Mikael Olsson

Ownership Reform and Corporate Governance
The Slovak Privatisation Process in 1990-1996
ABSTRACT

Since 1989, there has been a period of rapid change of the economies of the former Eastern bloc. Within a few years, the majority of the formerly centrally administered economies had begun restructuring their economic systems, including the privatisation of formerly state-owned enterprises. This process developed differently in different countries, depending among other things on their historical traditions and the momentum of their social, political and economic transformations.

This doctoral dissertation examines the privatisation of large-scale industrial enterprises in Slovakia prior to 1997. In particular the thesis analyses the changing political and institutional framework governing the process and method of privatisation; and how the governance of firms was affected by the new markets and ownership- and control-structures that were established. Special attention is paid to the role played by investment funds and investment companies established as a consequence of voucher privatisation. The research problem is approached both from an aggregate national level and from the enterprise level. The thesis includes a number of case studies of enterprises in Slovakia that underwent privatisation, and of investment funds that emerged to take part in the process. In addition, two panel-data sets were constructed for the sake of statistical analysis.

The study points to the drastic changes in privatisation policy and its enactment, under different governments. It leads to the conclusion that privatisation is a highly political process, whose economic effects cannot be separated from its distributional effects. This politicised nature of ownership reform is shown to have some negative side-effects with regard to the development of well-functioning governance structures. It is, for example, pointed to that the capital market, as it developed during the period of study, was highly non-transparent, characterised by high transaction costs and insider-trading. The study also documents an increasingly concentrated ownership structure of the Slovak industry and relates it to the changes in privatisation policy. In the final analysis attention is drawn to a recurring theme in the study, namely the issues related to the relative stability and durability of the institutional set-up. In many cases an insecurity about “the rules of the game” led to short-term incentives and opportunism on behalf of the economic and political agents.

Keywords: privatisation, ownership reform, corporate governance, the Slovak Republic, restructuring, property rights, financial sector development, economic transition, communist economies, path dependence, institutional economics, investment funds, transformation

Mikael Olsson, Department of Economic History, Uppsala University, Box 513, SE-751 20 Uppsala, Sweden

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To Tyra and Rut, my late and beloved grandmothers.
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Mikael Olsson
List of frequently used abbreviations

- figure illogical or not calculated (in case of official statistics)
  . figure missing in table
  a.s. akciová spoločnosť (joint-stock company)
  ANOVA analysis of variance
  ASIF Asociacia investičných spoločností a investičných fondov (Association of Investment Companies and Investment Funds)
  BCPB Burza cenných papierov v Bratislave (Bratislava Stock Exchange)
  BOB Bratislavská Opcná Burza (Bratislava Options Exchange)
  CEO Chief Executive Officer
  CFO Chief Financial Officer
  CMEA Council for Mutual Economic Assistance
  CNB Česka Narodna Banka (Czech National Bank)
  CPC Central Planning Commission
  CPP Competing Privatisation Project
  CR Czech Republic
  CSB Česká Skupinová Banka (Czech Savings Bank)
  CSFR Czech and Slovak Federal Republic
  CSOB Československá Obchodní Banka (Czechoslovak Trade Bank)
  CVP Centre for Voucher Privatisation
  DIK Družba investičných fondov (holder of investment voucher)
  DS Demokratická strana (Democratic Party)
  DU Demokratická strana Slovenska (Democratic Union of Slovakia)
  EBRD European Bank for Reconstruction and Development
  FMF Federal Ministry of Finance
  FNM Fond Národneho Majetku (Fund of National Property)
  GDP Gross Domestic Product
  GIF Garantovany Investicny Fond (Guarantee Investment Fund)
  HC&C Harvard Capital and Consulting
  HC&CS Harvard Capital and Consulting Slovakia
  HIS Harvardská Investicna Spolocnost, a.s. (Harvard Investment Company, Inc.)
  HSNPP Hlinka Slovaka Național People’s Party
  HZDS Hnutie za demokraticke Slovensko (Movement for a Democratic Slovakia)
  IB Investičná Banka (the Investment Bank)
  IC Investment company
  IF Investment fund
  IMF International Monetary Fund
  IIF Investment privatisation fund
  IPOs Initial public offerings
  IRB Investičná a Rozvojička Banka (the Investment and Development Bank)
  KB Komercni Banka (the Commercial Bank)
  KBB Konsolidácia Banka Bratislava (the Consolidation Bank of Bratislava)
  KDH Kresťansko-demokratické hnutie (Christian Democratic Movement)
  KSC Komunistická strana Československa (Communist Party of Czechoslovakia)
  KSS Komunistická strana Slovenska (Communist Party of Slovakia)
  LMBO Leveraged Management Buy-Out
  MANOVA multiple analysis of variance
  MICR Ministry of Industry of the Czech Republic
  MKDH Magyar kereszténydemokrata hizmet (Hungarian Christian Democratic Movement)
  NACE Nomenclature des activités économiques (Nomenclature of economic activities)
  NAV Net Asset Value
  NBS Národná Banka Slovenska (National Bank of Slovakia)
  NIE neo-institutional economics
  NMP Net Material Product
  ns not significant (in statistical tables)
  ODS Občianska Demokraticka Strana (Civic Democratic Party)
  OECD Organisation for Economic Co-operation and Development
  OF Občianske Forum (Civic Forum)
PFA  “Privatisation from above”
PFB  “Privatisation from below”
PM  Prime Minister
PPF  Privý Privatizačný Investičný Fond (First Privatisation Investment Fund)
PPP  Primary Privatisation Project
PSIS  Prvá Slovenská Investičná Spoločnosť, a.s. (First Slovak Investment Company, Inc.)
RIF  Restitúčny Investičný Fond (Restitution Investment Fund)
RM-S  RM-System
s.r.o.  spoločnosť s ručením obmedzeným (limited-liability company)
SAX  Slovenský Akciový Index (Slovak Share Index)
SBCS  Státní Banka Československá (State Bank of Czechoslovakia)
SCB  Statistiska Centralbyrå (Swedish Statistical Office)
SCP  Sredisko cennych papierov (Central Securities Register)
SDL  Strana demokratickej lavičky (Party of the Democratic Left)
SIEEE  Stockholm Institute for East European Economies
Sk  Slovenská koruna (Slovak crown)
SNC  Slovak National Council
SNS  Slovenská národná strana (Slovak National Party)
SOE  State-owned enterprise
SR  Slovak Republic
SSB  Slovenská Sporiteľná Banka (Slovak Savings Bank)
SSE  Stockholm Stock Exchange
SSR  Slovak Socialist Republic
SZB  Slovenská Zaručná Banka (the Slovak Guarantee Bank)
UK  United Kingdom
UN ECE  United Nations Economic Commission for Europe
UNCTAD  United Nations Conference on Trade and Development
US  United States
VHJ  Vyrobne Hospodarske Jednotky (Production Economic Units)
VPN  Verejnost Proti Nasiliu (Public Against Violence)
VSZ  Východoslovenske Železariene a.s. (Eastern Slovak Ironworks, j.s.c.)
VUB  Všeobecná Uverová Banka (the General Credit Bank)
ZB  Zivnostenská Banka (Entrepreneurial Bank)
ZIF  Zlatý Investičný Fond (Golden Investment Fund)
ZRS  Združenie robotníkov Slovenska (Association of Workers of Slovakia)
CHAPTER I

Introduction

‘In the absence of any valid or, for that matter, any kind of prescriptive “ex-ante” revolutionary theory in the East (or a positive and predictive theory of the demise of the Soviet empire in the West), the task of the social scientist is to understand in retrospect what actually happened.’

Claus Offe1

It now seems clear that the year of 1989 did not mark the ‘end of history’,2 but instead the beginning of an era of rapid and radical political, social and economic change, affecting a large part of Europe. The present study concerns one part of this change, namely the process, problems and results of ownership reform in the parts of Europe that experienced the rise and fall of the communist experiment, i.e. Eastern Europe.3 The issues will be studied using the case of the Slovak Republic (Slovakia), which until 1 January 1993 was part of the Czech and Slovak Federal Republic (CSFR), a statehood which just like the communist economic system has also since ceased to exist, at least nominally. By the time of the so-called “Velvet Revolution” of November 1989, the Czechoslovak economy was the most socialised in the region with 97 per cent of its net material product (NMP) originating in a, by and large, unreformed state-administered sector with a predominance of large firms.4 This made ownership reform and the establishment of institutions and mechanisms for corporate governance a more daunting task than elsewhere in the region.5

Many goals have been associated with ownership reform, and these are not only economic, but also political and ideological in character. The more commonly

2 See Fukuyama (1989); also, compare footnote 3, p. 53.
3 In the following the political term Eastern Europe is used to denote Bulgaria, the former Czechoslovakia, Hungary, Poland and Romania. Out of convenience, and to minimise confusion, the same term is used when reference is made to the same geographical area also in the post-1989 setting.
4 Savas (1992), pp. 573-574. NMP is the measure most oftenly used during the communist era, in comparison to GDP it excludes depreciation and the value added from most of the service sector; in an international comparison it can be noted that Great Britain under PM Thatcher cut the part of GDP produced by state-owned enterprises from 11.5 per cent in 1979 to 7.5 per cent in June 1987, see Vickers and Yarrow (1988), p. 1.
5 On definitions of corporate governance, see footnote 15 and Chapter II:4.
stated economic goals include the following: a hardening of the notoriously “soft budget constraint”;\(^6\) a closer approximation to profit maximisation as the main goal for firms;\(^7\) encouraging the “creative destruction” and reallocation of resources connected to freely transferable rights to ownership (property rights). Finally, ownership reform has been considered a necessary though insufficient pre-condition for the establishment of institutions and mechanisms of corporate governance, which in turn has been seen as a pre-condition both for profit maximisation and “creative destruction”. In this sense ownership reform in Eastern Europe differs from privatisation programmes in western Europe since they are not only about achieving marginal efficiency increases, but rather about the creation of the basic institutions necessary for a functioning market economy. These privatisation programmes are thus also seen to be “institution-building” programmes.\(^8\) The mere transfer of ownership is thus not sufficient to establish a capitalist market economy, it has to take place as part of a process where it is also necessary to establish the ground rules (laws and regulations pertaining to ownership and property rights), the arena (the market and mechanisms for law enforcement), the players (firms, managers, owners, creditors, enforcement authorities etc.) and a more market-oriented efficient and enforceable incentive structure (various mechanisms related to corporate governance).

Bearing in mind the heritage of more than 40 years of communist rule, we will see just how difficult a task it would prove to establish the institutional set-up supportive of a market co-ordinated economy. These problems became especially apparent in the area of ownership reform where the communist era left its mark on a variety of levels; for example, by leaving a powerful platform for the vested interests of incumbent management which had \textit{de facto} control of productive assets during the previous regimes and by eroding most traces of private ownership in the sphere of industry and trade. These problems and the underlying rationale notwithstanding, privatisation was at the time deemed imperative and the Slovak Republic (then CSFR) embarked upon a path of reform where privatisation of the majority of state-owned assets constituted a cornerstone. These developments in Slovakia, their causes and effects, form the focus of this study.

1. A new field of research

The changes in Eastern Europe and the former Soviet Union opened up a whole new field of research. Sovietologists and researchers previously engaged in area studies were joined by many other academics who were attracted by the happenings in the area, partly on intellectual grounds, partly on ideological-political and personal grounds. This led to professionalisation in the field with many prominent re-

\(^6\) On the soft budget constraint, see discussion on page 63 ff.
\(^7\) The terms of the \textit{firm}, the \textit{company} and the \textit{enterprise} will below be used interchangeably.
\(^8\) \textit{Privatisation} is in this study defined as the state-led activities aiming at the sale or transfer of publicly (state) owned assets to private interests, thus excluding any of the wider definitions which may include policies of deregulation and restructuring of public enterprises. A further elaboration and definition of the concept of privatisation is made in Chapter IV:1. The concept of \textit{ownership reform} should accordingly be interpreted as a wider and more far-reaching concept.
searchers from the fields of law, economics, political science, sociology etc. taking an active interest in the developments in the region. Research on “transformation” has thus taken a number of directions and can today be found in many disciplines. For example, the process of democratisation of these formerly communist societies, with their different experiences and preconditions, is a strand of research which has attracted prominent scholars. An issue of special interest, which involves economists as well as political scientists, has been the relationship between the institutionalisation of democracy and the establishment of a market economy. In addition to this, research among economists, which have been the most numerous, early came to cover a wide range of topics, for example the output collapse, trade reorientation and various attempts to apply growth theory.

Many economists have also taken an active part in policy formulation in these countries; others, who either chose not to or were not invited, remained observers, researchers, or sometimes just plain obstructionists and critics. In the latter group, many have with the benefit of hindsight rightly criticised many of the wrongdoings and bad advice etc., and claimed that things could have been done differently and better. For example, lessening the output decline by keeping up investment. The irony, or rather the problem, is that such alternative solutions to some extent were as “theoretical” as some of the reform scenarios adopted (and criticised), and in a sense based on the same erroneous ideas of perfect information and foresight. Oddly enough, economic historians have so far largely shunned this opportunity to study societal and economic change first-hand. Important lessons can, and will as time goes by, be learned about the properties, conditions and hindrances for radical economic, political and social change. Part of the explanation for the lack of interest may be that the situation with regard to source material has not been sufficient for more traditional economic historians to take on the subject. This study is nevertheless an attempt to do so, despite the lack of traditional source material, which often has become the hallmark of economic history as a discipline. Although more complicated, it should be possible to approach the core of economic history research.

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9 Some of the “new” researchers had previously studied similar issues, i.e. questions about democratisation and the opening up and liberalisation of economies, in a Latin-American context which in this sense had functioned as a predecessor to the “transition” research being done on Eastern Europe. Examples include Adam Przeworski, cf. Przeworski (1991), and Jeffrey Sachs, cf. Sachs (1989; 1990) and Paredes and Sachs (1991).

10 Throughout the present study the term “transformation” will be used rather than the more popular term “transition”, since the latter implies that the economic changes have a clearly defined goal and that the point of departure is equally clear. Since neither of these propositions hold, the term transformation is preferred. The choice is also a consequence of the fact that one ambition with the study is to point out the difficulties with achieving economic goals when decisions must be made by agents (politicians) with widely differing interests (or, “utility functions”).

11 For seminal research in this field the reader is referred to Przeworski (1991), see also Bornefalk (1998). A different approach is offered by Offe (1997) who views the transformation as consisting of three different ones – the development of a market economy, democratisation and nation-building in a wide sense.

12 The debate about the pros and cons of so-called shock-therapy and gradualism, respectively, will not be dwelled upon in this study, although a brief account of the main lines of discussion is found in Chapter II:5.1. An interesting overview of parts of the debate is found in Portes (1994) who, however, noted that the debate was yet an ‘example of slogans replacing analysis.’ (p. 1180) – in itself a reason for avoiding the debate as much as possible in this study. A consequence is that relevant research will be referred to when appropriate throughout the study rather than to make a failed attempt to give an all-encompassing initial overview of the issues and stand-points put forth to date.
namely to answer questions concerning economic and social transformation processes in a relatively long-term and structural perspective. The aim of studies in this tradition is thus to describe and analyse dynamic developments and thereby create an insight and understanding of the aims, causes and implications of such change. Economic historians in this sense have a potential advantage as compared to economists proper in: (i) being accustomed with empirical research concerning long-run dynamic developments in a path-dependent context; (ii) having an openness in the use of analytical tools and source material; and (iii) being used to combine quantitative and qualitative methodology. The ambition of the current study is thus that the economic-historical approach will make a useful complement to studies carried out by researchers in other disciplines.

2. The problems and aim of the study

At the outset of reform the malfunctioning and discredited state-apparatus (planning agencies/ministries) stood as formal founders/owners of the whole industrial capacity in the Slovak Republic, but with precious little capacity to manage and guide the constituent firms.\(^{13}\) The vast majority of these firms had been founded on political grounds during the communist era, and their output had been sold on the artificial CMEA market where prices had no meaning and money no value without an accompanying allocation order from the central authorities. Managers had been isolated from competition and made their careers in a system with direct disincentives to innovation and with strong incentives for cheating on their superiors (ministries and central planning agencies). With centrally administered resource allocation and soft budget constraints, implying a situation where production was limited by the access to the physical means of production rather than the financial resources to pay for the inputs, management thus had no prior experience of a situation where the survival of the firm was dependent on factors such as productivity, sales, quality, profits, marketing; nor had they been given the incentives to focus on such matters. In the words of Clark and Soulsby the system had ‘led to a lack of concern with finance, costing, quality and selling’,\(^ {14}\) factors that are at the core of modern business. Maximisation of the net present value of the assets had, in an intentionally crude characterisation of the communist economic system, neither been possible (no real markets, money or prices), nor heard of. Rather, what was to be maximised from the viewpoint of management was the amount of input (allocation orders), with the implicit objective of minimising output (production targets). In this way the communist economy had almost reversed the “normal” logic of management and entrepreneurship.

With the collapse of communism and the communist economic system, it was deemed necessary to establish a new system for corporate governance, i.e. a new set

\(^{13}\) At end-1989 there existed in the Slovak Republic 156 registered industrial firms, all state-owned, and only six with less than 500 employees, see Appendix D, TABLE 8 (p. 324).

of institutions and mechanisms working to purvey market signals to managers. An important part of this change was to replace the above characterised state management apparatus with new principals (owners), having goals, priorities and incentives other than those made possible by the state-socialist structures, i.e. *ownership reform was seen as necessary*. If ownership reform was to have any meaning, it would however also be necessary to establish the channels through which the priorities of the new owners could be transformed into incentives for management, i.e. *institutions and mechanisms for corporate governance had to be established*. This need was the most pressing for the large industrial firms where the traditional owner-entrepreneur was least likely to materialise, and where the problematic separation of ownership and control has come to be considered a more or less natural state-of-affairs. It is consequently on industrial firms that this study will focus.

