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*In co-operation with the World Bank Group*

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**"Transparency and Disclosure"**

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**Session 1: Disclosure and transparency: what is at stake?**

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## **PRIVATIZATION IN SERBIA - Lack of Institutions -**

Designing of privatization models begins with an ideal situation wherein the anticipated processes should bring about a desirable outcome. Privatization goals are manifold - from transformation into a more efficient model of capital organization, through budget replenishment, to a definition of the chief transition direction, which is to establish economic and political democracy.

However, when applied, such goals come into conflict with real interests of the holders of political and economic processes. What eventually will prevail depends mostly on the degree of institutionalization of privatization process, assuming the development and strength of institutions critical to privatization - i.e. financial market institutions. Only if these processes are conducted through the institutions we could hope to have the Polish model result. Otherwise, the processes fluctuate under the pressure of other, non-strategic interests, taking the road towards the so-called "tycoonization", as recognized in Croatia.

To foresee the possible routes of privatization it is necessary to observe firstly the holders of realization of strategic and designed goals, then the holders of realization of real goals, finding out what instruments and institutions they both have at their disposal.

### **HOLDERS OF INTERESTS**

Holder of strategic interests, the realization of which should bring about not only the more efficient ownership structure of economy but the establishment of economic and consequently political democracy, is the state. Program elements in Serbia were formulated in the document prepared by G17 PLUS for the Democratic Opposition of Serbia on the eve of the September 2000 elections. This document however provides only hints. Privatization as a whole process was developed by Serbian Ministry for Economy and Privatization through the new Law (in effect as of 2001) and a series of bylaws.

The importance of privatization for transition and transformation of the whole society into a civil society, based on private property and market economy, has unfortunately been left unstudied. Thus the privatization is restricted in narrow program frames, implying that its positive results could remain unexploited up to their maximum.

Meanwhile, through the realization of this strategic interest, the state is in opposition to the short-term, almost daily interest, which pressure cannot be irrelevant. It is about the necessity of budget replenishment, for which the privatization proceeds are foreseen. Due to the initiated fiscal reform, budget centralization and the introduction of treasury in the Ministry of Finance, this pressure so far does not take an extent which could threaten the realization of strategic goals of privatization, and it is likely that such a tendency would continue.

Workers have their interests in the process of privatization as well, both strategic and short-term. Bearing in mind a saying that the best social policy for poor countries is the policy of economic development, the strategic interest of workers is undoubtedly a speedier and genuine privatization. This has remained in contrast to the short-term interest of each individual to keep the job.

The initial resistance to privatization stems from these short-term interests. The decisive moment in winning over the workers, through their unions, to support the strategic goals, i.e. privatization, is related to negotiations between ministers for privatization and finance of the Serbian Government and unions of metal and automobile complex of Zastava. Following that, other large enterprises call for the same model of "zastavization" as a solution to their own surplus of labor and lay-offs during the process of restructuring and privatization of their enterprises.

Speaking of workers, another reason for their ambivalent position should also be mentioned. Earlier laws on privatization made shareholders of them, creating a schizophrenic situation for both the employee and the employer at the same time. This position only strengthens the fundamental dilemma: a worker as a shareholder should seek the improvement of his enterprise and support its restructuring, including job reductions; meanwhile a worker as an employee strives to keep his job at all costs.

Enterprises make the third interest group in Serbian privatization. To put it simply, there are two groups of managers running the Serbian economy. The first group are those who have built their business empires in last 12 years, relying on the political power holders in former regime. Their position has from the onset been quasi-monopolistic, with their profit deriving from it, which likely means that they wish to maintain a status quo in the future. Privatization would be in their interest only if they could get a control of it by overtaking other companies. This has not been a massive case so far, perhaps because such giants were created not through privatization of state or socially-owned companies, but through overtaking/privatization of their businesses.

The second group of managers are those governing former and present socially-owned companies. It should be born in mind that those who managed the most successful companies have used the last moments when the old law on transformation of ownership was still in effect and transformed the socially-owned companies to shareholding companies. To put it more precisely, quasi-shareholding companies, as shareholders/workers have a very little knowledge of shareholding and rights which the ownership of shares provides.

Speedy and complete privatization does not suit this group of managers as well, particularly if it carries the hazard of overtaking the majority block of shares by strategic investors, which is encouraged by the Law on Privatization. What applies for the managers of the companies which are in between of shareholding and state ownership, could even more be applied for socially-owned companies, i.e. for the whole segment of small and medium-sized socially-owned companies.

## **REALIZATION OF INTERESTS**

Each of these three interest groups naturally seeks to satisfy its own interests, using all permissible methods at their disposal. The state has created institutions which launch the process of privatization in every enterprise: Agency for Privatization and Share Fund, which manage the shares taken over by the state on the basis of previous Law on Transformation of Ownership. An interim share register with the Ministry has also been formed, which should verify the ownership on shares in the period prior to the new Law.

