia, September 1992. The law was strictly enforced so already by 1995 more than 1000 bankruptcy procedures had been implemented. Therefore, take-overs of liquidated assets can be assumed to play an important role in the ownership dynamics in Estonia. This is not the case in the two other countries. Also in Latvia and Lithuania bankruptcy laws were passed in 1992, but the implementation was relatively weak. The legislation has been strengthened in Latvia in 1996 and in Lithuania in 1997 and the implementation has been tightened in the latest years.

Figure 2-5. Overview over institutions important for corporate governance

	Estonia		**Latvia**		**Lithuania**	
product market **competitive pressure**	very high because of totally liberal trade		increasing		Increasing	
bankruptcy system EBRD – score*	strict legislation 1992 tough enforcement 4-		strict legislation 1996 tighter enforcement 3+		strict legislation 1997 tighter enforcement 3	
commercial law* **shareholders rights**	extensiveness 3+ effectiveness 4-		extensiveness 4- effectiveness 3		extensiveness 4 effectiveness 3	
financial system loans to private firms % of GDP	1997 856 mill $ 19%	1998 1101mill$ 20%	1997 510 mill $ 9%	1998 842 mill $ 13%	1997 907 mill $ 9%	1998 1065 mill $ 10%
stock market start stock exchange	May 1996		July 1995		September 1993	
	1997	1998	1997	1998	1997	1998
listed firms	28	25	50	69	516	611
capitalisation stocks mill $	1147	619	337	396	1295	1074
% of GDP	26%	11%	6%	6%	14%	11%
turnover stocks mill$	1594	950	80	61	85	223
turnover/capitalisation	1.34	1.61	0.24	0.16	0.07	0.21
% foreign portfolio	42%	45%				

*EBRD Transition Report 1999, the figures with maximum 4+ covers the result of a survey of experts and private law firms on bankruptcy and commercial law.
Capital market based on data from central banks and stock exchanges.

22. The legislation on registration, transfer and enforcement of ownership rights connected to the commercial code, laws on joint stock companies etc. are quite developed in all three countries. However, according to an EBRD-survey the implementation of the laws are somewhat behind in Latvia and Lithuania.

23. The financial system developed relatively fast in Estonia. Already in 1992-93 the system was strengthened after a major financial crisis. In Latvia there was an even more serious banking crisis in 1995 involving the largest commercial bank in Latvia. In Lithuania three of the largest banks were in

crisis in the end of 1995 and 1996. In both countries the banking crisis have been followed by a period of consolidation.

24. In spite of a crisis for some medium banks in 1998 Estonia has now a relatively strong financial system. The two largest banks have been taken over by Swedish investors and they constitute now the strongest banks in the Baltics. Also in the two other countries the banking system have been in a positive development the latest years. However, the crisis in Russia has delayed the consolidation and some medium sized banks have been closed or merged. In Estonia loans to private enterprises made up 12% already in 1994, by 1997 it had increased to 19%. In Latvia and Lithuania the similar figure was 9% by 1997. These differences are also reflected in the development of interest rates which reached a level under 20% for long term loans in 1994 in Estonia. This happened 1-2 years later in Latvia and Lithuania. Therefore, bank credits have had higher importance for the situation of corporate governance in Estonian companies compared to the situation in the other two countries, but with the consolidation of the banking system we find an increasing importance for the bank loans in all three countries.

25. The Tallinn Stock Exchange was opened in May 1996. Before that time some trading of shares had taken place in the over the counter market. The development of the public offerings for minority shares facilitated the development of the exchange, but there has been no strong relation between the privatisation process and the development of the stock exchange. The firms dominating the main list are the big commercial banks, which were started as private entities. A few large companies have been added after their privatisation. In general the Tallinn stock exchange is characterised by a low number of companies - only 25 by the end of 1998. A few of them are heavily traded, especially a few large banks dominate the turnover. There has been quite high volatility since the start in 1996. Foreigners are strongly involved both with portfolio investment and in the control of core-holdings. From 1998 Swedish ownership of the two largest Estonian banks makes up a big proportion of the Western ownership of shares listed at the Tallinn Stock Exchange. By the end of 1998 the foreign share of the listed stocks were 45% (Bank of Estonia).