In the overall complexity of economic transformation it is these two problems, namely to establish new owners for the existing industrial capacity and to establish new institutions and mechanisms for corporate governance, that are chosen as the core questions of this study. Although this study is concerned with the developments in the Slovak Republic, these are questions which, to a greater or lesser extent, all transforming economies face and therefore have a general interest. They are also crucial in that their resolution will affect the potential for dynamic growth for a long time to come; and, they are of great interest since ownership reform of this scope and scale had never been attempted before. A further reason for focusing on industrial firms is that it is here that attempts of applying techniques and models for privatisation never used before were found, for example mass privatisation through the free distribution of assets – in and by itself warranting research on the topic. With the basis in these two problems, the aim of the study can be summarised in two distinct, although interrelated, questions that will guide research along the themes outlined below. Firstly, how was privatisation achieved? Secondly, what structures have emerged for corporate governance?

**The process of privatisation**

The first and principal theme concerns the analysis and description of the process of ownership reform in Slovakia. Of interest is to establish how such a radical change in ownership structure was brought about. The following questions helped to guide research on this matter. What ownership structure was inherited from the communist economic system? What goals and motives were underlying the process of privatisation? What means were chosen to realise the privatisation of assets? How were the methods for privatisation applied and/or changed? Further, what actors and/or groups of actors were influential in the process?

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15 Corporate governance in this sense work as a complement to economic competition, which fulfils basically the same function. There is, however, problem of operationalisation connected to the notion of corporate governance when applied on a societal level. The term is neither unambiguously defined, nor is there any deeper sense of agreement as to what constitutes the “best” system for governance. As indicated the intention is to apply a broad perspective where the system for governance is seen as dependent on the over-all institutional and organisational set-up. If this approach shall be feasible it is necessary to probe deeper into the concept, its constituent parts and its relationship to economic transformation; questions which will be discussed at some length in the analytical framework (Chapter II). For definitions of corporate governance, cf. Hart (1995). For an overview of the literature and an illustration of the widely differing views, see Shleifer and Vishny (1995).
The answers to these questions are sought primarily in Chapter IV, which is a thorough account of the privatisation process in Slovakia between 1990-1996, but also in Chapters V and VI which discuss the role of institutional investors and firm managers, respectively, in the process of privatisation.

The results of ownership reform and privatisation

The second theme of inquiry focuses more on the actual results of the process of ownership reform and privatisation. The questions asked are quantitative as well as qualitative in nature. On the quantitative side they include questions such as: To what extent were the goals with privatisation achieved, i.e. how much of industrial capacity was really privatised? What kind of ownership structure resulted, i.e. who became the main owners? As an integral part of this area follows the ambition to look at the changes in ownership over time. Questions include: Is there an increase or decrease in the level of ownership concentration, and how can one explain the possible changes? What type of owners is it that has grown strong? Of equal interest, however, as these more quantitative questions, is to establish what structures, institutions and mechanisms have emerged for corporate governance, i.e. how can the new owners and financial actors pursue and enforce their interests in the firms in which they have become stakeholders? Without functional governance, it will not be possible to take advantage of the various positive effects accruing from the specialisation in capital supply (owners and creditors) and supply of human capital (management). Both of these resources are scarce and needed to bring about the restructuring of firms. The development of corporate governance will thus be decisive for establishing the way and extent to which one economises on these scarce resources, and thus also to which extent the officially declared aim of privatisation is achieved, i.e. increased efficiency.

In this context, three areas of inquiry stand out as especially interesting. The first concerns the role of institutional investors. It was commented by Portes on privatisation in CSFR that "[i]t does appear, however, to have created an extraordinary system of corporate governance." Part of what is viewed as "extraordinary" was the large-scale emergence of investment funds as a consequence of mass privatisation with vouchers. This study consequently incorporates case studies of four of the more important actors on this hastily established arena for institutional investors. The main question asked is what role these new and inexperienced institutional investors came to play in corporate governance?

This question is closely related to a second area of inquiry, namely the interaction between ownership reform and "institution-building". As will be discussed in the analytical framework, economic outcomes depend on the general institutional and organisational set-up, for example on the many formal and informal institutions that guide the behaviour of economic agents, such as owners, banks and management. One such institution/organisation is the stock market, and in a special study is asked to what extent the emerging stock market is fulfilling the tasks/functions usually associated with the existence of such markets? It is also asked what role the institutional investors have played in the development of this market? Both the development of the stock market and the role of institutional investors are particularly

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interesting since they represent corporate governance solutions “imported” as a consequence of the chosen method for privatisation; it is thus interesting to see how they function in a “strange” environment.

A third area of inquiry focuses on the development of structures for corporate governance. These institutions are not a simple matter of legal details and enforcement, although they are indeed important. Attitudes and perceptions by, and among, the economic agents will be equally important for the functioning of corporate governance. Questions asked in relation to this include: What relations and perceptions are shaping the interaction between owners and management? To what extent are institutional investors, banks and other owners active on the governing boards of firms? How are the outside stakeholders viewed by management? What type of board structures have developed?

2.1. Scope of the study: why Slovakia?

When the study was initiated the object of study was confined within the borders of one country, Czechoslovakia. This, however, changed after the dissolution of the federation on 1 January 1993. This left the choice of either altering the study to become a comparative one, or choosing one of the two new countries; the option chosen was to complete the study using the case of Slovakia. The reasons for choosing Slovakia rather than the Czech Republic for the study are multiple: firstly, in comparison with other formerly communist economies, Slovakia is rather more representative in that its industrialisation to a high degree was directed by socialist policy, something which was not the case with the Czech Lands which already before the war had reached a relatively high level of industrialisation; secondly, Slovakia is interesting in that it inherited an economic reform which it only partially had taken part in formulating; thirdly, of the two countries the developments in Slovakia have received less attention by far, thus warranting some “affirmative action”.

Timewise, the main focus of the study is on developments between November 1989 and December 1996. Developments prior to 1989 will only be discussed in general terms as to provide a background for the economic transformation. The reason for ending the study in 1996 is dual. Firstly, and foremost, it was then officially declared that the large-scale privatisation was coming to an end, secondly, even when writing contemporary history it is necessary to let some time pass in order to get a proper perspective of the development studied. Further, focus will be on large- and medium-sized industrial firms privatised within the realm of large-scale privatisation. One reason for this limitation is that the impact of the communist era is most clearly visible in this sector since the vast majority of Slovak industry was established by political fiat, where economic calculations were based on non-informative relative prices. Accordingly, it is in this sector that ownership reform is the most challenging. Bringing back to private hands housing, shops, workshops, restaurants and bars, have proven to be relatively uncomplicated since the adverse effects of communism were not that grave. Also, the problem of capital is not as monumental either, often it is possible for the tenant or the entrepreneur-to-be to raise the capital needed in one way or another. The method has therefore been rather straightforward, in the majority of cases implying auctioning to the highest bidder. In the in-
dustrial sector, on the other hand, ownership reform is roughly an attempt to sell vaguely and ambiguously defined property rights that one does not know the value of, on a market that does not exist, to people with a relative lack of capital and experience. The argument for focusing on the industrial concerns is further strengthened by the fact that it is here attempts at using techniques never employed before are found, for example mass-privatisation by means of free distribution in combination with a proclaimed aim of still solving the problems of corporate governance.

The geographical limits have already been set out and explained above, and it is thus a country study of Slovakia with some ambitions of generating generalised knowledge about this particular aspect of transformation. There exists no ambitions of generating concrete and generally valid policy implications from the study, rather the aim is to point to the necessity of taking into account national characteristics when formulating policy. However, to the extent that policy implications can be drawn they will be discussed in the concluding chapter.

As will be shown, the agency problem is found on many levels in corporate governance, but the study is limited to the relationship between institutional owners/investors and management. Also, focus is on the ideas and attitudes that characterise the new relation between owners and management (a relation which is a new experience to both parties), and on how owners seek representation on the governing boards. Further, the question of finance will only be touched upon to the extent that it has a direct bearing upon governance.

3. Methodology, theory and sources

The general approach in the study is analytical and descriptive, and is developed through case studies and interviews. Focus is on the quality of the developing institutions of ownership and governance and the interaction between the new formal and informal institutions for governance and the already existing institutions (formal and informal) which together form the new institutional set-up. The importance of this set-up rests with: (i) how it shapes and changes the incentive structure for owners and managers and how it thus effects the behaviour of agents; (ii) the magnitude of the costs connected to various transactions, which thus affect the allocation of productive resources.

In order to establish the qualities of these institutions the level of analysis is tripartite, the first being an evaluation of privatisation policy and the political processes being part of the formulation and enactment of this policy on a macro-level. A second level of analysis is what we have chosen to term the meso-level. This refers to the focus on markets and market-actors and the analysis of the stock market and the surrounding institutional set-up. It also incorporates the case studies of institutional investors in the form of investment funds. The third, equally important level of analysis, is an investigation of the attitudes and behaviour of firms and managers on the micro-level, on the basis of case studies.

17 With “agency-problem” is referred to problems connected to the establishment of mechanisms whereby a principal (owner) can make an agent (management) act in congruence with his/her objectives; also see discussion in Chapter II:4.1.
This “division” does not imply that we see any boundaries which make them distinct analytical objects or that they represent separate spheres, rather as a methodological tool. Both the micro- and meso-levels are essential and needed to give depth and substance to the analysis as it will shed light on the actual application of the rules established. The case studies also serve to illustrate some of the results from the macro-level analysis. Taken together the approach has the potential to paint a fuller picture of the way the processes have unfolded.

3.1. Methodology and sources

The study uses a combination of quantitative and qualitative methodology. Quantitative methodology is suitable for establishing the pace and direction of variables such as privatisation or restructuring and the main characteristics of the governance structures. However, when attention is directed to the question of which factors can explain the observed governance structures and how methods for privatisation have affected this and the potential for governance and restructuring, it is necessary to turn to a more qualitative approach. Consequently, the answers to questions of the type “how” and “why” are sought by means of case studies, a method well suited for this type of task. The combined approach also implies the use of different types of sources (relating to the different methods of investigation). These methodological issues are discussed in more detail below.

3.1.1. Statistics and other sources

The macro-analysis and part of the meso-analysis rests on laws and regulations, national statistics and other primary sources as well as secondary material and interviews. Laws and regulations have in most cases been readily available, not seldom in official English translations, as many of them were deemed to be of interest for potential foreign investors. As for the national statistics they have gradually been improving and can now be considered to be of relatively good quality, at least in comparison with other countries in Eastern Europe. The gravest distortions of the communist era are also avoided due to our period of interest (post-1989). However, there are of course problems, not least with regard to time-series and private sector statistics.

Other primary sources include statistics and publications from, for example, the National Bank of Slovakia (Národná Banka Slovenska, NBS), the stock exchanges, ministries and the Slovak Fund of National Property (Fond Národného

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19 Regarding time-series data, problems include that: (i) prior to 1993 foreign trade was only registered on the federal level making it impossible to construct time-series for foreign trade which includes trade to and from the Czech Republic for the pre-1993 period; (ii) NACE industry classification was adopted only in 1992, making it difficult to follow industrial development on an aggregated level throughout the period of study – the previous classification divided industry in 19 “industries” and 81 “sub-industries”; and (iii) GDP has been measured on basis of national accounts only as of 1 January 1993. Regarding private sector activities it can be noted that private sector statistics include all firms where the state holds less than 50 per cent of outstanding shares – but, and more importantly, also include firms where the state-controlled Slovak Fund of National Property (Fond Národného Majetku, FNM) is the owner; more on FNM which was set up in 1991 with the task of processing transfers of property to new owners in Chapter IV.2.3. Further, comparisons with other countries is made difficult since countries have adopted different standards for the measurement of private sector activities, cf. ECE (1993), pp. 215-216.
Majetku, FNM). Whereas the former two sources (NBS and the stock exchanges) have been relatively unproblematic in the sense that information has been readily available, the other two deserve some comment. Information from the FNM on the methods and terms for privatisation has been scanty and sporadic following the 1994 elections, warranting the use of, for example, business press, newspapers and daily reports from news agencies (e.g. Reuters) to fill in the gaps. Likewise, the readiness of ministries to provide written documentation has varied over time, requiring resort to secondary sources in combination with interviews.20 Taken together, however, no serious problems were encountered with the material used for this part of the analysis.

3.1.2. The case studies

Case study methodology was as mentioned deemed appropriate to answer the questions of a “how” and “why” nature. An additional reason for utilising case studies is that the literature on corporate governance in economies of transformation has tended to focus on macro-analysis.21 Very few studies or sources were located regarding the attitudes and behaviour on the micro-level.22 The basis for the more qualitative analysis of micro- and to some extent meso-level behaviour is thus two sets of case studies, one with a selection of industrial firms (nine firms) and the other with a selection of institutional investors (four investment companies).23 Common is that they all rely more on qualitative methodology than quantitative, and were carried out by in-depth interviews with senior officials. The reason, in the case of firms, for focusing on senior management is their pivotal role both in the process of privatisation and in the restructuring of firms. Clark and Soulsby for example concluded that:

“[t]heir strategic roles in interfacing with the changing technical and institutional environment…make them particularly relevant subjects for empirical research….senior managers perform pivotal roles in transforming the technical and institutional relationships between the organization and its environment….”24

Thus, the competence and attitudes of senior management and other economic agents towards change could be expected to have a great effect on the outcome of economic transformation since they are not merely passive recipients, reacting to a certain institutional set-up and effectuating change accordingly; rather they can also be expected to adapt, change and circumvent the changes in this institutional set-up which are not to their liking. This constitutes yet a reason for paying closer attention to the micro-level responses.

20 A list of interviewees is provided in the bibliography, irrespective of whether the official in question has been directly quoted or not in the study.
21 Cf. the volumes edited by Frydman et al. (1996).
23 Although the developments in the Slovak Republic constitutes the actual “case” studied in this volume, the term “case studies” is chosen to denote also these micro- and meso-level studies.
In order to get the best possible overview of the issues of interest, subject to the constraints of time, financial and other resources, a strategic selection of units was necessary. The nine case study firms were chosen to provide some variance with regard to factors such as size, sector, stage of production, capital intensity, location and, perhaps most importantly, ownership structure and method for privatisation. As for institutional investors, they are represented by four of the dominant investment companies, three of them with close connections to banks. Regarding industrial firms the questions during the interviews focused on the following issues:\footnote{Interviews with firm-managers were conducted in English, German or with the assistance of a Slovak interpreter; it should be noted that the listing of topics discussed by no means sets out to be neither exhaustive nor one that was lavishly followed (after all, all interviews are unique) – but rather to give an idea of the topics that the interviews set out to cover.} the ownership structure (for example main owners, employee and/or management ownership, controlling shareholder); attitudes and relations with respect to the capital market (for example market monitoring, new emissions, bond issues, provision of information); their connections and relations to the banking sector; power relations and actual decision making; actual developments (for example restructuring, profit, political influence etc.).\footnote{These interviews were without exception conducted in English.} The interviews with senior executives of investment companies focused on similar issues, although from the “opposite” perspective.\footnote{These frequent illustrations from the case studies also warrants a more detailed presentation of the firms and the investment companies, something which is done in Chapter VI:1 and Chapter V:2.1, respectively.} The case studies were then completed on a “one-by-one” basis and what is presented in Chapters V and VI is thus the results of the analysis of the case studies, but with rich illustrations from the actual cases.\footnote{The first stay 6-17 November 1994, the second 20 September-13 October 1995, the third in May 1997; in addition, material has been collected and interviews undertaken during approximately six stays in Prague in the period 1992-1997.} In order to provide a broad picture where representatives for all actors/groups of actors of relevance for the regime of corporate governance were heard, and to some extent complement the sources as mentioned above, interviews were also undertaken with representatives for a number of other organisations, for example: the FNM (representing the state as an owner); the three securities exchanges; the Centre for Voucher Privatisation in the Slovak Republic; the Ministry for Administration and Privatisation of National Property in the Slovak Republic (below Ministry of Privatisation); the Association of Investment Companies and Investment Funds (Asociacia investicnych spolocnosti a investicnych fondov, below ASIF) etc. All interviews were carried out on location in Slovakia during three stays in the country in 1994-1997,\footnote{In addition, many of the interviewed persons have subsequently been approached by telephone or in person. The selection of firms and investment companies are also discussed in conjunction to the results.} and have been complemented with printed material about the organisations in question, for example annual reports as well as secondary material.\footnote{In addition, many of the interviewed persons have subsequently been approached by telephone or in person. The selection of firms and investment companies are also discussed in conjunction to the results.}
management/officials. A typical interview lasted approximately two to three hours, and sometimes there were topics where one would have wished to probe deeper but time did not permit. An advantage, which to some extent alleviated this problem of depth and versatility of the answers, was a relatively good insight and a priori knowledge, for example about the communist economic system, issues of transformation, the region and country. Being an outsider brought advantages as well as disadvantages. On the positive side can be noted that the image of a “sympathetic, naive and ignorant foreigner” made people speak more freely during interviews. A disadvantage is that this naiveté and ignorance surely in many cases was less of a mask put on than a reflection of reality. Secondly, with respect to the reliability and accuracy of the collected information, it should be pointed out that during the interviews there were certain types of questions which were avoided by the respondents. This was especially apparent for: (i) questions relating to the political situation and politically initiated changes with respect to the institutions of importance for corporate governance; and (ii) interviews with firms where the state still had some direct/indirect influence, a situation which in itself provided some information and insight. Similarly, some enterprises in the end declined to participate on the terms agreed upon. On the other hand, in some cases it has been possible to compare the information received with information about the firm/organisation received during more “informal” contacts, for example from other employees, friends and acquaintances with insight into the respective firm/organisation. Thirdly, affecting both the quality and depth of the information, there is in Slovakia still a prevailing reluctance to provide data about the firm, its results and financial situation and so on, since such data is commonly viewed as “business secrets”. The alternative has been to employ secondary sources for some financial and operating data.

Even so, it is clear that the evidence and observations made on the basis of such a minor number of case studies should be taken as suggestive rather than conclusive. Still, this is in line with the rationale for using case studies in the first place, namely to provide the basis for depth and substance to the analysis of issues which through literature studies have been found to be of importance, and thus to better illustrate the responses and strategies of firms during transformation.

3.1.3. Statistical analysis

To compensate to some extent for the shortcomings with regard to generality which is inherent in the use of case studies, these have been complemented with statistical analyses of a database comprising the majority of firms (902) traded on the stock market in Slovakia (RM-Systém, RM-S). The database includes financial data, ownership data, share-price data as well as information about board membership in the period 1990-1996. The period covered varies with the variables, ownership data for example is only available from 1993 when firms were put in private hands. The

31 It can be noted that also Clark and Soulsby (1995, pp. 224-225) in their case study made a notice of that their position as “naive outsiders” helped to create an atmosphere conducive for gathering information. A similar experience was reported by Heclo and Wildavsky (1974) in a study of British fiscal policymaking.

