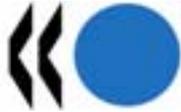


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REPUBLIC OF TURKEY
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**PRIVATIZATION
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**Conference on
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***Some Experience with Worker Participation in Czech
Privatization***

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Conference on “Privatisation, Employment and Employees”

SOME EXPERIENCES WITH WORKER PARTICIPATION IN CZECH PRIVATIZATION

INTRODUCTION

As seen from the historical view, the Czechs had good tradition in the development of economic democracy, employee ownership and financial participation.

Let us remember that in the pre-war time the country had a dense network of co-operatives in industry, trade and financial services (e.g. popular co-operative saving banks - „kampelicky“).

This idea of the real employee control of enterprises was significant part of the reform package of 1968 and subject of economic thinking and practical attempts to introduce it in praxis.

Partial attempts to reform the economy in 1988 just before revolution and a little before (impacts of “perestroika”) could not be successful but was also connected with some weak form of employee participation.

After revolution won in early 90-ies the concept of the political power which implicitly and later explicitly declared points of departure not compatible with trade unions opinion.

- Labor force as any other merchandise, is only subject of supply and demand on the market;
- Demonstrated aversion to trade unions, principles of representation of employees and collective bargaining, distorting market;
- Demonstrated aversion to the possible representation of employees in company boards (first of all possibility to influence the structure of board of directors)
- Demonstrated ideas of radical liberalism refusing solidarity in contrary with active, strong individuality.

The principal attitude of this, for many years ruling political power, to the idea of any privatization into the hands of employees, was refusing and envisaged as extremely harmful. Despite of it the new, independent trade unions, emerging in the revolution and actively participated as strike committees and in General strike, build up the position in society, which was now, after ten years recognized also by representatives of this political party.

Also trade union attitude had been changing. From the participation in national consensus concerning the adopted way of transformation to the subsequent solutions of problems arisen in the real life of transformation, employee position in enterprises included.

THE BACKGROUND OF DECISIONS OF THE PRIVATIZATION PROGRAMME AND DEDICATED ROLE OF WORKERS' OWNERSHIP.

In early 1990 the discussion initiated on the scope and form of large-scale privatization. The principal three possible designs or proposals (representing emerging differentiation of political concepts and interests) coming under discussion, were the following:

- a) Privatization should be restricted to smaller units. Large enterprises should be separated from the state (for example, by forming public holding companies subject to parliamentary control) and all efforts made to improve management and corporate governance in general. Privatization should be based on the enterprise's business plan and focus on attracting new capital or foreign strategic partners.
- b) With the exception of small businesses, enterprise ownership rights should be transferred to employees using some forms of employee ownership plans – ESOPs.
- c) Distribution of assets free of charge or for a nominal sum to all citizens.

Concept of the management by workers ownership figured in political programs of more parties - first of all in the Social Democratic Party election program in both the 1990 and 1992 elections, employee ownership appeared as a possible privatization method in some of the early 1990 government documents on the subject.

After the election victory of the Civil Forum (a political movement broadly and liberally oriented towards the introduction of a market economy) in June 1990, the ESOPs and employee management of enterprises lost support.

Private property-based reforms attained greater popular appeal. The Civil Forum was committed to the idea of voucher privatization, which also reduced the interest of general public for employee ownership: in this way everybody would become an owner, not just the employees of a particular enterprise. Also the defeat of the broad employee ownership concept in Kromeriz (Moravia), where participated president with Czech, Slovak and federal prime ministers contributed to the adoption of the fast privatization and shock therapy in transition. The reasons for this can be found predominantly in the interaction of politics, economics and interests of main players and the will of the broad population to change the social and economic order. More over, the participation of “all” population in (voucher) privatization was offered as a more general method embracing employees (employee ownership).

THE FEATURES OF THE ADOPTED PRIVATIZATION PROGRAM

The adopted large scale privatization program was based on the straightforward transfer of privatized firms to new owners – no particular rights for employees nor any prior restructuring. But the program was flexible in terms of the privatization methods admitted. Within the voucher scheme citizens could either allocate their vouchers to established investment privatization funds (included into the concept of voucher privatization) or use them to bid for shares in specific enterprises.