26. The capitalisation and turnover on the Riga Stock Exchange are considerably lower than in Estonia, see figure 2-5. However, the Latvian stock exchange has developed quite rapidly in the latest years. This is in close connection with the acceleration of privatisation of large companies and of public offerings of shares. Of the 67 companies listed on the Riga Stock Exchange in 1998, 59 are privatised companies.

27. The National Stock Exchange of Lithuania (NSEL) was established already in September 1993. The early start is closely connected to the high speed of privatisation in the early years of transition in Lithuania. Many of the enterprise involved in large privatisation were listed on the Lithuanian Stock Exchange, so the number of enterprises listed has been much higher than in the other Baltic countries. In the second and third stage of privatisation many of the minority state holdings were sold directly on stock exchange. However, most of the companies have been relatively small compared to the average listed company in Estonia. Only 4 companies were listed on the main list in Lithuania, less than half of the numbers in Estonia and Latvia. Even, including all the more than 600 enterprises listed in Lithuania, the capitalisation in relation to GDP was not higher in Lithuania than in Estonia, see figure 2-5. The main problem in Lithuania, however, has been very thin trading, so the price set at NSEL has not been a good indicator for the market value of the shares in most of the listed companies.

28. The three Baltic stock exchanges have started a co-operation with the aim of a high degree of integration including the start of a common Baltic list of blue-chip stocks. This integration will

probably further accelerate the strengthening of regulation and transparency, which has happened in the latest years in all three exchanges.

29. The development of the exchanges is, however, relevant for only the few very large companies. For all the small and medium and most of the larger enterprises the development in competition, the general development in legislation and enforcement, and the development of the credit system is the decisive variables for the corporate governance environment. In these areas Estonia have had a reasonable functioning system since the mid-1990s, while for Latvia and Lithuania the same level was not reached before around 1997-98. In the following sections we will look at the effects on the dynamics of ownership and on economic performance and restructuring.

3. SUMMARY ON OWNERSHIP ANALYSIS AND ECONOMIC PERFORMANCE

30. The privatisation process and the results on ownership, corporate governance, and economic performance have many similarities between the three Baltic countries, but there are also differences depending on specific policies and the development of the institutional framework. In this summary we will start each point by outlining the general trend and then go deeper into some of the main differences between the countries. We have already summarised the main elements in the privatisation process in section 2. This section will focus on ownership and economic performance or restructuring, but also make some connections back to the specific privatisation models and institutional conditions in each country. We will follow the division in three subsections: 1) ownership structure after privatisation/establishment of new firms, 2) ownership dynamics after privatisation, 3) governance structures and economic performance/restructuring.

3.1 OWNERSHIP STRUCTURE AFTER PRIVATIZATION/ESTABLISHMENT OF NEW FIRMS

31. The ownership structure now existing in the Baltic countries is both a result of privatisation/start of new enterprises and of dynamic change in ownership after the establishment as private entities. It is seldom possible to make a clear distinction between de novo enterprises and privatised enterprises. However, in general most of the small enterprises with less than 20 employees are started as new although often with some privatised assets, on the other hand most large private enterprises with 100 or more employees are privatised. In between it is more difficult to distinguish the group of medium sized enterprises, and only in some cases we have been able to make a clear distinction in the analysis.

32. The general trend in all three countries is that management ownership is dominant for small enterprises, both for new started and for privatised. Like in the West smallest enterprises in trade, small manufacturing etc. have been started by a sole proprietor. The new co-operatives have been a special way of early private start ups giving the broader group of employees a more formal role in the ownership-structure, but we assume that most of these enterprises very quickly transformed to management owned enterprises. In the privatisation process managers of enterprise of small enterprises or more often smaller branches of a larger enterprise have got relatively good possibilities to take-over their units. This was especially the case in the early period of transition in all three countries. In some cases, especially in Estonia and Latvia broader, employee ownership were encouraged in the early small privatisation. In Lithuania, on the contrary, in privatisation of small

enterprises there were fewer advantages for employees than was the case for large privatisation in relation to the LIPSP program.