32 Examples of such secondary sources include the business weekly TREND Tydzenník o hospodárstve a podnikání (TREND Economy and Business Weekly) and Reuters Business Briefing.
database, below referred to as “RM-S Database”, was constructed from three main types of sources: (i) a commercial database from RM-Systém provided on CD-ROM in .xls-format; (ii) written publications from RM-Systém where data-entries have been made manually; and (iii) data from sources and materials connected to the case studies where data-entries also were made manually.

Statistical analyses, using StatView 5.0 software, has been done on three different samples of producing firms: the case study sample (Case-9, C9); a random sample of 56 non-financial firms (Sample-of-56, S56); and a retrospective sample of the 60 most profitable firms (Top-60, T60). Regarding the nine case study firms no attempt was made to achieve randomness in the sample, the number was deemed to be by far too small for any such exercise to be meaningful. Rather, the ambition was to, by means of a strategic selection, achieve a spread with regard to the factors discussed above. The random sample of 56 non-financial firms was derived from the above-discussed database. Of the total 902 firms, 490 firms remained after excluding non-industrial firms. From this set, a random sample of approximately 15 per cent of firms was chosen, using SPSS software (S56). The retrospective sample of Top-60 firms comprises the 60 most profitable industrial firms in the same database. The measure of profitability used was the average return on capital in the 1993-1996 period as calculated from data in the database.

The overall aim of the statistical analysis has been to detect likenesses and differences between the three samples and within the samples over time. The analysis of variance first of all served the purpose of highlighting to what extent the case study sample is to be seen as representative. Focus in this respect has been to perform comparisons between C9 and S56. A second aim, related to the use of T60, has been to gain insight into factors of importance for the successful restructuring of firms. The logic behind using such a retrospective sample as T60, with its inherent bias towards “survivors”, is to see whether there are any significant differences in this set with regard to ownership, corporate governance etc. compared to the case study firms (C9) and/or the random sample (S56) which can serve to explain their relative success.

3.2. Theoretical approach

The very nature and dimension of this process of societal transformation, is that it effectively eliminates the possibility for detailed economic modelling. Nor is it an aim of this study to engage in such modelling, which is best suited to test the effects...
of single shocks on existing economic processes and institutions. Rather, since change is all-embracing, it is necessary to turn to a general theory for economic and social change; one that operates on a high level of abstraction; and one that can take into account the implications arising from the existing and changing institutions. Such a general theory can provide the guidance necessary to: (i) put our specific object of study in proper relation to other aspects of reform, namely as one, although crucial, building block; (ii) to give us guidance as to why privatisation may be desirable and what goals that could/should be connected to a programme for privatisation; (iii) make explicit the importance of functioning institutions for corporate governance for economic growth and efficiency; (iv) give some guidance with respect to the political dimension of transformation.

The traditional mainstream neo-classical approach is not considered up to this task. The necessity of modifying it is directly derived from the object of study, namely the dynamic change of organisations, institutions and the underlying property rights; factors which are either not treated at all, or taken as invariant in traditional micro-economic analysis.35 When attempting to study and analyse phenomena which are part of a transforming economic system the basic premise of *ceteris paribus* is not workable since the object of study is one where everything is changing, and it is also changing simultaneously albeit not always at the same pace and in harmony.

A specific problem with the traditional neo-classical approach is its reliance on instrumental rationality, where actors have correct theories and *objective* models through which they can view the surrounding world and base their “correct” decisions. The crucial difference of the approach chosen is that the costliness of information and transactions is acknowledged to be an inseparable part of a modern capitalist economy, thereby modifying the standard rational choice model. The notion of rationality *per se* is adhered to, but a main point is that actors behave rationally according to their *subjective* models of the world, subject to the institutional (formal and informal) set-up. This procedural rationality acknowledges that ‘ideas and ideologies play a major role in choices, and transaction costs result in imperfect markets.’36 In the words of Simon, the rational person ‘goes about making his or her decisions in a way that is procedurally reasonable in the light of the available knowledge and means of computation.’37 This notion of *ex ante* rationality thus brings focus to processes rather than merely the outcomes (i.e. *ex post* rationality), which tends to be the focus of the traditional neo-classical approach.

The approach is thus a mixture of neo-classical economics and institutional economics, an approach often identified with the work of North, and which below is

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35 For a critique of the insufficiency of neo-classical economics when studying processes involving institutional change, cf. Ees and Garretsen (1994), who also correctly warn of the risk of functionalism in neo-institutional economics (p. 8 ff.).


37 Simon (1986), p. 211. Simon there undertakes an interesting comparison of the use of the term rationality in psychology (cognitive psychology) and neo-classical economics. In the latter case, rationality is viewed in terms of its resulting choices (substantive rationality), whereas in psychology focus is on the process of arriving at a decision (procedural rationality). Simon furthermore shows that substantive rationality and utility maximisation is not sufficient to explain and predict economic behaviour.
referred to as neo-institutional economics (NIE). The choice of NIE as a theoretical base is in part at least a pragmatic choice based on the necessities of the subject being studied. Looking at existing research, one does not find any “ideal” approach for this type of task. Of the existing approaches, however, NIE, with its strong emphasis on property rights and transaction costs ex ante is the most promising, since both of these aspects are at the core of ownership reform in transforming economies. NIE also has the great advantage of accommodating for the study of changing organisations and institutions, and allowing the incorporation of theories of corporate governance.

A distinctive feature of NIE in comparison to the traditional “institutional economics” is that it holds on to part of the essential “core” of neo-classical economics, that is: stable preferences; the rational-choice model with its emphasis on maximising individuals, although here according to procedural rationality (see above). In addition, when analysing collective choice and the political constraints on privatisation some elements of interest-group theories of decision-making and political economy are introduced. Once again, NIE has the advantage of being more open to eclecticism than standard neo-classical economics.

4. Organisation of the study

The further organisation of the study breaks down into five different chapters. Chapter II defines the analytical framework through which the recent changes in the structures of ownership and governance are to be examined. The approach of NIE will be outlined and institutions (formal and informal) defined, their role in economic change discussed, and their close affinity to the concept of transaction costs highlighted. The issue of property rights as an institution is also discussed. The section concludes with a discussion of the importance of corporate governance and the problems connected to it. It is argued that the return to an efficient economic system is not only a question of ownership, rather, in order to create a sound institutional

38 For the writings of North see above all North (1990); but also North (1981); North and Thomas (1973); Davis and North (1971). For an elegant and thorough exposition of the main lines of the Neo-institutional paradigm (as understood in this study) see Eggertsson (1990); for a shorter and more comprehensive account, see Eggertsson (1994). Also, for a short account of the development of institutional analysis see, North (1993); finally, for a critical account of the atheoretical strains in NIE see, Posner (1993). 39 For an exposition of what is termed traditional “institutional economics”, cf. Hodgson (1988); Langlois (1986). 40 A basic postulate is that people prefer more to less, i.e. they want to increase their utility (of which pecuniary wealth is one source). 41 The part that is most oftenly rejected by “institutional economics” is methodological individualism and the notion of rational-choice, cf. Hodgson (1994; 1988). However, interesting to note in this context is Veblen’s defence of methodological individualism, he wrote: ‘It is, of course, on individuals that the system of institutions imposes those conventional standards, ideals, and canons of conduct that make up the community’s scheme of life. Scientific inquiry in this field, therefore, must deal with individual conduct and must formulate its theoretical results in terms of individual conduct.’ Source: Veblen (1936:1909), p. 165. For a good overview of Veblen’s ideas about institutional change the reader is referred to Rutherford (1984); see also Cunningham Wood (1993). 42 Cf. Brennan and Buchanan (1985); Olson (1965); also Major (1993) pp. 11-15.
environment equal attention must be paid to competition and internal control/organisation of the firm.

Chapter III aims to give a general picture of economic development and reform in Slovakia. As a background, the chapter begins with an account for the communist experience of Slovakia, with special attention paid to the role and status of state-owned enterprises in the administrative command economy. The growth of industry and the inherited industrial structure is discussed. A more detailed account of the events post-1989 follows. Focus is on the general policies for macroeconomic stabilisation and liberalisation of economic activity, i.e. changes that would radically alter the institutional set-up. The chapter concludes with a brief assessment of the costs and achievements of economic transformation in general.

In Chapter IV the issue of ownership reform is tackled. The chapter begins with a discussion of the scale, scope and goals of privatisation. An outline of the various methods available and their implications follows. A minor section is devoted to the initial steps taken to foster a private sector by means of restitution and small-scale privatisation. The remainder of the chapter is a description and analysis of the actual policies pursued for large-scale privatisation in Slovakia and concludes with a brief overview of the main results.

Chapter V begins with an overview of the development of the stock exchanges in Slovakia, i.e. the market for property rights. Focus is on their performance and the establishment of a regulatory framework to co-ordinate trading. Follow does a section that analyses the problems of the capital market. The second part of the chapter directs attention towards the emergence, behaviour and relative influence of institutional investors (investment companies) that became dominant as a result of mass privatisation with vouchers. Issues covered include legal regulation of investment funds; portfolio strategies and their relation to and behaviour on the capital market; their strategies and problems when acting as principals towards the newly privatised firms and, not least, an analysis of what factors that led to their demise (in their traditional form).

Chapter VI turns to the enterprise sphere, i.e. those primarily affected by the policies for privatisation. In the first part of the chapter, focus is on how managers behaved during the process of privatisation and what kind of influence on the outcomes they achieved. In addition, the general developments with regard to the ownership structure are analysed. In the following section is turned to how governance relations have evolved on the micro-level. The last section of the chapter probes how relations between firms and the capital market have evolved. Throughout the chapter, the results of the statistical analysis are incorporated, although reported separately in Appendix D. The results in terms of firm-level restructuring and economic performance are also reported separately, in Appendix A. Chapter VII, concluding the study, is an attempt to bring together the three levels of analysis into a concluding analysis. The main findings will be summarised and some implications of the research will be discussed.
Within the field of economics, the late 20th century has seen focus turning towards the existence and functioning of the firm, to the questions of incentives and ownership, the relationship between owners, creditors and managers, and more recently, a revival of the institutional approach in economics. This revived focus on the question of ownership was in the western market economies reflected in the drive for privatisation of industry and utilities and further liberalisation of markets, a drive equally economically, politically and ideologically motivated. With the fall of the communist economies in Eastern Europe and the former Soviet Union, some of these main themes in economic literature and discourse would be turned into practical policies in a number of formerly communist countries. Economic transformation is currently on-going in approximately thirty countries in different parts of the world. This is a motley crowd of countries who differ on most counts. In order to comprehend the complex developments in countries like these, and above all in Slovakia, a framework that directs our attention to the factors of importance for a dynamic development is needed. That is the purpose of this chapter and the study.

In this study, it is posited that at the core of economic transformation rests a change in the incentive structure in order to change the behaviour of firms toward activities which at least approximate profit maximisation, rather than in rent-seeking through continued protection and customs barriers. The major question is thus how this should be achieved. Economic theory cannot say how this change is supposed to take place. Theory can, however, give guidance with respect to what factors will be of importance and to some extent also define some necessary al-

2 In addition to the 27 countries which made up the former “Soviet Bloc”, i.e. the Soviet Union and Eastern Europe (incl. former Yugoslavia, GDR and Albania), similar changes are also taking place in for example Vietnam and China. The emphasis on privatisation varies considerably, but in Eastern Europe privatisation on a larger scale than ever witnessed before has been taking place. For the probably best and most comprehensive overview of developments up to and including 1995, see World Bank (1996).
though not sufficient conditions. In the discussion below, the following propositions will be discussed: (i) a change in ownership is a necessary, not least in order to break with some of the past habits, but not sufficient condition for a successful transformation; (ii) competition will likewise be pointed to as a necessary although insufficient condition; and (iii) the necessity of establishing mechanisms and institutions for corporate control as a pre-condition for restructuring, rationalisation, modernisation and investments in industrial capacity is pointed to. The analytical framework thus draws on a mixture of approaches within economics, where the emphasis on competition is derived from the neo-classical approach. The property rights literature puts attention to the importance of ownership and the relationship between clearly defined responsibilities and rights. The corporate governance literature emphasises the need for institutions and mechanisms to align the interests of principals and agents when ownership and control are separated. The transaction costs theory, in turn, points to the requirements for efficient markets and the need for information. The institutional approach, finally, directs attention towards the importance of laws, norms of behaviour, the importance of politics and the existence of path dependence.

1. Transaction costs: what and why?

The basic point of departure within NIE – and also a unifying element in the approach – is admitting the existence of transaction costs. The concept of transaction costs was introduced by Coase when asking the crucial question of why there existed such constructs as firms. In the neo-classical world of full and free information there should be no need for formal hierarchical organisations to undertake productive activity, this could just as well be achieved by free entrepreneurs who bought and sold the services and products needed exactly when the need arose, since the cost for transacting would be zero. In a world where this was not the case, and where firms and other hierarchical organisations prospered on competitive markets, Coase also observed that information was costly. These costs could be mitigated and kept just as low or lower within a firm as would be the case for “free-market” transactions, and that was the essential nature of the large firm. The firm is an aid to reduce the number of formal contracts, each of which is connected to positive transaction costs, by replacing them with long-term contracts within the confines of the firm, thus “internalising” the market at a lower cost. In addition, the firm bears the potential of lowering costs and increasing competitiveness by the generation of cumulative and collective learning within the firm and within networks of firms. It is to be expected that for the transforming economies, transaction costs would be increased during transformation as a result of the breaking up of
giant industrial concerns and disruption of existing networks. The idea of “one na-
tion, one factory” and central planning had resulted in a high degree of
“internalised” co-operation, a co-operation which must be re-organised and re-
negotiated at substantial costs.6

Hence, the total cost for production is the sum total of the transformation cost in-
curred when processing the inputs and the costs connected to all transactions, where
the firm obviously has a potential for affecting not only the former but also the lat-
ter.7 The difference compared to the neo-classical approach to production costs is
captured by Matthews when writing that transaction costs consist of the costs of
arranging a contract ex ante and monitoring and enforcing it ex post, as opposed to
production costs, which are the costs of executing the contract.8 Thus, by adding
the concept of transaction costs one gets a more realistic view of the firm.

However, the existence of transaction costs is not confined to product and factor
markets, they are costs connected to all types of human exchange. The result of in-
roducing them into the analysis is that factors such as ownership rights, economic
organisation and political decision-making all become important if one is to under-
stand the nature of economic growth.9 Thus, only after introducing them does it be-
come relevant to study for example political processes – an aspect which in Eastern
Europe is of utmost importance since much of the economic transformation is
policy-driven.

Even though the introduction of transaction costs is a positive step in the sense
that it provides a tool for analysing a number of phenomena which neo-classical
analysis cannot account for, there is an inherent problem of definition and meas-
urement connected to them. Although their existence has been recognised by many
economists, there still has been no consensus with respect to defining them. And,
serious problems arise also when attempting to measure transaction costs, no matter
how they are defined.10 Thus, disregarding the close to insoluble problem of meas-
urement, and agreeing with the statement that transaction costs are a useful notion
whose usefulness declines proportionately with the preciseness of the definition,11
this study has chosen to adopt a wide definition which gives the descriptive realism
sought. The definition chosen therefore begins with the proposition that transaction

6 See Frydman and Rapaczynski (1994), p. 80 ff. An example is the organisation of foreign trade which
previously was centralised to specialised foreign trade companies which handled all trade, for example
all textile producers in the country, a function which each producer now must organise themselves. This
can in part help to explain the decline in output experienced by most transforming economies.
7 See North (1990) for a discussion, pp. 27-28; this view has however been criticised by e.g. Hodgson
(1994) who wants to explain the existence of the firm, not with the existence of transaction costs for
establishing and policing the enforcement of contracts, but with the firm being a mechanism for cultural
transmission and enhancement of competence through “in-shop” learning. One may however ask
whether this internal learning, emphasised by Hodgson, is not exactly a method for reducing existing
transaction costs?
10 North and Wallis (1986) made an attempt, not to measure transaction costs per se, but to measure the
relative size of the sector of the economy which was primarily engaged in exchange of one kind or an-
other, i.e. the transaction sector – whose share of GNP in the US rose from 26 per cent 1870 to 54.7 per
cent in 1970.
11 A characterisation of transaction costs by two economists, James Quirk & Charles Plott, as quoted in
Davis (1986), p. 149.
costs are the costs of all resources required to transfer, capture and protect property rights.12

The implications of the existence of transaction costs are far-reaching. On a methodological level it implies that one cannot hold on to instrumental rationality since agents can never have perfectly objective models of the surrounding world, and even if they somehow could get this insight (model), the world of costly information would prohibit them from using it (getting the input) to make the optimal decisions which would result in the “perfectly efficient outcomes” so characteristic for the neo-classical world of economics. Further, their existence makes clear the necessity and functionality of markets, not only as mechanisms to provide clearing prices, but also their role in providing information about the goods and services traded, for example about their existence, price, quality and/or design. Such information would in their absence entail search and information costs for the party with a need/interest for these goods and services which in many cases would be prohibitive. A good illustration is the existence of a stock exchange. Without it a potential investor would encounter great difficulties in finding out what shares were available, their relative merits and price, a situation which most likely would result in a decision on behalf of the investor to invest capital elsewhere (for example another country or sector) or not at all. Imperative for economic transformation and privatisation is thus to establish a system that can economise on these costs, for example negotiation costs, monitoring costs, information costs, agency costs and costs for upholding prevailing institutions/property rights.13

Continuing with the example of a stock exchange, it must be pointed out that information, in and by itself, is also a requirement for a stock exchange to function efficiently.14 At the same time, a stock exchange may serve to generate knowledge and information about firms and alternative investment opportunities if supported by the proper institutional set-up.15 Competition is another factor which can serve to reduce transaction costs by putting pressure on agents to lower their total cost for production, of which transaction costs are one constituent part. Other examples of institutions that may reduce transaction costs, and thus enable exchange, include standards of measurement and the rule of law. The existence of transaction costs will also have implications for the value of property rights, and they will be decisive for the extent to which agents are willing to protect these rights.16 An implication for this study is the important role of the state in fostering markets, competition, the rule of law, standards and so on. Equally important, however, is that the same constraints with respect to foresight apply to the state as any other actor, thus limiting its potential for “correct” decisions.