The privatization of each state owned enterprise was based on an approved privatization project, which had to contain a detailed description of the assets to be

privatized, the number and composition of the resulting privatization units, and the status of these units (limited liability companies, joint-stock companies, plain physical assets etc.). The privatization project also had to propose a method of privatization:

1. Transformation of a state-owned enterprise into a joint-stock company and subsequent transfer (distribution) of shares;
2. Direct sale to a predetermined buyer;
3. Public auction or public tender;
4. Free transfer to municipal ownership;
5. Free transfer to social security, health insurance and other publicly beneficial institutions.

The transformation of a state-owned enterprise into a joint-stock company (which was the most important method and used in the case of large state-owned enterprises) enabled this ways of the share distribution (allocation):

- a) Distributed through *voucher privatization* to Czech citizens;
- b) Sold directly to a domestic or foreign owner;
- c) Sold through an intermediary (stock-exchange or financial institution);
- d) Transfer free to municipalities and health insurance companies;
- e) Sold to employees in the form of *employee shares (10 per cent just immediately changed to 5 per cent, according to law)* ;
- f) Issued to former owners against their restitution claims (RIF–Restitution investment fund 3 per cent, according to law);
- g) Kept temporarily or permanently by the National Property Fund. The temporary means the shares will be sold immediately after the ongoing agreement is reached with strategic partner, the permanent ownership means the government will retain central control over key enterprises (various possibilities, inc. „golden share“ rights) .

In June 1991, the government approved and issued the list of enterprises to be privatized in the first and second privatization waves, further those which were to be liquidated and those which were to be privatized at a later date).

Any domestic or foreign natural person or legal entity (incl. trade unions, employs groups, employees together with management) was allowed (eligible) to submit a competing privatization project. Management of every state-owned enterprise dedicated (listed for privatization) was obliged and founder-ministry responsible, to prepare the so-called basic privatization project to be submitted by a given deadline

The assessment and scrutiny of submitted privatization projects was exercised by the Ministry of Privatization

The mechanics of the voucher privatization, yielding shares in joint-stock companies:

- 1) The privatization authorities issued a list of enterprises to be privatized for vouchers, giving a rough estimate of the book value of the assets to be privatized;
- 2) Czech citizens could then register their vouchers for an administrative fee of CZK;
- 3) Any legal entity could, under the conditions of the law, register an Investment Privatization Fund (with status of an independent joint-stock company), or an open or closed mutual fund;
- 4) The privatization authorities published a list of registered Funds;

- 5) In „Zero Round or Round Zero“ vouchers could be assigned to Investment Funds. Those who did not assign (allocate) their vouchers to Funds, they had to invest their vouchers individually (for selected enterprises) ;
- 6) The privatization authorities published a list of privatized enterprises giving information on their most important economic indicators, such as the number of shares offered, and share price in terms of investment „points“ (each voucher represented 1,000 investment points). In the first round, the prices were uniform; in subsequent rounds, the prices were adjusted upwards (if there was great demand for the share) or downwards (if there was little or no demand). Special price model has been used.
- 7) In every round, private individuals and Funds bid for selected shares on the basis of a given price. If the demand for a given share was smaller than or equal to its supply, shares were assigned to the bidders. Otherwise, shares remained unplaced and investment points remained with their owners (for the next round);
- 8) When the process had run its course (that is, when only a small fraction of privatization points remained unplaced), the bidding procedure was terminated and the remaining vouchers declared void. The privatization authorities had some discretion as regard when the bidding should be terminated; in both waves of voucher privatization, the number of rounds was small (5), the same as was the number of unused points (around 1 per cent);
- 9) After the bidding rounds had ended, the shares were transferred to individuals or Investment Privatization Funds;
- 10) The Investment Privatization Funds then issued their own shares and distributed them among their investors.

The privatization wave took about two years: 6 to 8 months were needed to collect and approve privatization projects, the distribution and registration of vouchers. „Round Zero“ and bidding for shares took more than 12 months, and another couple of months were required before the shares were transferred to their owners.