33. The result on ownership structure was a very high proportion of manager owned small enterprises especially in Estonia and Latvia and a somewhat lower proportion in Lithuania. Ownership of a broader group of employees is also found in small enterprises, but this type of ownership was more evenly distributed also to cover medium and large-sized enterprises. This brings the total proportion of insider ownership to a quite high level compared with international standard. Thus in January 1995 it is estimated that in 30%-60% of the private companies in the three countries insiders own at least 50% of the firm. The percentage is highest in Latvia and apparently lowest in Lithuania, but in Lithuania the number are relatively high in large companies and insiders own shares in nearly all companies including those which do not have a single group owning the majority. In the industrial enterprises in Lithuania around 75% of the employees own shares. In Estonia, we find an incidence of employee ownership, with one in four employees owning shares in private firms in 1995.

34. In Lithuania, nearly all enterprises have at least an element of employee ownership, the broad group of employees has a quite strong position versus management, and there are fewer non-owners among the employees than in Estonia and Latvia. In Lithuanian industry their employees dominate managers in relation to ownership. In Estonia and Latvia the two types of ownership have about the same weight when measured in January 1995. However, in Latvia there is a higher proportion of enterprises with majority insider ownership than in Lithuania.

35. Foreign ownership has been most important in relation to some of the very large privatisation in all three countries. However, this type of privatisation started some years earlier in Estonia than in Latvia and are first in these years taking off in Lithuania. This is a major reason why foreign ownership up till 1996 is very important in Estonia while minor important in Latvia and of negligible importance in Lithuania. Because of the proximity to Finland and the general international openness Estonia has also seen a quite high proportion of foreign ownership in small enterprises especially in trade. There are some tendencies in this direction also in Latvia while in Lithuania the share of foreign ownership is lower than in the two Northern countries.

36. By 1996, in Lithuania, a relatively high proportion of enterprises are categorised as “no majority”, no single group - state, outsiders or insiders - have the majority of the shares. This is mainly because the state kept a substantial minority stake in many enterprises in the LIPSP-privatisation, and the following process of selling out these shareholdings has been relatively slow up to 1998. In both Estonia and Latvia there is a considerable concentration of shares at a single group of owners leaving only 2-6% of the private enterprises in the category of “no majority”.

37. One of the main barriers for establishing insider ownership is the lack of capital. Foreign investors on the other hand have a strong advantage in access to capital. Special advantages for insiders in the privatisation process might change this relation. In the Baltics this was the case in Lithuania. In Estonia and Latvia there is a strong tendency for a relatively low capital intensity in insider owned enterprises. This is especially the case when measured as nominal capital per employee, but this is also the tendency for total assets per employee. Here is a significant difference from the situation in Lithuania. Here, total assets per employee are about the same in insider as in outsider owned companies. Nominal capital per employee in employee owned enterprises in industry is lower than for other ownership types, but the tendency is much weaker than it was the case in Estonia and Latvia. It is probably the higher level of support for employees in Lithuania, which explains this difference. In the other countries insiders including the broad group of employees could

only afford a take-over when the price reflected in the nominal capital per employee was relatively low.

3.2 OWNERSHIP DYNAMICS AFTER PRIVATISATION OR START UP

38. The initial ownership structure after privatisation cannot be expected to fit to the long run preferences of different stakeholders and to the most efficient distribution of ownership on different owner groups. Therefore, the dynamics of ownership structures after privatisation is very important. However, trading of shares, enforcement of ownership rights and other elements in the institutional framework for corporate governance might hamper the dynamic adjustment resulting in a high degree of inertia in the ownership structure.