12 This is a combination of the definitions found in Barzel (1989), p. 2, and Pejovich (1995), p. 84.
14 Yet another example is the labour market. It is difficult to see what magnitude the search- and information-costs related to the procurement of specialised labour would take if there was not a functioning labour market. For a discussion of transaction costs, institutions and the labour market, see Myhrman (1994), pp. 23-24.
16 See Section 3.
2. Institutions: definition and impact

Institutions are defined by North as ‘the humanly devised constraints that shape human interaction’, and thus structure the incentives in all types of human exchange, political, social or economic.\(^{17}\) The institutional set-up can thus be defined as the sum total of all rules, enforcement mechanisms, behavioural norms and subjective models of reality held by the various agents.\(^{18}\) An important point is that these models of reality cannot be objective since full and free information is a utopia. The impact of these institutions is to form the rules of the game, a game which ultimately is about the allocation and use of scarce resources (who gets what and does what and under what circumstances). The traditional view is that these institutions ‘define and limit the set of choices of individuals’, leading to the conclusion that rationality will be procedural rather than instrumental.\(^{19}\) While acknowledging the actual conclusion with regard to rationality, it is important to point out that their impact is not only to constrain behaviour. Institutions can just as well be viewed as enabling; for example, the more rigid the institution, the greater the degree of security actors will feel, which in turn increases the degree of choice within a system.\(^{20}\)

In an “ideal type” dichotomy, two basic types of institutions could be identified, formal and informal.\(^{21}\) The formal institutions (rules) are easy to grasp, and are constituted by various written rules and include political rules (e.g. constitutions, electoral laws), economic rules (e.g. property rights, corporate law, tax law etc.) and contracts between different actors or groups of actors. A common characteristic is that they are upheld by the judicial system, police and military. Also, the cost of disobedience is officially sanctioned by some central authority and is supposedly equal for all actors. As society and the various exchanges taking place have become ever more complex, formal rules have been gaining in strength and increasing quantitatively.\(^{22}\)

Informal institutions (conventions, norms and attitudes), on the other hand, have traditionally been the main focus of institutional economics. Veblen, for one, took a great interest in these ‘settled habits of thought common to the generality of men’,\(^{23}\) which he found to be of great importance for human economic behaviour. This view of informal institutions has not changed very much; and more recently, for example, North defined them as ‘codes of conduct, norms of behavior, and conven-

\(^{17}\) North (1990), p. 3; note that North’s use of the term “constraints” may be somewhat misleading as it in one sense does not leave room for purposeful action in order to achieve a certain goal, neither does it leave room for non-action. Rather, the term “guide” is more appropriate. However, in the literature the terms rules, constraints and institutions are often used interchangeably to depict the same phenomenon.

\(^{18}\) North (1992).

\(^{19}\) North (1990), p. 4.

\(^{20}\) Cf. Offe (1995) who uses the example of money to illustrate this, stating that ‘[t]he institution of money can mediate innumerable transactions only because none of the parties to these transactions can deliberately affect its value.’ (p. 51) Although the example in some cases may no longer hold for an empirical test it is still valid for the majority of actors; however, also the fact that it no longer holds, points to the fact that Offe may be right, i.e. once it becomes obvious that actors stand to purposefully change the value of a currency it loses some of its attractiveness for many types of transactions.

\(^{21}\) Such a dichotomy is useful to illustrate the principle differences between the two. However, in reality the types of institutions that affect our behaviour form a spectrum with no clear-cut lines.


\(^{23}\) Veblen (1961:1919), p. 239.
tions. These are thought to be upheld by factors such as social pressure, habit etc., and that the price paid for violation is of a social character, for example non-acceptance by other members of the community, complaints etc. Just like in the case of formal institutions, informal institutions can have an enabling impact by economising on transaction costs by unburdening individuals of the need to assess and evaluate each particular move and thus ‘relieve us from much of the need to generate ad hoc judgements.’ This way they can lessen insecurity concerning the behaviour of other actors. The importance of informal institutions, and the problems with a pure neo-classical framework, is put very well by North when he points out that the transaction costs connected to measurement and enforcement of the complex contracts needed in a world of specialisation would be prohibitive if people acted in accordance with the behavioural assumptions of neo-classical theory. He writes:

‘[i]f individuals maximized at every margin so that they would cheat, lie, steal, or kill their competitors whenever it paid, it is hard to imagine that the costs of transacting would not foreclose modern economies.’

For institutional economists formal and informal institutions help to enable the majority from doing exactly this, and thus enable the kind of advanced transactions and specialisation so characteristic for modern society. The importance of differentiating between the two types of institutions is that it is in the nature of informal institutions that they tend to change incrementally and rather slowly. Formal institutions, however, can at least on the face of it be changed much more quickly, for example with the stroke of a pen when a new law is adopted. Nielsen catches the difference well when stating that ‘while formal structures might be changed overnight, (informal) institutions survive, creating stability but also inertia and hindrances for the process of systemic change.’

27 Nielsen et al. (1995), p. 29. However, it should be noted that during normal circumstances the actual contents of formal institutions are also rather slow to change, i.e. changes in the legal regulation are often incremental in nature. Nevertheless, given the political will there exists a possibility to implement radical changes of the formal institutions which is not open with regard to informal institutions.
28 An example is that in general everybody ought to abide by the law, but the way in which we interpret the law and adjust our behaviour to it depend upon personal experiences, which in combination with our heritage and upbringing have shaped our system of norms.
tions of society (on average), runs the risk of not being respected, or meeting fierce resistance. Privatisation programmes, which give “undue” benefits to for example the former “nomenklatura”, may result in political backlashes for the party/parties backing it.29 At the same time it may prove necessary with concessions to other well-organised influential groups whose actions can directly influence and/or hinder the implementation of reforms.

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One problem with an institutional approach once again relates to the question of definition. North makes a point of the crucial difference between “institutions” and “organisations”, i.e. between rules and players.30 This is however a distinction which is not adhered to by all institutional theorists. One example is Myhrman who distinguishes three types of “institutions”: (i) rules of conduct, for example table manners, punctuality, honesty; (ii) aids to exchange, for example money, language; and (iii) physical constructs and organisational forms for the purpose of executing certain tasks, for example business firms, insurance companies, trade unions, families.31 Whilst the first two fit well with the notion of institutions as “rules”, the latter would according to the view taken here (and North) be the players (organisations). The danger of subsuming actors and rules in the concept of institutions is that the potential for explanation may diminish or disappear. However, a middle ground which could work is adopted here, that is to look at the phenomenon of a firm as an institution, even though the individual firm is an example of an organisation. Such a definition can also be argued for on grounds of referring to the organisations as but another contractual arrangement, i.e. as a set of institutions.32 Such a middle ground could also serve to alleviate the confusion stemming from the fact that people in general have a clear pre-conception of what an “institution” is – making it intuitively appealing to call various firms, banks, governmental agencies etc. as “institutions”.

2.1. Institutional effects: transaction costs, incentives and innovation

The economic importance of institutions rests with their profound effects on transaction costs, incentives and innovation. The institutional set-up is what shapes the incentive structure of an economy. The relationship between the two is rather straightforward in that the former decide what kind of behaviour is rewarded; affect the degree of risk connected with a certain course of action; define what is illegal and the consequences for disobedience etc. However, in a world where the assumptions of free and full information and perfect competition do not hold there is no guarantee that effective institutions, in the sense that they lower transaction costs, will evolve and prevail. When information is costly, and there is a lack of competi-

29 The same applies to certain tax laws, if they are not interpreted as being fair and just there will be substantial attempts at tax evasion, a situation which increases the transaction cost connected to the formal institution, sometimes up to a point where the revenue (e.g. tax) is less than expenses for policing the rule.
tion, it is not unusual that institutions which further increase transaction costs in society, thus being detrimental to efficiency and welfare may develop and take root. A good example is the communist economic system where formal institutions, introduced largely on political and ideological grounds, proved so detrimental for economic efficiency that they actually helped to undermine the system they were set to support. This is not to say that all institutions established on political and ideological ground are detrimental to economic efficiency; quite to the contrary, many formal institutions fall back on a politico-ideological rationale and they are in the majority of cases formulated and enacted through the political system. However, the more transparent and better informed the various decisions are, the lesser is the risk for arbitrariness and for self-interest to be governed by rules inconsistent with economic principles.

An area, which can serve to further illustrate the importance of institutions and incentives, is innovation. The role of innovation in economic development has received much attention and is certainly not without importance when studying economies in transformation or the communist economic system in general. In the latter case, the disincentives for innovation are claimed to have played a significant role in the demise of the old system. In the case of today’s transforming economies there is a great need for restructuring and innovation. To bring this about it is crucial that: (i) the institutional set-up gives incentives for such activities; and (ii) that the institutional set-up is such that it reduces uncertainty about the future. A distinguishing feature of innovation, as compared to routine-investment, is exactly that it contains a not insignificant risk-premium due to the lack of knowledge about the future – a premium that will be affected by the existing institutional set-up.

Closely related to innovation, and also dependent upon the institutional set-up and the incentive structure which it gives rise to, is what North terms “adaptive efficiency” and which he sees as ‘the key to sustained economic growth’. Adaptive efficiency relates to the possibilities for trial-generation in society, without which there would occur no innovation. It is dependent on factors such as entry rules, structures for corporate governance, organisational flexibility and so on, and implies an economy where actors are flexible and entry- and exit-mechanisms are functioning. On a more concrete policy level, this puts demands on competition policy, ownership structure (privatisation) and bankruptcy regulation etc. Adaptation to changing patterns of demand must be both possible and profitable, which means that the rules first of all must make it legal and possible (e.g. through flexible markets for labour and capital), and secondly, minimise the structural aspect of risk (by creating stable rules of the game). An example of the opposite was the centrally administered economy, which gave neither the right, nor the incentives, for management to engage in innovation and risk-taking.

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33 For an analysis of innovation as the driving force in the process of economic development, see Schumpeter (1942); on innovation and industrial transformation, see Dahmén (1988).
35 North (1992), p. 3.
2.2. Institutional change and economic growth

Although the aim is not to analyse growth and development per se in Slovakia, there is reason to give a brief account of the forces involved, thereby enhancing the understanding of the role of privatisation and corporate governance. In this approach growth and dynamic development depend not only on amounts of labour and capital (extensive growth), but also on innovation and adaptive efficiency (intensive growth). In somewhat more formal terms, total production can thus be viewed as a function of the amounts of capital, labour, raw-materials and the existing incentive-system. The logic of the relationship is that the institutional set-up (formal and informal institutions) defines the incentive-structure according to which economic and political actors make their innumerous decisions upon which economic development and performance will hinge. These actors will at a given point in time act as to get the highest payoffs/utility, and in the final analysis it is the institutional set-up which defines in what kind of activity this maximum payoff will arise. For growth to occur is thus needed incentives promoting adaptive efficiency, which is necessary both for new innovations to be made and for the actors to make the best possible use of these innovations (their adaptive ability). Growth can then be viewed as a function of the latter two (innovation and adaptive ability) and is thus, in less formal terms, a function of new products, methods and the capacity of putting them to use. The outcome (total production) will, in turn, have repercussions on the institutional set-up and the political system and, as discussed above, many formal institutions are created by means of collective action through the political system; the political sphere thus has the dual role of a player and a rule-setter.

In this way the institutional set-up provides the limits within which the existing actors have to work, but at the same time institutions are changeable since they are human constructs and can be used as the focus of change for various actors or groups of actors. This leaves us with the question of how and why institutions change? The sources for change can be divided into three major groupings. Firstly, major changes in the relative prices may cause changes in the institutional set-up and thus cause actors to behave differently, for example when an asset becomes relatively more valuable increased efforts will be diverted to the appropriation and protection of the same, and new rules may be formulated as consequence of the increased interest in the asset in question. Continuing with the same reasoning, it would be expected that changing preferences on behalf of the various actors due to education, religion and ideology will have profound effects on the informal institutions and on our subjective models of the world. Thirdly, the conscious or uncon-

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37 See North and Thomas (1973), pp. 1-8, for a discussion of sources and implications of growth, but note that they conclude that innovation is not a source of growth, it is growth. Below will, however, be adhered to a definition where innovation is seen as one source of growth among others.
40 The model was, to the knowledge of the author, first suggested by Myhrman (1994). This presentation however differs on some crucial points, it is here explicitly acknowledged that economic outcomes will have repercussions on the institutional set-up by means of affecting human behaviour and thus the informal constraints which are an integral part of the institutional set-up.
41 Cf. Libecap (1978); North (1990), chs. 9-11; North and Thomas (1973), p. 6.
scious change of the formal rules by actors will result in a change of behaviour. Such changes in the formal institutions may be either endogenous or exogenous. The former then refers to a gradual and evolutionary change of rules, much in line with the above discussion. The latter, however, is a change of a more radical type, brought about for example by changes in ideology, external shocks and changes in technology.42

Institutional change is thus a function of the behaviour of the actors, a behaviour which in itself is bounded and guided by the existing institutional set-up. Under normal circumstances, this set-up is relatively stable in the short run, thus lowering uncertainty. This stability/rigidity may, as previously pointed to, provide for a more flexible economy where actors more easily adapt to changing conditions (price signals) since the total risk exposure is lessened when they can trust the “rules of the game” to remain stable.43 In a dynamic, long run, perspective they are however defined/affected by various optimising actors.

The temptation in being able to change the rules to fit better with ones’ own interests is obvious, although in most cases it is associated with high costs (lobbying etc.).44 A relative exception is the transformations in Eastern Europe where the fall of communism meant that a large part of the formal rules became outdated and/or discredited, thus decreasing the inertia inherent in institutional change. During such circumstances, the costs for changing the rules to ones own liking are lowered and one would thus expect to find such attempts on a large scale. What one would expect to see therefore is a development where interest groups work to redistribute the costs and benefits connected to various rules in order to maximise their own utility, not least when it comes to privatisation. So, even in the cases where one “objectively” knows which rules would be the most beneficial, there is no guarantee that this will even be the aim of policy, and even less whether it will be the result of policy. Once again, two factors which may “improve” the chances are transparency and well-informed decisions.

3. The question of property rights

One of the more important and palpable institutions, and definitely the one of greatest importance for this study, is the one of property rights. The ties between NIE and the property rights school are also indeed close.45 When discussing the behaviour of rational actors in the face of changing institutions it was concluded that there is no guarantee for efficient solutions to evolve; the relevant question of more

42 Cf. Pejovich (1990), pp. 4-6.
43 Cf. discussion in footnote 20 (p. 21).
44 Such change would typically occur when there is “disequilibria” between organisations and the existing institutional set-up and when “equilibria” cannot be achieved through recontracting. As “equilibria” is defined a situation when no groups or organisations see gains large enough from a change in the institutional set-up to offset the costs connected to such an effort.
45 The property rights approach actually goes back at least as far back as Marx, being the first to explicitly assign an explanatory effect to the ownership structure [see, Pejovich (1982)]; for seminal work see, Coase (1960); Calabresi (1961); Demsetz (1964); Alchian (1965); and for a 'unified structure to analyze exchange, the formation of rights, and organization’ see Barzel (1989).
or less effective will thus depend on the incentive structure and of utmost importance for the incentive structure is the institution of property rights. The relationship is put strongly albeit clearly by North and Thomas when stating that 'economic growth will occur if property rights make it worthwhile to undertake socially productive activity.'

To understand the role of property rights in NIE and in economic transformation it will initially be necessary to make a definition that is workable and congruent with the above discussions. Then, of interest is the relationship between various property rights’ regimes and the economic outcomes, a relationship which is surveyed by a discussion of their effects on the incentive structure and their relationship with transaction costs. In the section to follow (Section 4), the question of the use of property rights in the case of the modern industrial enterprise, i.e. the question of corporate governance, is posed.

3.1. Property rights: definition and impact on incentives

In the following discussion the ambition of using broad definitions which, at the expense of precision, increase the descriptive realism, is employed. A useful definition of property rights in this tradition is the one proposed by Furubotn and Pejovich in which they explain that:

'Property rights do not refer to relations among men and things, but rather to the sanctioned behavioral relations among men that rise from the existence of things and pertain to their use. Property assignments specify the norms of behavior with respect to things that each person must observe in his interactions with other persons, or bear the cost for non-observance.'

As can be seen, the importance of informal institutions (e.g. social norms) also emerges when it comes to property relations. The contingency on social norms implies that the formal structure of property rights has to be concordant with the general norms prevailing in society if they are to be stable, respected and durable. However, as with other institutions there is a double causality in that the imposition of a new regime of property rights may create the impetus for changing norms and

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46 North and Thomas (1973), p. 8; the logic is that with perfectly delineated property rights the social and private rates of return will be in parity, and the behavior of individual agents will be the behavior which is most efficient for society on the whole (see Section 3.1).

47 Furubotn and Pejovich (1972), p. 1138. A more narrow and close to classical definition is the one made by Alchian (1965) in an article connected to the revival of the property rights approach, implying that property rights is 'a method of assigning to particular individuals the “authority” to select, for specific goods, any use from an unprohibited class of uses.' [quote on p. 818]

48 The view of property rights as abstract social relations is not new. In 1923 Irving Fisher wrote that: '[a] property right is the liberty or permit (under the sanction and protection of custom and law) to enjoy benefits of wealth (in its broader sense) while assuming the costs which those benefits entail...property rights, unlike wealth or benefits, are not physical objects nor events, but are abstract social relations. A property right is not a thing.' Source: Fisher (1923), p. 27 [emphasis in original]. Property rights are thus posited to be human rights, i.e. rights held by humans, see Alchian and Allen (1977), pp. 158-160; also Jensen and Meckling (1976), footnote 6, who call the distinction between human- and property rights ‘one of the all time great semantic flimflams.’
informal institutions. Also, like with institutional change in general, change in property relations can be either endogenous and gradual, for example through the on-going sale and purchase of assets, or it can be exogenous and radical when the political sphere, on one ground or another, imposes far-reaching new measures, for example privatisation of industrial assets or the enclosure reforms regarding agricultural land.