EMPLOYEE PARTICIPATION, OWNERSHIP AND PRIVATIZATION

The new Act on State-owned Enterprises (approved on 19 April 1990) stated the extent of employee management participation to a 50 per cent representation on the state-owned enterprises Supervisory board, the remaining board members being nominated by the founding branch ministry. **Supervisory Board** responsibilities included discussion of enterprise development, management and accounting supervision, the profit allocation and liquidation, merger and division. The boards were also allowed to propose to the branch ministry the dismissal of the state-owned enterprise's General Manager.

More important and perspective was situation in the case of state-owned enterprises transformed into the form of a (state-owned) Joint-stock company. Employee participation in the Supervisory Boards (German model with board of directors and supervisory board) of such enterprises was mandatory only if the workforce was greater than 200 employees; furthermore, employees were entitled to provide one-third of Board members (the Law on Joint-stock companies approved on 18 April 1990 –effective as of 1 May 1990). This form of employee participation has been transferred to the general Commercial Code (*Adopted on 5 November 1991 and in force as of 1 January 1992*), where employee representatives on Supervisory boards are obligatory for companies with more than 50 employees. Last situation after many amendments of the Commercial code – employees vote one-third of supervisory board members.

Since the approval of Act on Joint-stock Companies (18 April 1990), the Czech legal system has also introduced **employee shares**. The law of 1990 allowed joint stock companies (at the time mostly state owned) to issue free or discounted employee shares with the same rights as regular shares, with the sole difference that retiring or departing employees had to sell their shares back to the company. The mentioned Commercial Code limited the volume of discounted (from their face value) employee shares to 5 per cent of the enterprise's equity capital. The rights pertaining to employee shares may be different to those of regular issues, an option which has indeed been taken up by most enterprises. The recent solution has changed the status of employee shares.

Special legal provisions apply to employee shares. Employee shares could have been issued as a part of the privatization of state-owned enterprises. The rules and procedures were as follows:

- 1) The privatization project could propose that part of the shares in a privatized state-owned enterprise be issued as employee shares;
- 2) The Ministry of privatization – if it approved the privatization project as a whole – approved the issue of employee shares up to 10 (5) per cent of equity capital; the Fund of National Property transformed the state-owned enterprise into a joint-stock company and held all its shares, including employee shares;
- 3) The privatized enterprise bought employee shares at their *nominal value*
- 4) The privatized enterprise distributed employee shares in accordance with its Articles of association- (approved by two-thirds of shareholders present at the Annual General Meeting).

The employee shares have been in voucher privatization adopted for significant number of joint stock companies - out of 1,688 companies transformed in this manner, 480 proposed (and got approval for the privatization of part of their shares as employee shares. It is clear on the other hand, that even maximum of 5 per cent could not established control over the enterprise – unless effective participation in the voucher privatization of this enterprise by employees directly or via setting-up own investment privatization fund, which could bring good outcome. In the event only a minority of enterprises exercised this option. The main reason for this was incorrect evaluation of assets (enterprise's equity capital,).

Employee shares in the first and second waves of privatization, Czech Republic, 1995

| Employee shares | | No. of shares | No. of companies |
|--|-----------|---------------|------------------|
| First Wave | Approved | 2757100 | 220 |
| | Purchased | 1112406 | 82 |
| Second Wave | Approved | 2416870 | 260 |
| | Purchased | 920856 | 89 |
| Total approved | | 5173970 | 280 |
| Total purchased (1) | | 2033262 | 171 |
| All joint-stock companies privatized (2) | | 748218044 | 1688 |

(1) As of 7 February 1995.

(2) As of 31 December 1995. The figure refers to all joint-stock company shares approved for privatization, including shares not yet sold and strategically held by the state.

SELECTED CASES OF EMPLOYEE OWNERSHIP

Some managements encouraged their employees to invest voucher coupons into company or employees have expressed own internal interest to do so; a good example is ZPS Zlin, a machinery producer exporting to the advanced industrial countries. The ZPS Shareholders Association, which was formed by its employees, retirees and local residents, played an important role as one of the largest shareholders in co-operation with the enterprise management. ZPS Zlin was successful company. Nevertheless – the developments in this company led to economic fall and now is the company in the governments revitalization program (introduced under the social democrats ruling for retention of significant domestic companies, affected by the voucher privatization) .