39. In fact some degree of inertia characterise all three countries. Except for the continuing privatisation transferring ownership from the state to the other groups there is only little dynamics between the broadly defined private ownership categories such as insiders, domestic outsiders and foreign outsider. In this respect we find somewhat more dynamics in Estonia than is the case in the two other countries. However, the main change takes place within the group of insiders. In all three countries there is a strong dynamic trend to transfer broad employee ownership to management ownership.

40. Especially in Estonia and Lithuania the data show a quite fast change in ownership. The dynamics are not so profound in Latvia, however, here the survey covers only 167 enterprises and they were asked about historic data, implying a bias in the direction of stability. Thus, our conclusion is that there has probably been a rather dynamic change also in Latvia. There is a tendency, most pronounced in Estonia, especially for change away from employee ownership in large enterprises. Also the group of enterprises with “no majority” are falling in all three countries.

41. The tendency away from employee ownership can also be found on the personal level in the enterprises. The number of non-owning employees is increasing in all three countries, except for small enterprises in Estonia. This confirms the tendency for higher stability of employee ownership in small enterprises.

42. Dynamics with foreign owners taking over privately owned enterprises can also be found in the material although the frequency is rather low. Here we find some indication of gradual take-overs to a higher extent that take-overs in one blow.

3.3 OWNERSHIP STRUCTURES AND ECONOMIC PERFORMANCE

43. The general conclusions in most theoretical literature on the relation between ownership and economic performance / restructuring is that private performs better than state, outsiders better than insiders, and within these groups: managers better than employees and foreigners better than domestic investors. We can construct a scale like shown in figure 3.3-1.

44. Foreign ownership is considered to have the highest potential for efficient economic performance and restructuring because of the access to capital, management skills, including corporate governance abilities, and access to international business networks. All the companies in the transition economies will meet strong barriers because of the lack of developed institutions and high market uncertainty, but foreigners have an advantage because of their strong links to the Western markets. This is the main advantage in relation to concentrated domestic outside ownership.

45. Insider ownership on the other hand, and especially employee ownership, are considered to have specific disadvantages because employees might have special objectives of stable jobs and high wages differing from profit maximisation. They might lack the necessary management skills and they have limited access to capital. Management ownership lies somewhat between employee ownership and outside domestic ownership.

Figure 3.3-1. Theoretical predictions on efficiency for different owner groups

--> higher

State	**employee**	**manager**	**Outside dom.**	**foreign**	efficiency
Information and incentive problems	spec.goals lack of skills and capital	between employee and outside	Specific Barriers In Transition	profit-max + capital + manage skill + networks	
	specific barriers on the domestic market lack of efficient financial market etc			access to well functioning international markets	

46. However, before evaluating the actual performance of the different owner groups it must be checked whether they have the same starting conditions. Foreign owned and management owned enterprises are both the result of new start ups as well as privatisation, while broader employee ownership are mainly the result of the privatisation process. There are striking differences concerning size and capital-intensity. Management ownership is especially found in small enterprises, while employee ownership tend to be larger on average. Insider-ownership has a quite low capital-intensity and foreign owned a rather high intensity and this concerns both privatisation and start-ups.

47. For privatised enterprises an important question is if specific owner groups can “skim the cream” when choosing the companies for take-overs while other groups are left with the low performing enterprises. Data for the very early years before privatisation are difficult to get and not very reliable, but the indicators we have got show that there is no significant variation in the level of pre-privatisation profitability between owner groups. There is no evidence of “cream skimming”. However, both the descriptions of the early privatisation process and the data on capital-intensity gives some indications that insiders might have acquired their enterprises for a relatively low price.

48. Looking at the economic results for different ownership structures quite strong general trends in all countries are apparent, and these trends are both covering data for the small samples of the early periods of transition, 1993-1995 and the large samples covering 1996 and 1997. A few of the results are based on deeper econometric analysis, e.g. factor productivity for Estonian panel data, but much of the results are based on simple descriptive data and shall be taken as preliminary, see a summary of the result in figure 3.3-2.