Returning to the static characteristics of property rights one may begin by dividing them into three functional types, usus (control), usus fructus (income) and abusus (alienation). Usus, then is the right to use a specific asset in any way one chooses. In the case of a firm, for example, it is the right to decide about production. Usus fructus is the right to be the beneficiary of the income/profit stemming from the use of the asset (or bear the current losses). Abusus, finally, is the right/obligation to bear the consequences of changes in the net value of the asset, that is, one is free to capitalise on an asset (sell it), take a mortgage on it etc. These relationships can also be described in terms of disposition-rights where ownership primarily refers to usus fructus and abusus, and control to usus.52

If continuing with the example of a firm, the claim is that property rights have to be exclusive and freely transferable if resources shall be utilised in the most productive way.53 Beginning with the quest for exclusive rights, in the sense that property rights are only limited by well defined rules which are manifest in law and not by the behaviour of other economic actors and/or their utility functions, the idea is that this gives the best incentives for static efficiency (productive as well as allocative).54 With exclusive rights the bearer has the right/obligation to the full residual income/loss (usus fructus) ensuing from the use (usus) of the asset, a fact which gives him/her the incentives to maximise this value. That is, the exclusiveness of property creates a strong linkage between the use and its consequences.55 The ideal example would be the traditional owner-manager-entrepreneur. However, as will be discussed below, in the real world it is exactly this separation of ownership and control which sets up the agency problem.56

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49 In line with the above discussion it could be expected that the introduction of private property in a society where this institution has never existed at a certain point in time would reach a "threshold-level" after which there is a self-reinforcing effect. Interest groups would make demands for protection of these rights, which lead to changes in formal rules and their enforcement. For a discussion of the role of private property in the process of nation-building, using the example of England and Russia, see Pipes (1995), p. 7 ff.
50 Pejovich (1994).
52 For a discussion in terms of rights of disposal, see Berglöf (1988), pp. 19-22 (an approach which is returned to and developed in the section on corporate governance); for a similar classification, which takes into explicit account the habit of owners to delegate rights of control (usus) to hired management, see Komai (1992), pp. 62-67.
53 Cf. Alchian (1965); Furubotn and Pejovich (1972); Nutter (1974).
54 Putting the existing resources to the best use in the time period in question.
55 The importance of usus fructus lies equally much in the "whip" as in the "carrot", i.e. that one has to bear the losses in case the use of the assets is not sufficiently good.
56 The implications of the rareness of this species (owner-manager-entrepreneur) are discussed in conjunction with corporate governance and agency costs (Section 4).
If adding the assumption of transferability, the incentives will be for maximisation of the discounted net present value of the asset, since the owner has the alternative of capitalising this value by selling his/her property rights (*ab zusus*). Here, the time horizon of the asset holder will have no negative impact on the use. The implications for the incentive structure are made clear by Alchian who writes that ‘capitalization of future effects into present values, combined with the ability to *capture* that market wealth by selling to a second party, provides an effective stimulus to the control of actions that affect present capital values.’

Further, transferability is not only desirable in order to neutralise possible negative effects arising from personal time preferences, but is also seen as a pre-condition for *dynamic/adaptive efficiency*. The argument is that only with full transferability will the resources be used by the actor/entrepreneur that has the best talent for it, and thus achieves the highest productivity. If this is to be realised there has to exist well-functioning secondary markets for property rights. The capital markets will thus ideally, through their continuous evaluation of firms, favour organisations that combine trial-generation and error-elimination in the best way. In addition, it is a pre-condition for well-functioning capital markets that one is free to use ones property as security when taking loans (*ab zusus*).

A third qualitative demand on property rights, discussed by Pejovich, is what he terms a *constitutional guarantee* of ownership which ‘divorces economic wealth from political power.’ The demand may appear controversial, but its basic implication is that economic wealth of an individual should not be dependent on him/her having political power, a situation that was rule rather than exception in communist economies. Exclusive and transferable rights, in combination with a constitutional guarantee may thus, if adhered to, provide a boundary between economics and politics, and thus enhance the long-term stability and predictability. If such a border does not exist it may turn to a strong disincentive for long-term investment and entrepreneurship by adding a substantial element of political risk into every investment analysis. In short, the described “ideal type” of property rights, given that they are perfectly delineated and enforced, is the one which would bring the social and private rates of return most closely in parity, and thus result in growth.

### 3.2. Property rights and transaction costs: delineation of rights

The importance of property rights with respect to economic outcomes is something which ascertains itself not only by means of supplying different incentive structures to the economic actors (see above); they will also matter by implying different levels of transaction costs connected to maintaining the existing system of property rights. **Making sure the economy develops the best possible way over time, in main relying on the right incentives for innovation (technical as well as organisational).** The arguments for productive, allocative and dynamic efficiency are developed and put in a testable form in Grosfeld (1991), pp. 145-150.

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58 Making sure the economy develops the best possible way over time, in main relying on the right incentives for innovation (technical as well as organisational).
59 The arguments for productive, allocative and dynamic efficiency are developed and put in a testable form in Grosfeld (1991), pp. 145-150.
60 Pejovich (1990), p. 29.
61 For an empirical analysis of a related issue, see Frydman et al. (1998) who present empirical evidence that politicisation of decision making is responsible for observed inefficiencies in the cost behaviour of state-owned enterprises in the Czech Republic, Hungary and Poland as compared to privatised firms.
rights, i.e. some systems/regimes of property rights will have lower transaction costs than others, implying greater/lower over-all efficiency in the economy. The use, protection and transfer of property rights, like all other aspects of exchange in the real world, is related to positive transaction costs. The total transaction cost pertaining to a specific regime of property rights can be divided into two groups, the first relating to the exchange (acquiring and disposing) and protection of rights, and the other related to the use of the same, for example monitoring costs (agency costs).63 Both depend on the institutional set-up, a set-up which ideally should enable the formation of exclusive and freely transferable property rights as well as provide protection for the owners and exclude others from the use of these scarce resources without the explicit or implicit approval of the owner. The relationship is put succinctly by Eggertsson who concludes that ‘the institutional framework of society determines the cost of controlling assets, which influences both how resources are used and the willingness of individuals to acquire and invest in assets.’64

The costs for formation, i.e. costs pertaining to the search process and negotiation costs, depend on the amount of information that is readily available. Consequently, the larger the quantity and the better the quality of information available to the potential purchaser of a property right, the lower the transaction cost for this exchange.65 An implication is that, for example, disclosure-requirements for joint-stock corporations may be seen as a perfectly legitimate regulation even if it increases costs for the individual firm per se.66 Transaction costs will thus be higher if there is no market for evaluation of rights to goods, services or firms, a fact which make us aware of the necessity of functioning markets for productive capacity, capital, goods, services, labour and so on, as well as other mechanisms to provide the maximum amount of information and transparency at lowest possible cost.

Supposing that the formation of a regime of clearly defined property rights has taken place, then the value of these rights will be affected by, among other things, the amount of resources needed to have these protected and respected by other agents.67 Since transacting is costly, property rights will only be protected up to a point where the marginal cost for protection equals the extra revenue/utility resulting from this additional use of the asset, i.e. the value of an asset can be maximised by less than full protection of it.68 The assets obviously have no value to the owner if transaction costs relating to their delineation and defence are higher than rents accruing from the assets in question. This protection is a typical public good with increasing returns to scale, where the state has an important role to play since such

63 Agency costs are discussed in the section on corporate governance, see Section 4.
65 See Pejovich (1990), pp. 38 ff.
67 Of course the actual value of all property rights/assets primarily depends on the capitalised net value of profits or rents attached to them. This net value, however, may be increased or decreased depending on the level of transaction costs related to its acquisition, use and protection.
68 Cf. Barzel (1989), pp. 1-4; Alchian (1969), pp. 352-355. An example is the very talented researcher who holds unique knowledge/information on a topic, which he/she sells to various clients when working as a consultant on his/her “spare” time. The cost to make perfectly sure that this information is not spread to other potential customers would be prohibitive, and the same researcher may also find pleasure (utility) in making sure that others know about his talent by dissipating some of the knowledge during, for example, cocktail-party conversations – i.e. full protection is neither feasible nor wanted.
provision can serve to drastically reduce total resources (transaction costs) spent on protection, thus increasing total wealth in society.

The “ideal type” society with low transaction costs pertaining to the protection of property rights would thus be one which is based on the rule of law; where contracts are fulfilled by most actors and those who do not are disciplined according to existing law by central authorities; where social norms are such that they defer individuals from infringing on others rights etc. The importance of the latter cannot be underestimated; not even the most efficient judiciary could function if it would have to settle even a small fraction of all exchanges taking place. In a well-functioning economy therefore the majority of exchanges rely on informal rules and self-reinforcing mechanisms. Hence, the implications of a specific property rights regime will depend on the general institutional set-up, and one cannot expect identical ownership structures in two countries to have identical effects and outcomes.

However, where there is not free trade as well as perfect delineation and enforcement of property rights this situation remains a largely theoretical benchmark. Eggertsson mentions a number of factors which may introduce significant and positive transaction costs into market exchange: a weak state failing to protect and enforce rights; when the state precludes exclusive rights in some areas; by imposing administrative regulations, for example price-ceilings, which limit transferability and cause people to waste resources on queuing, lobbying etc. and thus precludes an efficient allocation of rights; by introducing regulations which overly limit the choice-set of economic agents, for example as was the case in the centrally administered economy.69

Of importance for this study is that this points to the important, albeit changing, role of the state – both during and after privatisation. If transaction costs were zero and property rights exclusive and freely transferable, the initial distribution of property rights would not affect the efficiency with which resources were put to use, only the distribution of wealth. However, transaction costs are not zero. Thus, during privatisation it is important to acknowledge that in a world of uncertainty and positive transaction costs the initial distribution of property rights is not likely to quickly re-adjust to an efficient solution, i.e. the policy of privatisation (who gets what) will affect the economic outcomes for some time to come. It is thus important to “get things as right as they can get”, given the constraints, already from the beginning. After privatisation the state remains important, the prime task then should be to ensure the smoothest possible exchange and protection of rights in order to make possible the gradual adaptation to changing conditions and thus to increase efficiency.

3.3. Is there a case for private property rights?

Above was discussed the characteristics and implications of exclusive and transferable property rights, which leaves the question whether such a regime is more compatible with private rather than state ownership? Although it is not within the scope of this study to once again try to prove the advantages of private ownership, neither

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theoretically nor empirically, one cannot altogether avoid the question. Thus, below is briefly examined the theoretical reasoning and some empirical evidence.

The theoretical arguments for private ownership mainly revolve around the implications for incentives. One line of reasoning focuses on the proposition that with state ownership the nominal owners (citizens) have neither interest nor possibility to affect their agents (politicians and public managers), a situation which results in high agency costs and X-inefficiency. The lack of interest is due to the very vague and indirect impact on the individual of the profit/loss of the public enterprise. The limited possibility to influence/control the agents is derived from the very dispersed ownership and the high agency costs connected to making their voice heard through the ballot box. An implication is that public firms and managers may be guided by and pursue other motives than profit maximisation, thus complicating coordination, motivation and causing bureaucratisation. This theoretical line of reasoning is illustrated by Hanke who writes that:

'[t]he consequences of public ownership are thus predictable. Public managers and employees allocate resources (assets) that do not belong to them. Hence they do not bear the costs of their decisions; nor do they gain from efficient behavior. Since the nominal owners...do not have strong incentives to monitor the performance of public employees, the costs of shirking are relatively low.'

The weakness in this reasoning is that the scenario depicted by Hanke may just as well be that of a modern industrial joint-stock corporation where ownership is dispersed, that is after all the so-called agency problem. The same situation with management not bearing the full consequences of their actions and problems of monitoring are present in any firm without sole proprietorship. The motivation for public managers and politicians may be equally good (bad) as for private agents, and it is thus not self-evident that agency costs must be higher with state ownership; if functioning incentive systems can be constructed in the private sector the same can be done in the public sector.

To make a theoretical case for private property rights it is instead necessary to focus on the transferability of rights where the inherent disadvantages of state ownership become more obvious. Transferability of rights is not compatible with state ownership in that there can be no endogenous change in property rights of state-held assets. This is in congruence with Alchian who holds that 'the inability of a public owner to sell his share of public ownership' to be the main difference between the two systems of ownership. As a citizen-owner of an enterprise, one can only divest this holding by emigration (or suicide). The alternative is exogenous

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70 In general elections there are many issues other than the public company X that may have a higher priority on behalf of the principal (voter).
71 For an excellent account on the perverse effects on management behaviour resulting from non-profit goals under various types of ownership configurations, refer to Alchian (1969), p. 352 ff. Also, note that this study is only concerned with various industrial concerns, not public utilities, health care etc.
73 See discussion in Sappington and Stiglitz (1987) who focus on differences in transaction costs for government intervention, where state ownership lowers them, making it more likely with intervention; also see discussion in Suleiman and Waterbury (1990a), pp. 4-7.
74 Alchian (1965), p. 822 [emphasis in original].
change, i.e. change of title to a public enterprise taking place through government fiat after a process of collective choice (for example privatisation). None of the scenarios accommodates for transferability while the enterprise is a public one. When transferability is non-existent none of the economic advantages related to it can be realised, for example: (i) there can be no concentration of ownership with the resulting improvements of incentives on behalf of the principals; (ii) comparative advantages in ownership cannot be realised despite the fact that the different talents, time preferences etc. of citizens make for comparative advantages in ownership; and (iii) utility cannot be by re-allocating risk to fit the utility functions of different individuals. It is thus the transferability of rights that make possible the separation and dynamic specialisation of ownership and control, thereby realising the gains from comparative advantages in the two tasks. In addition, transferability is what makes evaluation of management possible, both through “voice” and “exit” (see Section 4.2).

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Turning to the empirical studies, however, there is compelling support for improving performance post-privatisation. Still, neither the causal relationship nor the theoretical underpinnings are clear. For example, not even the above argument on transferability is left undisputed. In one study Borcherding et al. conclude that ‘it is not so much the difference in the transferability of ownership but the lack of competition which leads to the often observed less efficient production in public firms.’ Hence, there exist no firm theoretical grounds for claiming that private ownership per se is superior. The question which is unresolved is whether property in the legal sense (i.e. private vs. state ownership) makes much difference on the performance of assets, or if it is the market structure (i.e. competition) that is the crucial variable. However, there is empirical support for private ownership being mostly in congruence with competitive markets, which in turn, leads to better performance. Also, there is evidence which points to within competitive markets private ownership is superior to state ownership and, as noted above, that performance improves after privatisation.

A non-controversial conclusion, in line with the general approach, is thus that many factors together will determine the relative efficiency with which a firm is

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75 It is of course possible to imagine a fully private joint-stock company where every adult citizen holds a share, but it is highly unlikely considering the gains that can be made from increased holdings by those who are interested and prepared to sacrifice time for monitoring the company.

76 Alchian (1965), pp. 823-828.


78 Borcherding et al. (1982), p. 136, their conclusion is based on a review of app. 50 empirical studies of firms in the United States, western Germany, Australia, Switzerland and Canada – the results showed higher unit costs for public undertakings in the vast majority of cases; for another overview of the empirical findings, see Bös (1991), pp. 50-60.


80 Cf. Mises (1974), pp. 120-127; Grosfeld (1991), pp. 142-161; Comisso (1991); Hartley and Parker (1991); Alessi (1980), interesting is that Alessi, among other things, find that state enterprises adopt innovation more slowly, have lower rates of return, overcapitalise, and are more sensitive to organised political groups than unorganised.

81 Kay and Thompson (1986), p. 16; on post-privatisation performance, see footnote 77.
operated, for example market structure (degree of competition), ownership structure (private vs. state, and type of organisation), and the control structure.\textsuperscript{82} It is clearly difficult to imagine revolutionary improvements in efficiency resulting from the introduction of one or the other (markets or private property) on their own since the ‘essence of property based arrangements involve reliance on the self-interest of individual owners acting under the constraints of a market.’\textsuperscript{83} All previous and subsequent statements on incentive effects etc. of property rights rest on the implicit assumption of the existence of market competition, although it is not a subject that will be treated explicitly in this study.

4. Corporate governance in economies of transformation

The above discussion on the virtues of private property rights rested primarily on their effect on incentives, and it is now returned to the question which was implicitly posed above, i.e. what happens in a world where the traditional owner-entrepreneur-manager is more rare than common? What happens when there is a divorce of ownership and control? How can the gains accruing from a specialisation in management and finance, respectively, be realised? What happens when ownership is divided between many parties, each owning only a small part of the property and thus having the title to only a fraction of the ensuing profit? These are questions which have been in the focus of economic discourse over the entire 20th century, but especially since the work of Berle and Means on the modern corporation and motives other than profit maximisation on behalf of hired managers.\textsuperscript{84} The basic question, put in its cruelest form, is: \textit{how can it be made worthwhile for economic agents with capital (owners/financiers) to entrust the same to strangers (managers)?}\textsuperscript{85}

In this section the aim is to provide a framework through which questions like the ones above can be analysed. In Section 4.1 the basic concept of agency costs is introduced, its relationship to transaction costs highlighted and the ensuing need for corporate governance discussed. The implications of the communist heritage in Eastern Europe is also touched upon. Section 4.2 outlines the basic features of various mechanisms and institutional solutions that are used to reduce agency costs. In Section 4.3, finally, is discussed how these various mechanisms are applied in the dominant systems for corporate governance which have evolved in the developed market economies. Also, their implications for various institutional solutions, for example the role of the stock market, are discussed.