Other large industrial companies have even established their own investment privatization funds with the intention to integrate employees and retain property (e.g. some big heavy industry companies in the northern Moravia region). But the fate of such cases is unknown – blocks of shares were probably sold in the process of the concentration and acquisition of shares for often unknown client (hidden domestic or foreign investor) by newly and quickly established agents of the capital market

Another example concerning companies, fully or predominantly owned by employees, are newspaper publishers. Several newspapers, originally (pre-1989) published by communist party-related organizations, were „privatized“ by their employees in the following way: the employees (led by the management) established a separate publishing company. At some point, the workforce left their former *employer en masse* and announced to their readers that the new enterprise will print in effect the same newspaper but under the slightly different title. In one case, the incumbent publisher tried to continue publishing the original title (“*Zemedelske noviny*” or “Agricultural News”, published by the Ministry of Agriculture); all other publishers agreed to sell or lease their rights to the new publisher, including “*Mlada Fronta*”, the daily with the highest circulation. “*Rude Pravo*”, the daily of the Central Committee of the Communist Party, was privatized in the same way, but without employee ownership: the new publisher was fully owned by its editor-in-chief and director. New title assigned: “Pravo“.

The former dissident monthly “*Lidove Noviny*”, which became daily in 1990 and was re-established as company controlled by the “Association for “*Lidove Noviny*”, was transformed into an employee-owned joint-stock company. Every employee was given the right to purchase up to 1,5 per cent of shares at a discount. At the end of 1992, over two-thirds of the shares were owned by employees and their relatives, the rest being held by the Association.

Partly because of economic difficulties (the newspaper market became very competitive in the early 1990s), and partly because of no one wanted to continue to run them on an employee-owned basis over the long term, all important employee-owned newspapers were sold to foreign publishing groups: starting with *Malta Front* – sold to the French publisher Hasn’t – and ending with *Lidove Noviny* which was sold to the Swiss publisher Ringer, when the employees decided to sell first part of shares and then the majority of them to another owner. By 1990, none of the national dailies remained in the hands of their employees.

Many important Czech banks have used employee co-ownership to stabilize their position and improve staff motivation. The second largest bank in the country, Komerčni

banka, has given its employees (60 per cent of them used it) the opportunity to subscribe a limited portion (1 per cent) of the new share issue under favorable conditions (the discount on the market price was 50 per cent). Because of stock market collapse, the price fell below even under the discounted price. Many employees also purchased shares in the bank in the course of voucher privatization. The participation of employee-owners is as low as that of other small (minority) share holders.. No shareholders' associations or other body was formed to represent the interests of employee-shareholders until final (recent) change of the role of employee shares by Commercial Code in 2000. Despite the disappointment caused by the price development of the shares sold to employees in 1994 the bank maintains that partial ownership represents an important means of motivation, especially for managers. Therefore the bank intends to continue in introducing the share option plan in next years.

A similar approach by issuing new shares was used by other banks. This activities have been finished by privatization of government portions of shares and in this way by the completion of privatization of the Czech banking sector. New owners, groups of foreign banks, will present own policies in this respect.

CORPORATE GOVERNANCE AND PRIVATIZATION

When doing assessments of the first part of the privatization ending with the distribution of shares of companies and investment funds, in the country emerged over night millions shareholders. In the next process of spontaneous concentration ("third wave of privatization"), the illusion of popular capitalism disappeared. Voucher privatization was unprecedented economic experiment, which has totally changed relations and property distribution. After liberalization of the economy, prices, opening foreign trade, domestic market, inflow of foreign investment changed also total social and economic environment. But voucher privatization has not changed the control of the state over largest Czech banks, large productive enterprises and public services and utilities – join stock companies (government retained majority or significant amount of shares).