Table 3.3-2. Summary on economic performance of different ownership groups

	Estonia	**Latvia**	**Lithuania**
Initial conditions Size capital intensity profitability	 FO low EO average, MO low FO very high EO and MO low IO average, FO ?	 FO average IO smaller FO very high IO lower no information	FO average MO smaller EO average FO high EO and MO average FO and IO average
growth in sales	FO high	FO high	FO and MO high EO average, OO low
Export share	EO?, FO higher	-	-
Employment change	FO highest growth EO less reductions EO and MO higher increases		FO high growth EO sluggish adjustment
Factor-productivity	FO 19-21% higher EO 13-24% higher MO 15-31% higher OO same level as SO	no significant results	no significant results
Labour-productivity	EO average	FO highest	FO highest EO and MO high
wage level	EO and MO lower FO higher	FO highest PO lower than SO	FO highest EO and MO high
profitability, (return on assets)	FO lower EO and MO higher	FO lower IO higher	FO low, later high EO high, MO average
Finance debt/equity bank loans/employee	 EO and MO higher FO higher EO and MO lower SO lower	 FO average, IO high FO highest IO low SO lowest	 FO higher FO higher EO and MO lower
Investment/employee	FO highest EO and MO average	FO highest IO higher than OO	FO highest
Special note			Financial owned firms worst performance

FO=foreign owned,EO=employee, MO=management, IO=insider, OO=outside domestic, SO=state, PO=private
Based on Jones and Mygind, 1999 a, b and c and Mygind, 1997 a and b

49. The performance of foreign owned enterprises has the following characteristics:
- High capital-intensity from the start
- High sales per employee, and high growth rate of sales
- High export share (only documented for Estonia)
- High labour-productivity, measured as value added per employee, (Difference to other groups lower when measured as sales per employee).
- High investment level
- Relatively high level of debt and good access to bank loans (Bank loans per employee much higher than for other owner groups).

50. These figures show that foreign owned enterprises takes the lead when it concerns pro-active restructuring, that is developing new markets, new products and new production methods. In this way the foreign owned companies used their advantages in relation to access to capital, and market networks.

51. The other side of the coin is that foreign owned enterprises have:
- Relatively high wages,
- Higher cost of capital connected to the high capital-intensity,
- Factor productivity on the same level as insider ownership,
- Relatively low return on assets.

52. The results indicate that the high level of assets have not yet paid off in foreign owned enterprises. Profitability is lower and factor productivity on the same level as in insider owned enterprises although foreign ownership have advantages in management and easy access to international market networks.

53. If we look at insider owned enterprises, they seem to be examples of more defensive restructuring:
- Cutting down employment - sometimes somewhat sluggish,
- Paying relatively low wages,
- Having problems of getting bank-loans,
- Implementing relatively low investments.

54. However, at the same time they can show relatively good results on:
- Relatively high profitability and factor productivity.

55. This is related to relatively low capital-intensity at the starting point, but it also indicates that they have done some restructuring and improved their use of scarce resources in a direction of higher efficiency. Compared to domestic outside owned enterprises insider ownership are doing surprisingly well in most measures across the three countries. This is the case for factor productivity for Estonia - no significant differences for the other countries can be found.

56. The most important deviation from the general trend is a somewhat higher capital-intensity in employee owned enterprises in Lithuania. This was the result of the first stage privatisation program enabling employees to use vouchers for buying also relatively expensive enterprises. This gave room for somewhat higher wages in these enterprises although still significantly lower than in foreign owned enterprises.

57. For Lithuania we also have results from 1997 showing that enterprises owned dominantly by financial companies are doing comparatively worse than other private enterprises. We take this as a sign of banks taking over enterprises in economic crisis. In this way financial companies have started to play a role of active creditors, but we se no strong signs that financial institutions play an active role as owners in the economy in general.

4. FINAL REMARKS AND PERSPECTIVES

58. The three Baltic countries show many similarities in the development of new ownership structures, but they have followed different paths of privatisation and this has to some extent resulted in differences in the structures of enterprise governance.