\textsuperscript{82} See Hartley and Parker (1991).
\textsuperscript{83} Frydman and Rapaczynski (1994), p. 177.
\textsuperscript{84} Berle and Means (1932).
\textsuperscript{85} Even though the question is a paraphrase of Jensen and Meckling (1976), p. 330 and Alchian (1969), all of whom have asked similar questions, it must be noted that already Adam Smith was aware of a potential problem. Smith wrote: ‘[t]he directors of such companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.’ Source: Smith (1976:1776), p. 741. However, the issue addressed by Smith was one qualitatively and quantitatively very different; not until the emergence of the large corporation did the agency problem become acute.
4.1. Agency-costs and corporate governance

At the core of the question of corporate governance rests the agency problem, i.e. how to provide a mechanism whereby a principal (owner) can make an agent (management) act in congruence with his/her own objectives, under conditions of asymmetric information and diverging interests. The problem is found on various levels in organisations and society, for example in the relationship between management and workers as well as that between voters and politicians. In the following, however, focus is on the relationship between the firm (its management) and its principals (the owners), and to a lesser extent on the relationship between the firm and its creditors (the banks). The agency problem in this case results from the fact that stake-holders (owners and creditors), due to specialisation, are forced to delegate residual control rights (usus) to managers since they cannot get involved in everyday decisions.

There are, however, substantial economic advantages in holding usus (being in everyday control), managers have ample opportunities to take action that keeps net profit low, and at the same time increase their personal wealth/utility. This managerial discretion can manifest itself in various ways, shirking, short-termism and outright theft are all examples, although the most common behaviour is growth maximisation and diversification in place of profit maximisation. Empirical research also shows that managers, for example, ‘resist takeovers to protect their private benefits of control rather than to serve shareholders.’ These foregone profits for the owners/investors, in addition to the resources spent to minimise this type of opportunistic behaviour (monitoring costs and bonding costs), are in their sum total termed agency costs. Agency costs are thus costs incurred when an owner is using/attempting to use his/her property rights, making them the second part of the total transaction costs related to exclusive and transferable property rights. The two component parts of the total transaction costs are closely related in that effective institutions for the exchange and protection of rights may also serve to reduce agency costs pertaining to their use. This follows from the view of the firm as a nexus of internalised contracts; i.e. the better the general institutional environment for enforcement of contracts (external), the lesser the costs for formulating and supervising internal contracts.

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87 For discussions of managerial behaviour, cf. Baumol (1959), pp. 45-53 and 88-100; Marris (1964); Williamson (1964); also see Demsetz (1983) who, although recognising the problem, argues that the assumption of profit maximisation is not empirically valid for the owner-entrepreneur either (see pp. 377-381). The article makes explicit that the potential inefficiency arises from the fact that there are positive costs of monitoring, not from the division of ownership and control per se (see p. 380 ff.). This, however, is in full harmony with the ideas put forth in this study where positive transactions costs are a basic premise for the analysis.
89 Jensen and Meckling (1976), pp. 308-310.
90 For a discussion of the firm as a nexus of contracts, see Jensen and Meckling (1976). The difference between the explicit contracts of market-allocation and the implicit contracts used within organisations is that the former is a formal institution which in itself relies on formal institutions and organisations for its maintenance, while informal contracts to a greater degree rely on informal institutions for adherence. If formal contracts would be used for all exchanges, the total transaction costs would be higher as discussed above.
The core of the problem, and the explanation for the existence of agency costs, is that owners and management have different goals and incentives, and that monitoring is costly.\textsuperscript{91} The costs related to perfect delineation of the authority of managers are prohibitive; what owners can do is try to minimise the agency problem and agency cost through various arrangements and contracts, for example incentive pay, stock-based income in combination with various monitoring devices. Resources will be spent by the owner on this type of activities up to a level which 'equates the marginal cost of monitoring to the marginal wealth increment from reduced consumption of perquisites by the manager.'\textsuperscript{92}

Corporate governance is thus about lowering the transaction costs resulting from the specialisation in capital-suppliers and management, i.e. about finding and establishing institutions and mechanisms which can reduce the agency-costs arising from the separation of ownership and control. Without functioning governance it will not be possible to take advantage of the positive effects accruing from specialisation in ownership (capital supply) and management (for example economic, technological, and marketing skills) since capital owners simply would not dare to part with their capital and put it into ventures which are run by other people who have better information on the actual happenings within a firm and thus are in a position to use this money in many ways other than to maximise profit.

Of importance for this study is that these 'governance mechanisms are economic and legal institutions, that can be altered through the political process – sometimes for the better.'\textsuperscript{93} Bearing this in mind, the aim of policy ought to be to create a system in which external stake-holders (owners and creditors) can control and influence the internal work of management; in a competitive environment it is organisations with this type of corporate governance that eventually will be the main actors on the market.\textsuperscript{94} If this internal co-ordination is not in place and working, the external co-ordination of activities (the price system) will not yield the desired results in terms of resource allocation and increased efficiency, since corporate governance is a way of reinforcing the market signals on management.\textsuperscript{95} Under such a scenario, there is a risk that privatisation would not lead to profit maximisation, restructuring and increased efficiency. Such a situation would also hamper access to the external finance needed for restructuring. In all, the end result would be lower productivity and growth than would be the case with functioning structures for governance.

The agency problem is enhanced by the situation in Eastern Europe where monitoring is made difficult by the lack of stringent accounting rules, developed capital markets and experienced financial intermediaries, i.e. parts of the institutional set-up is partly lacking or underdeveloped. At the same time transformation, like any period of rapid change in the business environment, increases the need for monitoring, rendering the lack of it even more serious. Further, the inherent short-termism of managers is likely to be exaggerated when the insecurity of their own future position increases, and a change of ownership may well result in the dis-

\textsuperscript{91} Alchian and Demsetz (1972).
\textsuperscript{92} Jensen and Meckling (1976), pp. 329-330.
\textsuperscript{93} Shleifer and Vishny (1995), p. 3.
\textsuperscript{94} Cf. discussion in Frydman and Rapaczynski (1993); please note that they use the term “institutions” rather than “organisations”.
missal of incumbent management. Finally, the traditionally strong influence of management in the running of firms increases the agency problem, i.e. the countries have, to different degrees, inherited an insider problem. All of these factors together thus enhance the need for effective corporate governance. However, making this statement it is still far from clear how this co-ordination shall be achieved, looking at Germany and Japan illustrates that the question of corporate governance can be “solved” with very little room for the actual nominal owner.

4.2. What mechanisms for control?

What mechanisms are then available for this control/discipline of management and its behaviour? A crude classification can divide them as originating from four different markets, the market for corporate control, the product market, the labour market and the capital market. Beginning with the market for corporate control, i.e. the market where property rights are traded, there are two alternative ways through which owners can exert their influence, “voice” and “exit”. The former (voice) implies the active participation by owners. Malperformance on behalf of management would through active monitoring by owners result in an owner-initiated change of management. Exit, on the other hand, implies owners that are relatively passive with regard to management, and their influence remains indirect. By selling shares in a underperforming firm they will lower its value on the stock exchange, thereby making it more difficult and costly for the firm to raise capital on the capital market (see below). In addition, by lowering the price the firm will be opened up for potential hostile take-overs, with an accompanying risk of replacement of management.

Which one of these two mechanisms will be dominant will in turn depend upon the institutional set-up. A prerequisite for voice to be viable is, for example, concentrated ownership so that owners have both the power (enough votes) and the incentives (the wealth-effect of a substantial holding) to pursue this active monitoring. Exit, on the other hand, puts much stronger emphasis on a well-functioning stock market, not only because it is necessary to have a relatively liquid secondary market if an investor shall be able to sell his/her holdings when he/she so wishes, but also since it is the changing evaluation of a firm that conveys the signals both to banks and potential investors. Also, if owners cannot capitalise their assets they will not have the incentive to maximise the net present value of the firm.

Thus, the greater the concentration in ownership the more likely it would be to see owners taking an active interest in firms. What forms this active monitoring will actually take, and what levels of ownership concentration is needed to create the incentives for active monitoring, will also depend on various formal institutions. For example, rules on preferential voting rights and whether share ownership is admi-

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96 See Frydman and Rapaczynski (1993), pp. 41-43.
97 On Germany and Japan, cf. Prevezer and Ricketts (1994) and Roe (1993); for a discussion of the somewhat ambiguous relationship between corporate governance and private ownership see Williamson (1992); also see Rapaczynski (1992).
98 For seminal work, see Manne (1965); for an extensive discussion of the implications of exit and voice the reader is referred to the original, i.e. Hirschman (1970), pp. 1-43; also, for a discussion of this in relation to the transforming economies in Eastern Europe, see Hamilton and Isachsen (1991), pp. 406-410.
sible to all economic agents or not, is such an issue in corporate law. Conversely, one may expect an illiquid stock market to be associated with voice rather than exit. In addition, informal institutions will be important. It may, for example, be hypothesised that the lack of a business culture where managers are used to be subordinated to outside owners may lead to (Slovak) managers having some difficulties in accepting, understanding and accommodating the influence of outside owners. If this proposition holds, one would also expect manoeuvring on behalf of management to keep owners at arms length. In the same line of reasoning, it should not surprise if the state finds it difficult to give up their former formal control over enterprises.

A basic requirement for the market for corporate control to function, irrespective if focusing on voice or exit, is that information about the firms, their financial status and so on is widely accessible. In terms of policy, this implies the existence of for example effective disclosure requirements. This is then yet an example of the complexity of institutions; a market for corporate control may be created by political and administrative fiat but will remain dysfunctional as long as, for example: (i) disclosure is insufficient; (ii) information about the ownership structure is not available to existing and potential owners; (iii) a business press is not available; (iv) low-cost (transaction costs) mechanisms for the sale and purchase of shares is lacking. The stock exchange as a formal institution thus relies on a complex network of laws and regulations which together influences trading, the behaviour of agents and intermediaries, protects minority shareholders etc. These factors are all necessary preconditions since also voice requires widely available information and mechanisms through which trade in property rights can take place.

A special aspect of this supportive institutional set-up is regulations pertaining to the protection of minority shareholders. Protection of their rights can, for example, be in the form of restrictions on self-dealing of insiders or in the form of voting rights. If minority protection is lacking it would most likely have a very negative impact on the development of for example liquidity since investors would be afraid of entering the market. Also, in Slovakia where privatisation led to very widespread shareholding by the general public – direct or indirect – such protection may be expected to be of crucial importance for the development of the stock market.

A second mechanism for control is the discipline that will emanate through competition on the product market. This mechanism can work in two ways. Firstly, if competition is fierce, profits will be lowered (in comparison to other companies in industry) for those companies who cannot keep up, signalling to owners that management is not fully up to its task and that it should be replaced. Secondly, even if owners do not take action, the discipline of competition will cause underperforming companies to go bankrupt, thereby both freeing productive resources for a better

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99 Cf. Shleifer and Vishny (1995), pp. 21-23. However, it should be emphasised that this protection ought not to not be taken to the extreme, e.g. protection in the sense of requiring in law the equal purchase price in the case of a take-over. The latter would bear the risk of retarding transferability and thus hindering effective corporate governance. This is in line with the property rights approach which acknowledges that there exists a real premium for larger blocs of shares in comparison with the odd share offered by a small individual investor, i.e. the economic value of shares is not always equal even though voting rights are identical, see Manne (1965), pp. 116-117.

100 See Hart (1983).
use and re-evaluating the performance of the responsible executive managers. The minimum requirement for any firm is to show positive profits, this is ‘the criterion by which the economic system selects survivors….’ Managerial slack will thus be possible only as long as the firm can show sufficient profits to keep up with its competitors. A prerequisite for this mechanism is the development of competitive product markets, a development complicated by the monopolised industrial structure inherited in Eastern Europe, but mitigated by the promotion of international trade and competition. Yet, it should be remembered that this disciplining mechanism only poses a downward limit for acceptable results, behaviour and managerial slack. In addition, it is by no means certain that it will be the most efficient firms that survive – this will also be affected by the institutional set-up in terms of subsidies and regulations, i.e. the role of the state in industry and trade policy.

A third market that assists in disciplining management is the capital market. Here creditors will have an influence, partly through their assessments for new credits, partly through the threat of bankruptcy. An underperforming firm will thus face higher costs for credit and/or increased demands for collateral when attempting to acquire new funds; this holds irrespective if they seek to acquire these resources by emission of equity, bonds or through direct credit. Jensen and Meckling write: ‘[t]he price buyers will be willing to pay for fixed claims [i.e. lending money in return for collateral, my remark] will thus be inversely related…to the probability of bankruptcy.’ A pre-condition for this mechanism, as well as the product market to work is, however, the existence of an institutional set-up making bankruptcy possible – something which at the outset of reform was lacking in all transforming economies in Eastern Europe. Further, just like with competition on the product market, the threat of bankruptcy is only a real alternative for firms and managers with very bad performance – it is no guarantee of great performance.

Finally, there will be competition on the managerial labour market that may serve to discipline existing management. Fama divides this into an “inside” and an “outside” market for management, where the first refers to possible careers within the firm and the latter to the external labour market in general. An example is that senior management will have a strong interest in showing good results if they are to remain attractive on the labour market; junior management will also have an incentive to watch for managerial slack – observations which may render them a future position among the ranks of senior management. A potential problem in Slovakia and Eastern Europe is that the efficiency of these mechanisms, i.e. internal and external labour markets, may be hampered not only by the lack of institutions and organisations which make for a mobile labour market, but also by the relative lack of experienced management, financial expertise and so on. This lack is a conse-

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102 See Easterbrook (1984), p. 652 ff.; in his article he concludes that monitoring by debt is cost-efficient and thus explains the peculiar behaviour of paying dividends and at the same time raising new capital on the debt-markets.
103 Jensen and Meckling (1976), p. 341; this is since there are costs related to bankruptcy which will consume part of the value of the assets of the firm.
104 See Fama (1980).
quence of the communist economic system that may be solved over time, but which during the process of transformation will limit competition by reducing the supply. A related aspect is that, given that the institutional set-up is conducive for “long-termism”, corporate governance may be strengthened by the informal institution of “reputation-building”. In such an environment firms and managers, in order to survive in the long run, stand to gain from honouring most of their promises. With respect to finance this good-will can serve to enable future financing.\footnote{Cf. Kreps (1990) who describes the faith arising from reputation-building as ‘the glue that permits mutually beneficial transactions to take place, transactions that would otherwise not be made because of their costs’ [quote on p. 93]; Diamond (1989) makes a formal model with focus on the relationship between borrowers and lenders.}

All these mechanisms serve the purpose of aligning the interests and incentives of managers with those of the owners. They are all important for the performance of the firm, but it is very difficult to grade them in terms of importance. Furthermore, depending on the general institutional set-up for governance they will be relied on to varying degrees, that is they refer to different systems for corporate governance – systems that in the theoretical literature seem quite distinct but which in reality tend to blend. These systems are briefly outlined below.

4.3. What systems for governance?

The above mechanisms for control/governance, and many others, have been used in various combinations and to varying extent in different countries/regions of the world.\footnote{An empirical overview of various existing models for corporate governance in OECD countries is found in Mayer (1996).} Together with the respective financial systems, they constitute different institutional set-ups for corporate governance and finance. The question of finance is obviously closely related to corporate governance, since in the real world governance is constituted by an intricate network of relations where banks and other creditors who provide investment capital are at least as important stakeholders in the development of a firm as are the share-holders. Not seldom do the functions merge when banks, providing credit, also hold shares – either directly or through some intermediary.

Looked upon from the financial side one can state that a firm without sufficient internal resources to cover its financial needs has two basic alternatives, either “arms-length finance” or “control-oriented finance”.\footnote{See Berglöf (1995), pp. 66-74; Berglöf develops a framework, based on these two alternatives, for understanding corporate governance in economies in transformation.} Although definitions and classifications of different systems of governance and finance abound, yet another will be attempted below, one that later can be used for analysing the specific situation in Slovakia. Initially a distinction is made between the market-system and bank-system (Section 4.3.1), which both serve to exemplify and develop the above distinction between arms-length finance and control-oriented finance. The distinction is then elaborated by focusing on different control-oriented systems, differentiating between “debt-control” and “equity-control” (Section 4.3.2). In a sense, these sections thus focus on different issues: firstly, the distinction between passive and active owners/investors; secondly, if active, what basis is there for this control?
4.3.1. Market-oriented vs. bank-oriented systems

One of the two “ideal-type” systems would be the market-oriented system for governance and finance, commonly referred to as the “Anglo-American” or “outsider” system. This system, although being the one most frequently referred to in neoclassical textbooks on corporate governance, is in a sense an exception which above all is found in the United States (US) and the United Kingdom (UK). Equity is usually owned either directly by the individual investor or through an intermediary and tends to be dispersed and anonymous. An important feature is the emphasis on institutional investors (pension funds etc.), which in the UK own about two-thirds of the outstanding equity, but with relatively small stakes in each firm. Characteristic is also its active market for corporate control and concurrent greater role for the outside investor. A basic pre-condition is an active and well-developed capital market for trade in property-rights. This however does not imply that the individual owners take an active part in the running of the firms.

Regarding finance, the firms rely more on issuing bonds and shares than on credits from banks, which have a rather small role in financing the activities of firms. It is thus a special case of what Berglöf terms “arms-length-finance”, i.e. one based on relatively passive investors who provide funds in return for contingent ownership to various assets – either through purchases of bonds or shares by portfolio investors without ambition to control – only to spread risk and/or maximise profits. An important characteristic of arms-length-finance is thus that investors usually remain passive with respect to the running of the firms as long as it performs adequately enough to fulfill its obligations to the investor, or in the case of shares, as long as the price development of the share equals or exceeds expectations. \(^{109}\)

The system is related to a one-tier board system where owners as well as executive management is represented, both of whom are elected by the controlling shareholders and responsible for the annual shareholders meeting. Here the “rights and obligations of the board are indivisible and unalienable.” \(^{111}\) Owners are seldom directly represented on this board but rather elect outside experts from other firms or institutions with “an incentive to build up a reputation as experts in decision control.” \(^{112}\)

Rather than the pursuance of active control and direct monitoring of management by owners, governance relies above all on evaluation of performance and hostile take-overs of firms – or the threat of the same. \(^{113}\) It is thus a system where exit dominates voice. The underlying logic is that active trade in property rights gives a correct market-evaluation of the firm and its performance, managerial slack

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\(^{109}\) Mayer (1994), p. 188.


\(^{111}\) Moerland (1995), p. 25; this system is, in addition to the US and the UK, also frequent in Australia and Canada. The article by Moerland represents an excellent overview of the various disciplinary mechanisms used in different corporate systems.

\(^{112}\) Moerland (1995), p. 25; the importance of reputation-building should not be underestimated, in e.g. an audit firm it is often the most valuable asset.