Through the Law and bylaws, the state has appointed other institutions for the sale of shares, i.e. the auction of companies which are on sale. This refers primarily to stock exchange. It could

be said that incapability of adjusting the existing institutional network to the needs of not only privatization process, but financial market in formation as well, stems from there.

Managing Board of the Belgrade Stock Exchange has four ministers as its members - three of them from the republican and one from the federal government. Most of other Board members went to the Agency for Bank Rehabilitation, following the bankruptcy of the four major business banks. Finally, brokers have only three members. The Board structure makes the Stock Exchange look more like the governmental agency than a market institution. This happens in the time of necessity to sell the majority of capital in the state and determine its market price as precisely as possible.

It is needless to point out a discrepancy between the methods of the state administration managing and managing of what should be a *par excellence* market institution, opening up the space for malpractice, regardless of competence and benevolence. Stock exchange as such has no impact either on managing boards discipline or their control. This is undoubtedly the first impediment to the achievement of the privatization strategic goals.

Given the above facts, the protection of rights of small shareholders, or investments in general, can hardly be taken into account, because the split position of workers as shareholders and employees additionally opens up the space for the manipulation of workers' interests as small shareholders<sup>1</sup>. Principles of shareholding and corporate governance can barely be discussed without an efficient stock exchange, connected to market and open to all interested parties. It is even more difficult to address the establishment of confidence in financial market and moreover in the whole new system the formation of which has only started.

Institutional insufficiency is further contributed by the position of the Security and Exchange Commission, being a federal institution. Montenegro has formed a separate Commission, so that the federal Commission regulates the Serbian market exclusively. This opens up the possibility for political opposition to the decisions of Commission, whenever opportune, which reduces *de facto* the effects of the Commission's *de iure* work.

Further deprivation of the small shareholders' rights is provoked by the lack of investment funds. Without these, it is impossible to merge small interests and consequently to obtain a greater significance for small investors.

There is also the third group active in this area - a group of managers. The lack of institutions, low level of shareholding culture, non-established mechanisms of market and investors protection leave ample possibilities to this group. As of previous period to this date, there has been an established practice of acting towards the state administration for both subgroups - taycoons and managers of new shareholding and socially-owned companies. Such a practice is supported by the fact that there are no serious changes of personnel in the state administration, which gets an additional dimension in privatization - old groups tend to guard their interests.

To protect their own interests, managing boards of the new shareholding and socially-owned companies have at their disposal another direction of activities - towards employees, as their shares are needed to establish and maintain the control over enterprises. More than enough

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<sup>1</sup> It is interesting that certain unions have started to insist on workers' education on the principles of shareholding and rights based on share ownership, which is in contrast to their supposed role in the system.

possibilities of malpractice are available, including, for example, depreciation of shares or exclusion of unwanted buyers from the exchange auctions.

This ends up with the management-buy-out-model of privatization, under the conditions created by the management itself, which either exclude all other interested parties, or place them in an unfavorable position, instead of the intended investment model, outlined by the Law. Thus the interests of one group are satisfied, but the state interests, relative to the budget replenishment, as well as to the strategic goals of privatization are undermined. The methodology of origin speaks a lot about the nature of further development - if something was created irregularly it would demonstrate strong tendencies to develop in the same manner, and to re-produce the conditions under which it was created. Such a buy-out by the management would jeopardize the rights of small shareholders as well, presuming the rights of workers in the case of Serbian privatization.

Capital should by all means finish up in the hands of those most capable. This is one of the privatization goals. Both sub-groups of managers are certainly competent, as they have managed to sustain their companies, and to enlarge the capital in many cases in the most unfavorable conditions of a rigid anti-market regime and international sanctions.

The capability to survive in such conditions does not offer a safe guarantee of the successful capital management in normal conditions. There is a reasonable trend to renew the conditions in which the capital was made initially, assuming illegitimate and insufficiently institutionalized conditions.

The civil society model, which should be an ultimate goal of transition, presumes that the function of profit and social development both go in the same direction. This could be achieved only if processes are assigned to institutions, whereas the institutions are provided with efficient instruments of influence on processes.

In other words, only strong institutions provide that individual entrepreneurial skills make no damage to the society. In Serbia at present, the process of privatization needs the following steps so as to provide that its result do not come in contrast to the strategically proclaimed goal:

1. To reform the Stock Exchange;
2. To strengthen the Security and Exchange Commission, not excluding the establishment of republican and regional commissions, taking into account the specificities of regions;
3. To establish the central securities register, with the Payment and Settlement Bureau and
4. To form investment funds.