59. All three countries have a quite high degree of management- and broader employee ownership. This was especially the case for the early stage of privatisation and concerned mainly small and medium sized enterprises with quite low capital intensity. For Lithuania also larger and more capital intensive enterprises were taken over by a broad group of employees. Estonia has been the fastest to promote significant foreign investment, but the other countries have been catching up the latest years.

60. Some of the differences have been levelled off in the dynamic changes of ownership structures. The strongest change has been managers taking over the ownership from other employees. Although this process probably will continue for a longer period, the ownership structure of all three Baltic countries will for the foreseeable future have a quite strong element of employee ownership, and management ownership will continue to be on a high level especially in small and medium sized enterprises. At the same time foreign ownership will play a strong and increasing role in these small open economies.

61. How are the perspectives for restructuring under these conditions? The results on economic performance suggests that not only foreign companies can implement restructuring, also management- and employee owned enterprises undertakes restructuring although often more defensive than is the case for foreign owned enterprises. The task for the Baltic economies will not only be to further develop the co-operation with foreign investors, but also to improve the conditions for the domestically owned enterprises to match the foreign advantages. This could be the case in relation to access to capital, management training, building networks for exports etc.. Important for the development of a business infrastructure would be the development of the financial markets in general and more specifically the development of specific credit-schemes for small and medium-sized enterprises. Also the development of institutions for management training, management consulting and activities promoting exports-connections and international networks for SMEs can be an important elements in restructuring the Baltic economies. Concerning employee owned enterprises some consulting efforts could further develop their advantages in relation to employee participation, motivation and alignment of the interests of owners and employees.

REFERENCES

Arkadie B.V. et. al. (1991): *Economic Survey of the Baltic Republics*, Stockholm

Bradshaw, Michael, Phillip Hhanson and Denis Shaw (1994) *Economic Restructuring in The Baltic States: The National Self-Determination of Estonia, Latvia and Lithuania,* Edited Graham Smith, pp. 158-180. New York, St. Martins Press

Carlin W and M. Landesmann (1997): From Theory into practice? Restructuring and Dynamics in Transition Economies" *Oxford Review of Economic Policy*, vol. 13, no 2 pp. 77-104.

Earle, J.S., S. Estrin and L Leshchenko (1995) "Ownership Structures, Patterns of Control and Enterprise Behavior in Russia" mimeo, Central European University.

EBRD 1999 *Transition Report for 1999*, EBRD, London.

ESA - Estonian Statistical Office - statistical publications

Estrin, Saul (ed.) 1994 *Privatisation in Central and Eastern Europe*, Longmans

Frydman R, C. Gray, M. Hessel and A. Rapaczynski (1997): Private Ownership and Corporate Performance: Some Lessons from Transition Economies, *C.V. Starr Center for Applied Economics, Economic Research Reports*

Frydman et al. (1993a) *The Privatisation Process in Russia, Ukraine and the Baltic States.* CEU Privatisation Reports, V.2, Budapest, London/NY

Jones D. and N. Mygind (1998): Ownership Patterns and Dynamics in Privatized Firms in Transitions Economies: Evidence from the Baltics, *CEES Working Paper Series, no 15,* Forthcoming in Baltic Journal of Economics

Jones D. and N. Mygind (1999a): The Nature and Determinants of Ownership Changes after Privatization: Evidence from Estonia, *Journal of Comparative Economics*, vol. 27 no 3 pp. 422-441

Jones D. and N. Mygind (1999b): Ownership and Productive Efficiency: Evidence from Estonia, *CEES Working Paper Series, no 24*

Jones D. and N. Mygind (1999c): The Effects of Privatization on Productive Efficiency: Evidence from the Baltic Republics, *CEES Working Paper Series, no 22*

Kein A. & V. Tali (1994): The Process of Ownership Reform and Privatisation, paper from Institute of Economics, Estonian Academy of Sciences.

Kein A (1995): Capital Market Institutions in Estonia, Estonian Academy of Sciences, Discussion Papers, no 44.