\(^{113}\) The mechanisms for the actual take-over can vary, the three basic techniques are direct purchase of shares, a proxy fight, or merger – although the latter is not connected to any “hostility” – see discussion in Manne (1965), p. 114 ff.
will consequently cause equity-prices to fall below their potential value. Low prices, in turn, open up for a hostile take-over to be effected. However, also the mere threat of a take-over is a forceful disciplinary mechanism and it has been asserted by many economists that pressure on management is the most likely to be successful if there is a chance for take-overs when performance is not adequate.\footnote{See Parker (1993), but also see Alchian (1965); Jensen and Meckling (1976); Fama (1980).}

Of interest in the Slovak setting is that Morck et al. found hostile take-overs to be the main force behind change of management when industry as a whole was poorly performing, whereas the board of directors were more successful at doing their job (monitoring and replacing underperforming executive management) when the firms were underperforming its industry. They explain these results with the fact that if the firm underperforms its industry ‘managers can be blamed with some confidence.’\footnote{See Morck et al. (1989) [quote on p. 842].} For Slovakia this may give some indication as to both the problems of effective monitoring by a one-tier system of board of directors during a period of economy-wide contraction (industrial production was 1993 app. 55 per cent of its 1990 level) and the importance of an alternative mechanism for replacing incumbent managers, for example take-overs.\footnote{On industrial production, see Appendix A, TABLE D 1 (p. 301).}

An advantage of such a system includes that it provides a relatively inexpensive mechanism for corporate governance, i.e. a system with low transaction costs. It is also an institution for the effective spreading of risk among investors by providing a mechanism whereby owners can capitalise their property rights, thus reducing the risk-premium demanded by owners for holding shares. This explains the relatively low concentration of ownership since the alternative cost (risk-cost) of holding controlling blocks of shares increases in a market-oriented system. However, for the system to work properly markets must be functional and liquid. Ideally investors purchase and sell to generate revenue, as opposed to gaining controlling stakes in different firms. Also, as previously discussed, information on the firms and their financial situation must be widely available. Still, as Berglöf points out, in the transforming economies these prerequisites are often not met. Asset markets are generally illiquid and property rights are still ambiguous.\footnote{Berglöf (1995), p. 69; factors affecting the balance between the two is analysed in Jensen and Meckling (1976).} A consequence is that as long as good collateral is not readily available, the possibilities of relying on arms-length finance/a market-oriented system will be limited. Other drawbacks of the system include that it might enhance the short-term interests of management since they cannot be sure to stay in position, and it makes equity-financed investment more expensive since dividends in general are higher in the market-systems of the UK and the US in comparison to other economies.

The other “ideal-type” system for governance and finance is the bank-oriented system.\footnote{This type of governance is also referred to as the “insider”, “Continental” or “network-oriented” system. Still, below will be used the term bank-system, and it will be exemplified by the situation which is prevalent in the Germanic countries of Europe, i.e. Germany, Austria, Switzerland and the Netherlands. It should be noted that this makes our overview differ from Moerland network-oriented systems which includes also for example the family control which is prevalent in the “Latin” countries of Europe, i.e. Italy, Spain, France and Belgium, and the Japanese “keiretsus”, see Moerland (1995), pp. 20-22.} Here banks play an important role both in finance and governance. The
system is related to a passive and relatively less developed and liquid capital market and stock market, as opposed to the market-system. Savings in the economy are here redistributed mainly through the banking system or different savings associations. Consequently, firms often finance their activities through bank credits rather than through new emissions of shares or bonds. In return for financing the firm is forced to give up part of control in one way or another, thus making it a special case of what Berglöf terms control-oriented-finance.  

Ownership in this system has been found to be more concentrated, control-oriented and long run. The role of the individual investor/share-holder is rather limited; the dominant owners are usually families, banks and other firms or groups of firms through an intricate system of cross-ownership. In part, this can be explained by the fact that a bank-oriented system, with less room for risk-spreading than a market-system with its lively stock-market, entails comparatively large risks for the banks, something which can be mitigated with large holdings and long-run network relations.

Governance is based on the active involvement of the owners, usually through the supervisory boards which is the board made up by outsiders in this two-tier board system. Senior executive management is found on the executive board, while owner-representatives, experts and potential representatives of the employees is found on the supervisory board, executive powers are thus separated from supervisory powers. In this system, monitoring is more important than market-evaluation, i.e. “voice” is a more important factor than is “exit”. The general picture is thus that this system is closer to both debt-control and equity-control (see Section 4.3.2) than is the market-oriented system. An advantage of the system is that the active involvement of banks may make external financing of investment an easier task – not unimportant in the Eastern European context. Also, as discussed above, the lack of liquid assets and markets in Eastern Europe make the alternative of arms-length-finance/a market-oriented system difficult to achieve on a larger scale – thus firms in need of finance will have to turn to some type of control-oriented finance. Control-oriented finance will also be the topic of the following section. In conclusion, these two systems, bank-system/control-oriented finance and market-system/arms-length finance, entail very different prospects for the stock exchange and for the type of finance to be relied upon by the firms.

4.3.2. Debt-control vs. equity-control

In the case of control-oriented finance there still exists many alternative ways to pursue this control, where control is a function of the type of claims held. A first classification would divide them into two groupings, debt-control and equity-control. Depending on where emphasis is put (debt or equity) one could also here talk about a bank-oriented vs. market-oriented system for corporate governance. Yet, the following discussion use the terms debt-control and equity-control since

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121 On bank-industry relations and networks see, Lindgren (1989).
123 A good comparison of the two is found in Mayer (1994).
they both say more about the basis for control than do any of the alternative classifications. Of interest in this context is that the role of the stock market will differ substantially between the two and it is therefore interesting to look at their respective characteristics.

The equity-control system is based on the controllers having equity in the firm in which they have an interest. This equity will then allow them to perform ex ante and interim control of the workings of the firm. The ex ante control would typically refer to various potential investment decisions. To perform this control, these equity holders may have taken seats on the supervisory board. A difference compared to debt-control is that this control, ex ante and interim, is control being performed when the firm is not in default, i.e. under “normal” operations, whereas debt-control will fill its most important function when the firm is underperforming and/or in default.

The major distinction between debt-control and equity-control lies in the nature of the claims on the firm. Debt-control is based on the controller holding debt in the firm; this has consequences for the nature of monitoring since these claims are state-contingent, as long as the firm keeps its part of the contract these debts cannot be turned over into equity. This implies that monitoring will be confined to ex post monitoring, i.e. after the firm has gone into default. Important to note, however, is that debt-control and equity-control are not mutually exclusive. Many investors will choose to have a combination of the two on the asset side of their balance sheet. A priori it is not possible to say what type of control will be the most efficient; this is highly dependent on the nature of the agency problem, for example, is management likely to overinvest or underinvest? In times when restructuring is necessary, debt-control may have some advantages compared to equity-control; on the other hand, on a more developed market, equity-control has advantages in that principals may use their control-capacity at an earlier stage.125

Just as important as the instruments, is the question of what type of actors that exercise this control, and what incentives and possibilities (concentration) they have. In effect, this is also what the general discussion has focused on, i.e. banks vs. shareholders, or insiders vs. outsiders. Ownership by insiders clearly bears the risk of hindering restructuring, a problem that will be returned to when analysing the methods for privatisation (see Chapter IV:2). However, since it would mean bringing the discussion too far astray to touch more deeply on that topic, that is left for the description and analysis of the Slovak development. It will suffice to point out that ‘for the purposes of governance, the two intermediaries [investment funds and banks, my remark] form part of a single state-contingent corporate governance arrangement where control shifts from equity to debt when firms come into finan-

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124 For a discussion of the terms ex ante, interim and ex post monitoring see Aoki (1995), p. 15 ff.
125 For a discussion of these different aspects see Berglöf (1995), p. 70 ff.; the viewpoint of the manager in choosing a method for finance (debt or equity) is discussed in Jensen and Meckling (1976) in a positive analysis.
126 An example of this risk is given by a case study of 20 Polish companies that were privatised “through liquidation”, i.e. management/employee-buysouts. The results indicated that: (i) investment in fixed assets was far lower than average for the sector; (ii) wages were higher than average for the sector. Source: Hashi (1995).
cial distress.'\textsuperscript{127} This can also lead to a more balanced view, which can combine parts of the bank-system with parts of the market-system. Such a balanced view of ownership and governance will have to take into account that the question of ownership is not only about providing capital and about decreasing risk, but just as much about making strategic decisions and control.

It is not possible to conclude what system is the best, the parallel existence of different systems in different parts of the world indicates that trade-offs between the costs connected to the various systems and mechanisms to some extent equal each other. Nor is it possible on a theoretical level to make such a judgement, and Moerland is surely right in concluding that neither system can be considered superior.\textsuperscript{128} In addition, an international comparison suggests some convergence with an increasing role for institutional investors in market-systems and a decreasing role for the main banks in the bank-systems.\textsuperscript{129}

5. A “private property regime”?

The ambition with this concluding section is to bring together some constituent pieces of the analytical framework outlined above, into a more policy-oriented discussion. This also implies a discussion of the role of the state. A problem in the discussions about economic transformation in general has been the dichotomous view of the system ahead. Many have foreseen/wished for the establishment of laissez-faire economies with total private ownership, also of health care and services that in western Europe for long have been perceived as public utilities (for example water, gas, and postal services).\textsuperscript{130} In this study it is held that this view is based on a misconception, both with respect to the starting point for the transformations and the qualities of the desired goal, i.e. a “market economy”.

Focusing on the question of ownership it is possible to make a general and crude typology of different systems of ownership, each of which has certain characteristics with respect to economic outcomes. An “ideal-type” system of private ownership can then be defined as a situation where property rights are vested solely in the hands of individuals or legal persons with purely economic responsibilities. Public, or state ownership on the other hand is when these rights are executed by public agencies. The qualities of both have been discussed above. Hence, when discussing economic transformation, it has sometimes been assumed (implicitly or explicitly) that these two form opposites existing on a spectrum which the “transition” should abridge. Here, however, it is asserted that this view is a misconception. Rather, it is below argued that the concept of communal ownership comes closer than state ownership to depict the situation in communist economies.

In its most extreme form, communal ownership can be defined as when ‘individuals and groups have the right freely to use property as they wish, and no one is

\textsuperscript{127} Berglöf (1995), p. 73.
\textsuperscript{129} Moerland (1995), p. 32.
\textsuperscript{130} Admittedly there are still some who propose some type of “third way”, cf. Kowalik (1995).
excluded from doing so."\textsuperscript{131} This type of ownership is the least desirable; its effects include over-exploitation of the resources and lack of maintenance. In terms of economics it is a matter of not being able to internalise externalities.\textsuperscript{132} In terms of crude reality, it comes close to being a description of the situation that prevailed in communist economies. This is not to say that there was a situation identical to "open access" – rather, the situation should be understood as one where de facto property rights were divided among incumbent managers and their respective ministries according to a very blurred boundary. That is, property rights were communal, although held among a limited group of actors where their relative strength and influence to a large extent was determined by information asymmetries. Eggertsson defined the situation as one where:

\begin{quote}
the center was only partly able to enforce its property rights over economic resources, which gave various agents of the state an opportunity to capture valuable rights and establish informal or underground networks of contractual relations.\textsuperscript{133}
\end{quote}

The freedom of managers was thus a consequence of the inability of the administrative apparatus to effectively control the former.\textsuperscript{134} In the states of "really existing socialism" authority was spread among the party apparatus, central planning agencies, ministries, management and workers, who all had some part in the running of firms, although there were few rules that were non-negotiable. At the same time as everybody had some rights, there was nobody who had any clear obligations and responsibilities in the Hayekian sense; in short, with communal ownership there existed no actor or group of actors (political or economical) with exclusive rights and obligations.\textsuperscript{135} A result is that there was a large gap between social and private rates of return to the activities undertaken by the economic agents in society, i.e. a complicated way of expressing that "incentive structures are perverted".

An implication of this view is that the complex process of privatisation in a sense is about the reintroduction of the actual concept of property per se in Eastern Europe.\textsuperscript{136} During communism, there were neither exclusive, transferable nor individual rights. This puts the question of private ownership in a different light, while programmes for privatisation in western Europe and the United States are about what Starr term "balance-shifting" and "boundary-blurring" respectively, the Eastern European privatisations are examples of "institution-building" programmes.\textsuperscript{137} This implies that the somewhat ambiguous empirical evidence on the virtues of private ownership from western surveys should be interpreted bearing in mind that a public enterprise in the west is often active in a competitive market environment.

\textsuperscript{131} Comisso (1991), p. 167; on the concept of communal ownership also see Carson (1975); Eggertsson (1990), p. 36 and pp. 255-256.
\textsuperscript{132} For a discussion of externalities and its relation to property rights see Demsetz (1967).
\textsuperscript{133} Eggertsson (1994), p. 31.
\textsuperscript{134} Cf. Rutland (1985), pp. 168-187. The situation was in other words one characterised by an acute agency-problem where the negative implications were exacerbated by the lack of other than administrative mechanisms (e.g. competition) to align the interests of the agents with the principals.
\textsuperscript{135} See discussion in Major (1993), pp. 8-15; note that Major uses the term "nomenklatura-ownership" to describe the state-of-affairs; for a similar reasoning pointing to the "lack of owners", see Frydman and Rapaczynski (1994).
\textsuperscript{136} Frydman and Rapaczynski (1994), pp. 10-14.
\textsuperscript{137} See Starr (1990), p. 30 ff.
with a predominance of private enterprises. In Eastern Europe on the other hand, the “institution-building” is about creating both markets and owners, and preferably the type of owners who will provide a more efficient incentive-structure for management and who will have the power to enforce their interests.

Privatisation in this wider context can be viewed as having two main purposes, firstly to create the basic private institutions, and secondly to create the public institutions necessary to uphold the private institutions. A possible result of this process, and from the viewpoint of increased efficiency a desirable one, is the establishment of a “private property regime”. A “private property regime” has been defined as a ‘social and economic order defining a new set of expectations that individuals may have with respect to their ability to dispose of the assets recognized as “theirs” by the legal system.’ The process is thus about redefining the limits between public and private, changing the balance of power between state and non-state agents and creating a ‘new mode of interaction’ between the two. The introduction of private property rights will not make much difference if it does not alter the behaviour of economic agents, owners, management and the state. If the new owners find it more worthwhile to lobby for continued subsidies and/or protection rather than restructure the firms supposedly under their control, not much has been won. The risk for such behaviour can be decreased if: (i) the state makes clear (in action as well as words) that such behaviour (protection and/or subsidies) is no longer their field of business; and (ii) mechanisms which actually enable the new owners to effect restructuring are developed.

A “private property regime” is thus about striking a balance between government and private activities, a balance that puts emphasis on private initiatives and limit government intervention so as to change the behaviour of economic actors. Only then can the various roles connected to the existence of a private owner be realised. This holds both for the owner in the neo-classical approach, where his/her function as purveyors of capital and bearers of risk are emphasised, as well as for the Schumpeterian view of owners as entrepreneurs and initiative-takers.

While socialism and economic planning, in the words of Rutland, represented ‘the triumph of politics over economics, in that the dominant characteristic is the intrusion of strong political priorities into the economic arena….’, economic transformation and privatisation is about “re-economising” economic life and introducing a different type of economic rationality.

### 5.1. “Designer capitalism” and/or path dependency?

The fall of communism in Eastern Europe resulted in a new field of study, “transition economics”. Like all fields of academia there must be a struggle to keep the interest alive and ensure new recruits to the team. The fight in this field has been the much-debated issue of “shock therapy” versus “gradualism”. This de-

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140 Frydman et al. (1995), pp. 4-5.
141 Rutland (1985), p. 94.
142 For a good overview of the debate, see Slay (1994); also, Roland (1994); Hoen (1995); Dewatripont and Roland (1992); Gligorov (1993) and Åslund (1993).
bate can be analysed in terms of different views on the implications and strength of the concept of path dependence in institutional and economic change. The basis for the existence of path dependence is the bounded rationality of man, something which give rise to routinised behaviour and inertia. According to North there are two forces which affect the path of change, *positive transaction costs* and *increasing returns to institutions*. The latter implies that there is a substantial initial investment connected to the establishment of an institution and learning costs for agents when adapting their behaviour to the new rules, which together result in increasing returns to institutions over time. The same inertia applies to the change of our ideas and conceptions of the surrounding world. If transaction costs were zero this would not affect outcomes, but since they are not one gets what is termed *path dependence*, i.e. once on a specific development path the existence of institutions and their increasing returns tend to reinforce it.

The existence of path dependence *per se* is not really in dispute, neither by shock therapists nor by gradualists. However, the interpretation of its implications with regard to reform varies widely between the two. A crude and stylised gradualist stance would be one where the only viable approach to reform is one with gradual (slow) changes, where changes in the formal and informal institutions can keep pace and the two remain in harmony. In addition, in this interpretation the existing informal institutions (shaped by the communist system) set the outer limits to reform. In its extremes the approach not seldom tends towards historic determinism and a very pessimistic view towards the ability for policy driven change, especially so with privatisation. The stance is at times taken as a justification either for doing nothing or at the very least for resisting reform according to any grand blue-print, and, as Portes critically notes, many who termed themselves as gradualists have been those who in practice are in favour of the ‘uncoordinated improvisation.’

The view of the capacity of the state is somewhat ambiguous; while often denying its capacity to guide and implement large-scale reforms there is often a very positive view of the (strong) state and its capacity within *some* areas, typically in an active industrial policy.

A corresponding crude characterisation of the shock-therapist’s stance would be one where the existence of the very same path dependence is taken as an argument for radical and comprehensive change as soon as possible. The argument is often that reformers should seize the “window of opportunity” while it exists, and before conservative (leftist) interests have the time to muster any real resistance. The idea is often that by quickly and radically altering the formal rules of the game one can force actors to adapt; whether they like it or not. The shock-therapists thus often tend to another extreme in their overly optimistic view of the effectiveness of top-down policies and its relative disregard for micro-economic issues. There is also a tendency to play down problems of implementation as they do not fully take into account the existence of a political reality and the constraints posed by a lack of administrative competency and resources. Also here the view of the state is thus

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143 Nelson and Winters (1982).
144 North (1990), pp. 92-100.
somewhat ambiguous, while holding that the state is (should be) weak there are few doubts about its capacity to enact large-scale reforms.