Huge number of economic subjects after privatization operated in the "market" environment without firm and enforceable rules and without a moral basis, standard capital market institutions. The situation of large enterprise was bad due to mutual indebtedness and behavior of the management during "pre-privatization agony" and after privatization. The spirit of trust disappeared. Social capital has been damaged when applying concept of radical liberal egoism. Some critics say the voucher scheme was neither efficient nor fair. We can only demonstrate the lack of transparency, corporate governance and corporate responsibility and instability. After privatization, the bad (mostly privatization) loans of banks amounted 40 to 50 per cent. The public costs for cleaning balances of the banking sector were 14 per cent of GDP (250 billions of CZK) and another 200 billion CZK for strengthening of banking assets at the beginning of transformation. In the economy operated 63 banks, 21 of them lost licenses because of failures. There were 426 investment funds registered at the beginning of privatization, many of them disappeared from market with property of their shareholders. Now we have about 15 functioning pension funds and another 15 in liquidation. The same can be sad about popular co-operative saving banks or real-estate market (housing developers) in liquidation – damaged heavily own clients.

One of the reasons was weak, if any, regulation of capital markets. The failure of the state as the guarantor of justice in economy and huge proprietor without responsible

exercising and enforcement of property rights was reason of economic crime. Nobody can summarize the costs of this kind of transformation. Everybody can understand, that trade unions fully refused responsibility for the developments and in every time have raised proposals for the way out.

It is true, that many things have changed since last three or four years. In particular total change of the attitude to the significance of the economic policy (especially microeconomic measures, regional policy and employment policy) helped attract renown foreign investors, their role in the economy is recognized. At this attitudes may be expected the development of trade union approach to employee ownership more positively. Representatives of trade unions (or work councils) in supervisory boards (one-third) of joint stock companies or in the tripartite body (Council of the social economic accord) on the national level do the best.

The real privatization has not yet been completed. We have to participate in the responsible preparation of privatization in significant sectors, where state is majority or substantial owner (communications, railway, energy, gas, water, metal industry etc). We do the best, that privatization will be successful with minimal transformation costs (employment) end optimal effect for the economy.

Trade unions co-operate with employers-associations and government bodies in extension of good practices in responsible management, invited Code of corporate governance of the Securities commission, support international movements toward social and environmental responsibility and protection of human and labor rights.

In general, the Czech voucher privatization should remain only history and a huge costly experiment.

CONCLUSION

Lack of official promotion for employee ownership and other forms of participation was typical for the Czech transformation. But after ideological victory of the voucher method and achieving the general consensus for fast transformation with the deep liberal elements, hardly somebody expected (despite of continuing criticism) something other. Government (right wing orientation) wanted to push-through private property and entrepreneurship. Vouchers – there is opportunity for all – not only employees. On the other hand, the government (architects of privatization) has not discriminated against employee ownership – but using combination of market game principles and the restriction of the portion of shares dedicated to employees. This did not encourage employees to bid for shares in their firm.

Czech way, in maximizing the national consensus and involvement of population in the privatization has focused heavily on voucher privatization – the free distribution of shares among citizens. The vast majority of the participants in voucher privatization have chosen to use their vouchers through special financial intermediaries – Investment Privatization Funds. These funds, many founded by banks, have become the most important owners of privatized companies. Since this funds (restriction by law) may not own more than 20 per cent of the shares in a single company, voucher privatization caused (has resulted in) dispersed ownership. Moreover, investment funds used to be mostly passive owners

Employee ownership was originally intended to become a complementary privatization method to voucher privatization

The history of employee shares as a special category of company shares with special rights (and disadvantages) has been finished by the so-known Euro-amendment of the Commercial Code. Now, according to the Articles of association, the company can transfer shares at favorable terms without restriction for employees.

Some companies continue in attempts in using employee shares to stabilize and motivate their labor force (there are also some examples of multinational, like Siemens, in commerce- retailers chains etc.). The role of the employee ownership may increase when broader pension reform will occur. But according to the recent thinking, we can not expect a mass conversion of companies to employee ownership (Despite of all problems and circumstances in the course of privatization, lastly attempts for recovery of the concept of the employee participation we can find in the declaration of the social democrats minority government in 1998. But appropriate proposals did not find enough support - like at the beginning of transformation.

Czech trade unions and employees could participate also in small-scale privatization and did it. Trade unions could establish own privatization investment fund, even trade union bank. This possibilities were not used due to above mentioned reasons.

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