Kein and Terk (1997): Management-Buy-Out and Management-Buy-In in Estonia, Chapter 4

Lee B. (1996): Lithuania, in (Lieberman et al. eds.): *Between State and Market*, World Bank/ OECD, 1997

LPA - Latvian Privatisation Agency (1995-1998): Annual reports, Riga

Liuhto K. (1995): Foreign Investment in Estonia: A Statistical Approach, *EUROPE-ASIA STUDIES*, vol. 47, no 3, pp 507-525.

Martinavicius J. (1996): Privatisation in Lithuania: The Legislative and Political Environment and the Results Achieved, in Mygind, 1996, pp. 267-294

Ministry of Economic Affairs (1999): (A. Purju ed.) *Estonian Economy, 1998-99*

Mygind N. (1994): The Economic Transition in the Baltic Countries - Differences and Similarities" pp.197-234 in *The Politics of Transition in the Baltic States - Democratization and Economic Reform Policies,* J. Å. Dellenbrant and O. Nørgaard, Umeå University, Research Report nr. 2, 1994

Mygind N (1995): Privatization and employee-ownership in the Baltic countries - a comparative analysis of conditions and development" pp. 199-284 in Mygind ed.: *Privatization and Financial Participation in the Baltic Countries - Midterm Results*, CBS,

Mygind N (1996): *Privatisation and Financial Participation in the Baltic Countries* mimeo, CEES, Copenhagen Business School.

Mygind N. (1996b): The Baltic Countries in Transition - a comparative analysis, in Mygind (1996) pp 13-94.

Mygind N (1997a): The economic performance of employee-owned enterprises in the Baltic Countries, *CEES Working Paper Series, no 6, 46 pages.*

Mygind N (1997b): Employee ownership and Participation in the Baltic Countries" in Uvalic and Vaughan-Whitehead (eds.)

Pohl G., Anderson R.E.,S. Claessens and S. Djankov (1997): Privatisation and Restructuring in Central and Eastern Europe: Evidence and Policy Options, *World Bank Technical paper no 368,* Washington D.C.

Purju, A. (1996): *The Political Economy of Privatisation in Estonia*, working paper, Centre for Economic Reform and Transformation, Heriot-Watt University, Edinburgh

Purju A. (1998): Interrelationships between privatisation methods, ownership structure and economic results: evidence from Estonia, conference paper 1st INTER-conference, Copenhagen, CEES/CBS august.

Purju A. and J. Teder (1998): Company adjustment and restructuring problems in Estonia between 1992-1995, working paper no 11, March, Tallinn Technical University.

Rajasalu T. (1994): Estonian Economy: Summer 1994, *Report*, no 2, Institute of Economics, Estonian Academy of Sciences, Tallinn.

Reardon, Jack (1996) "An Assessment of the Transition to a Market Economy in the Baltic Republics" *Journal of Economic Issues* vol. XXX, #2, June, 629-638

Semeta A. (1997): Economic Transition in Lithuania - 1996, mimeo, Vilnius

Shteinbuka. I. (1996) *Privatisation in Latvia and the Role of Employee Ownership*, in Mygind, 1996, pp. 155-200.

Sutela, P. (1994) Privatisation, Employment and Inflation in the Baltic Countries. *Communist Economies and Economic Transformation*, v.6, # 2.

Terk, E. (1996) “Employee ownership in Estonia” in Mygind ed., 1996.

Uvalic, Milica and Daniel Vaughan-Whitehead (1997) “*Privatisation Surprises in Transition Economies*” Elgar, Cheltenham, UK.

Venesaar U. and J. Hackey (1995): *Economic and social changes in the Baltic States in 1992-1994*. Estonian Academy of Sciences, Tallinn.

Vojevoda, L. and L. Rumpis (1993) “*Small Privatisation in Latvia*” mimeo, Inst. of Economics, Latvian Academy of Sciences.

World Bank (1993) *Latvia-The Transition to a Market Economy*

World Bank (1996) *World Development Report: From Plan to Market* Oxford Press, New York

World Bank (1998) *Lithuania - An Opportunity for Economic Success, vol. 2. Analytical Background,* World Bank Country Study, Washington D.C.