The stance derived from the above analytical framework is one where both the extreme shock therapist and the gradualist view are seen as flawed, and one that to some extent represents a compromise between the two. The essence of the view taken of path dependence is caught well by Nielsen et al. when they write that transformation is about ‘path-shaping in a path-dependent context’.\textsuperscript{146} On the one hand it is held that the almost determinist view derived from the gradualist stance is seriously flawed. History gives ample illustration to that changes are for sure possible to achieve and that paths of development can be altered.\textsuperscript{147} North writes that ‘[a]lterations in the path come from unanticipated consequences of choices, external effects….’\textsuperscript{148} He also writes that such reversals and changes in paths ‘will typically occur through changes in the polity.’\textsuperscript{149} The collapse of the communist system is a good example of all of these factors and the installation of new democratic governments represents such a change that may induce a path reversal. On the other hand, the notion of an “institutional vacuum” which underlies the shock therapists discussions about using “the window of opportunity” is equally flawed from this viewpoint in that it goes against the essence of an institutional approach.\textsuperscript{150} Rather, the practical implications of the existence of path dependency for former communist economies is succinctly described by sociologist Ilja Srubar who writes that ‘whatever ingredients may be used by a particular restructuring recipes, they will still ultimately have to be cooked in the oil or water laid on by real socialism.’\textsuperscript{151} That is, while acknowledging that the recipe does matter, this still points to the importance of the past.

A further implication of the analytical framework concerns the consistency of reforms where it is necessary to stress the need for macro-economic as well as micro-economic reform.\textsuperscript{152} A neglect of the latter can be compared to erecting a huge football stadium, joining FIFA, training referees etc. without fostering the players to use this institutional set-up. Privatisation and the establishment of mechanisms for corporate governance is the micro-economic reform that will have to accompany macro-economic reform, representing the creation of the players to play the stadium and the formation of the incentives which make them behave in the manner best for the team and the league respectively.

The notion of a private property regime includes all of these elements, and represents a situation where the formal institutions are somewhat in accordance with the

\textsuperscript{146} Nielsen et al. (1995), p. 26 [emphasis added].
\textsuperscript{147} Recent example include Spain’s reverse (from stagnation to growth) since the 1950’s, or the opposite development in Argentina during the second half of the century.
\textsuperscript{148} North (1990), p. 112.
\textsuperscript{149} North (1990), p. 112.
\textsuperscript{150} Cf. Eggertsson (1994), pp. 28-30; 43-44.
\textsuperscript{152} With macro-economic reform is here understood measures like establishing competition by means of liberalisation; the establishment of various formal institutions (for example laws); the creation of an economic environment where uncertainty is decreased by means of anti-inflationary policies and the introduction of convertibility etc.
informal rules and norms. The combination of macro-economic reforms, privatisation, mechanisms for corporate governance may together with the gradual change/adaptation of informal rules provide the basis for a private property regime. One can but agree with Frydman and Rapaczynski in that:

'[p]rivatization...is a prototype of a microeconomic restructuring process, in which the elements of design must work in tandem with [the] unpredictable, spontaneous evolution of economic institutions.'

In all, although path dependency is a useful concept also for the study of transforming economies, it should be used with caution and not interpreted in a deterministic fashion. Instead of the grand designs focus should be directed to specific issues where formal rules which one is aware of being counter-productive should be replaced as soon as possible, not to cause more harm. Even Stark, who is a sceptic of "designer capitalism", writes that: "[i]nstitutional designs do matter and can be for the better, especially if they are delimited in scope to solve particular problems of governance and co-ordination for specific sectors...." The same holds also for the "traditional" tasks of the state, for example ensuring macro-economic stability, establishing law and order etc. On a more practical level, North writes that one implication of path dependence is that:

'organizations that evolved as a response to the institutional framework that is being replaced will have tenacious survival ability and will attempt to "sabotage" the institutional transformation taking place.'

Consequently, if such sabotage can be controlled and kept within reasonable limits, one would expect a self-reinforcing process once over the "threshold", i.e. when a sufficiently large part of existing organisations and actors have a stake in the survival of the new institutions (for example private ownership) they can counter the influence of organisations and bureaucracies with little or no interest/future in a new institutional set-up. The policy dilemma however remains, how is one to get to this "threshold" without serious backlashes that may cause the process of transformation to come to a halt?

5.2. The continued role of the state

The analytical framework concludes with a brief comment on the role of the state in the process of transformation, a role which is held to have been underestimated. In this case the question boils down to whether the state “from above” can manage privatisation and create a system for corporate governance? Considering the problems of information, foresight, collective choice, bounded rationality, informal constraints etc., i.e. what the analytical framework has said about transaction costs, ra-

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153 It is written “somewhat” since in a dynamic society there will always exist some tension between the two.
155 Stark (1992), p. 21 [fn. 10].
tionality and incentives – it is not a too daring proposition to claim that there will be immense problems for the central authorities to effect such a change. The risk of failure is real and concerns two elements, the risk of failure of reason and the risk of failure of will. The risk of intellectual failure is apparent (for example lack of foresight), and the best bet is probably to rely as far as possible on self-correcting mechanisms and markets. Just like central planning proved untenable, the perfect design is untenable. The risk of failure of will is no less apparent, and it brings the lessons of Olson to mind, i.e. that small and well organised interest groups are likely to be the ones with the greatest possibility to affect central decision making. A priori one would expect that these groups in many cases are the same as those that stand to lose the most from a liberal economic transformation, i.e. incumbent management and government bureaucrats.

However, a second question then is whether it is likely that the necessary institutions for corporate governance will evolve spontaneously over time? This is not either a probable solution – also in the western economies this development has been either guided, confirmed or upheld by political decisions and bodies. A further complication in Eastern Europe is that industry is already in place and there is thus little time for an evolutionary development of these structures. A third question is then whether it is possible to continue without establishing some type of control? The answer is clearly negative, the need for control did not disappear with the establishment of a free market and the demise of central administrative control, rather, the time when state-control is dismantled is also the time for privatisation and corporate governance.

The dilemma is obvious, policy-driven change is needed, although it cannot be “good”. Frydman and Rapaczynski put two minimum requirements on a design if it is to overcome the problems of incomplete information and lack of foresight. They are that:

‘(i) the process of change is set up in such a way as to generate by itself enough information which, when fed back into the reform process, can allow for a proper adjustment of the design, and (ii) the design is flexible enough to leave sufficient room for spontaneous future developments.’

Taking into account this lack of foresight, a market-oriented system for governance, with a large number of freely traded shares, becomes intuitively appealing because, as Alchian reminds us, even in the absence of foresight, rationality etc. the existence of competition, imitation and innovation will lead some economic agents to pass the real test of positive profits. He writes: ‘[t]he economic counterparts of genetic heredity, mutations, and natural selection are imitation, innovation, and

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158 See Olson (1965).
159 See Roe (1991) for a discussion of the active role of the state in the development of the United States’ system for corporate governance.
161 “Control” should here be understood as control which: (i) is based on proper incentives on behalf of the “controllers” (i.e. owners); and (ii) gives the proper incentives for the ones being “controlled” (i.e. management).
positive profits.\textsuperscript{163} Thus, providing for competition may serve as a counterforce when foresight is (as always) limited. With respect to privatisation policy this implies, among other things, that a transparent process will increase competition and limit the chances for successful rent-seeking efforts, or alternatively, increase the costs for rent-seeking. Further, of utmost importance is that mechanisms for entry and exit are steadfast in their design, this follows both from the demands on flexibility and from the need for corporate governance.

Thus, a possible resolution lies in the acknowledgement of the lack of foresight, and in the acknowledgement of the need to take into account the implications of informal institutions. If this is done, the state has an important role in many areas. Firstly, it should, if possible, repossess property rights, i.e. terminating a system of implicit communal ownership. Secondly, for the creation of a “private property regime” it is important to take a firm stance against subsidies and protection in order to change the expectations of the economic actors. Further, the creation of groups with genuine self-interest/motivation in continued reform and the development of corporate governance is crucial. Finally, the state naturally has its role in the establishment of the formal institutions, for example laws, courts, standards etc. These can then form a counterforce to the vested interests of management (both in individual firms and as acting against non-competitive policies on behalf of the government such as subsidies and protection).

\textsuperscript{163} Alchian (1950), pp. 213-220 [quote on p. 220].
CHAPTER III
From reform to transformation

‘The organizational pattern of a socialist economy is arbitrary and the fact that some hierarchical units are called enterprises is essentially accidental.’
Jozef Zielieniec, Czech economist

The 20th century saw the rise and fall of the communist dictatorships in Europe as well as in the former Soviet Union. For the countries in Eastern Europe the experiment, which symbolically ended in 1989, entailed an economic policy based on nationalisation, centralised resource allocation, isolation from “western” markets in trade and, in most cases, collectivisation and speedy industrialisation with an all too great bias towards heavy industry – combined with the all-encompassing control exercised by the communist party. The year 1989 was a turning-point which put an end to the politically led command-administrative economic system, at least in its traditional form. It stood clear that without economic, ideological and political support/control from Moscow the communist system could not survive in Eastern Europe. With its demise developed a need for radical and comprehensive reform aiming for the establishment of democracy, the rule of law and a market economy based on private ownership. The latter has entailed policies for liberalisation, macro-economic stabilisation, privatisation and other institutional changes. This has also applied in former Czechoslovakia and later in independent Slovakia.

This chapter, which takes a macro-perspective on the developments in Slovakia, is divided into two parts. The first part (Section 1) intends to provide a brief account of the Slovak economy in a historical perspective and an outline of the main characteristics and shortcomings of the communist economic system as it evolved from 1948 to 1989. This is done to set the scene and put into a perspective the type of challenges posed by economic transformation. It is for example shown that many of its features constituted a clear negation of a well-functioning market economy

1 Zielieniec (1990), p. 7.
3 It should be noted that the notion of 1989 as being the “end of history” (see Fukuyama [1989]) is not subscribed to. Rather, the situation is captured well by Starr (1990, p. 49) who writes that “[e]ven those of us who take satisfaction in the remarkable rebirth of civil society in the East and revitalization of the liberal state in the West ought to know that this is only another season of our passions and not history’s last stop.”
and that the post-1989 policies of macro-economic stabilisation, liberalisation and privatisation in most cases can be derived from these shortcomings.

The second part (Section 2) aims to give a broad picture of the general economic development in the territory of former Czechoslovakia post-1989. It will be shown that institutional change indeed has characterised most aspects of economic life. During this discussion the macro-economic results of Slovakia, up to and including 1996, will be accounted for. Following a steep drop in production, economic growth resumed in 1994. Recovery, however, is so far fragile and its future to a great extent depends on the results of the micro-economic reforms intended to change the structure of incentives of economic agents, for example on what is achieved through privatisation and the institution-building necessary for effective corporate governance.

1. The communist experience, 1948-1989

Following millennium-long Hungarian rule, Slovakia in 1918 was made part of the Republic of Czechoslovakia which rose in the remnants of the then Habsburg Empire under the leadership of President Tomás G. Masaryk (1918-1935). Despite attempts in the latter part of the 19th century to industrialise northern Hungary (Slovakia) the Slovak parts of the country remained a basically rural society with no prior experience of democracy. This was in sharp contrast to the Czech Lands (Bohemia and Moravia) which had early been industrialised and possessed a relatively large urban middle class. In fact, the early years of the First Republic saw a de-industrialisation of Slovakia with industrial employment falling from 127,000 in 1921 to 83,429 in 1926. At the 1930 census a mere 36 out of 1,000 inhabitants in Slovakia were employed in the manufacturing industry, as compared to 175 per 1,000 in the Czech Lands. Close to 60 per cent of the population was engaged in agriculture and the vast majority of trade with the Czech Lands consisted of export of raw materials and agricultural products in return for, for example, energy and engineering products. Even though Czechoslovakia as a whole was relatively wealthy, the great differences within the republic were untenable in the long run.

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1 For a thorough account of the history of Slovakia from the early ages to 1993, see Kirschbaum (1995). Carpatho-Ukraine was made part of the Republic of Czechoslovakia in 1919.
2 See Steiner (1973), pp. 11-16 for a discussion of Hungarian attempts to appease nationalist aspirations in Slovakia by improving the economic situation. This early industrialisation laid emphasis on production of semi-finished products and raw materials in the Slovak parts, for example iron, textile, paper, cotton, while the bulk of manufacturing of finished goods was located in the vicinity of Budapest. The rate of illiteracy bears telling evidence of the differences; in Bohemia it was 2.4 per cent and in Slovakia it was 15 per cent at the time of the 1921 census, see Teichova (1988), p. 15 [Table 2.1].
3 Steiner (1973), p. 15. The population of Slovakia was at the time somewhat less than three million (1930 census).
5 See UN ECE (1949), p. 235. National income per capita in 1938 was $176, about equal to the European average, although about half of the Swedish level ($367/capita). On the prevailing regional disparities throughout the inter-war period, see Slepicka and Hoskova (1989).
Following the economic crisis in the 1930s (see Figure 1), which put a halt to growth and resulted in nation-wide unemployment of 30 per cent in 1935, Slovak economic development was put high on the agenda in a 1937 industrialisation programme submitted to the new President, Edvard Benes (1935-38 and 1945-48). Although the programme was never fully implemented the immediate pre-war years saw a marked expansion of the heavy-armaments industry in Slovakia.

The Munich-agreement in September 1938 radically changed the course of history in the region. Initially it led to the German annexation of the Sudeten borderlands. In October, however, clerical-fascist Hlinka Slovak National People’s Party (HSNPP) declared Slovak autonomy and banned other parties. Then, in mid-March 1939, as Hitler disengaged from the agreement and deployed troops to establish the German protectorate of Bohemia and Moravia on what was left of the Czech Lands, Hitler recognised the nominal independence of the Slovak State. The regime of Jozef Tiso and HSNPP then engaged in active collaboration with Nazi Germany and joined the German campaign in the war against Poland and the Soviet Union.

During the war Slovak industrial capacity was expanded in order to serve the German war effort. Enterprises were integrated into German monopolies and German capital participation in Slovak industry rose from 4 to 51.6 per cent between 1938 and 1942. In addition to armaments industry, production was increased in for example food-processing, textiles and the chemical industry, with the result that 1948 industrial output was nearly double the pre-war (1937) level. On the whole the war did not ravage Slovakia to the same extent that it did the Czech Lands; Germanisation was not as intense and the non-Jewish population was not as se-

Figure 1. Economic indicators in interwar Czechoslovakia (index, 1921 = 100)

Source: Teichova (1988), pp. 18-19; own computations.

Between 1921 and 1933, when unemployment peaked, there was a tenfold increase, from 71,000 to 738,000.

verely afflicted by the German dominance. Actual occupation did not come until the end of the war, following the August 1944 Slovak National Uprising against the regime.

In the spring of 1945, Czechoslovakia was re-established under President Benes and his National Socialist Party. A whole package of reforms were implemented, including a general programme for reconstruction, a currency reform (November 1945), conversion of the recently erected and/or expanded armaments industry, and, liberalisation of the war-time state regulation of the economy. In the partially free May 1946 elections the Communists gained 38 per cent of the votes cast and became the largest party. An all-party coalition with communist Klement Gottwald as Prime Minister (PM) was established, united on the need for a new economic policy to discontinue the grave economic downturn of the 1930s. The new policies (the Kosice programme), aiming at, as of today, a still untried model of democratic market socialism, incorporated demands for nationalisation, land reform and economic planning.

A two-year (1947-1948) indicative plan for the economic development of the country was prepared and enacted, one aim of which was to accelerate the industrialisation of Slovakia. Part of the plan was the transfer of 337 industrial plants from the Czech Lands to Slovakia leading to a net increase of some 24,000 jobs in Slovakia. The land reform, initially launched in 1945, was intensified in a second stage (1947/48) which focused on land owned by former aristocracy and the church. Also, there was a major thrust towards nationalisation of industry following the 1945 Benes decrees (see Section 1.1).

Meanwhile, the communists and Moscow gradually strengthened their hold. When the Marshall plan was announced in the spring of 1947 the Prague government initially agreed to participate, although Moscow subsequently forced them to withdraw. Then in November 1947, partly as a dress-rehearsal for what was to come, the communists under the leadership of Gustav Husák staged a coup in Slovakia and gained control over the Slovak governmental structures. Finally, in the February 1948 coup, the Prague government met the same fate and the one-party communist state was established also in Czechoslovakia.

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11 See Appendix D, TABLE 6 (p. 323) on industrial production.
12 The Tiso regime deported about 58,000 Jews to extermination camps, see Ryder (1994), p. 607.
13 The uprising, which also demonstrated a will to once again establish a joint state with the Czech Lands, led to armed struggles in many parts of Slovakia. Its defeat did not come until Tiso invited German troops to the country.
14 The Communist Party in Slovakia did worse than the Czechoslovak Communist Party, reaping only 30.4 per cent; in Slovakia, the Democratic Party was the largest with 62 per cent of the votes cast, rendering them 43 seats in the National Assembly. For electoral results are referred to Appendix D, TABLE 1 (p. 321).
1.1. The command economy

The economic equivalent of the one-party political dictatorship was the Stalinist command economy. This was a model where the political sphere monopolised the economy by attempting to centralise all decision-making; a model which should enable Soviet-type industrialisation of Eastern Europe; a model which relied on state ownership and heavy industry, and paid little attention to the natural preconditions of the various countries; and, a model which initially aimed at self-supporting economies (while Czechoslovakia had indeed been a very open economy). The Stalinist model was thus “egalitarian” in that it imposed a similar system on all countries within the Soviet sphere of influence, irrespective of their historical heritage.

Among the first measures taken was nationalisation of most productive assets outside agriculture. In most countries of Eastern Europe this took place around 1948, although in Czechoslovakia the main thrust had come already in October 1945 with the Benes decrees. Nationalisation then covered a large portion of big firms, manufacturing enterprises, banks and insurance companies, with the result that 61.2 per cent of industrial employees came to work in the state sector. By the nature of things the process was more comprehensive in the Czech Lands than in Slovakia since big business was more predominant in the former. Following the 1948 coup the turn had come to medium-sized firms, and the constitution imposed a limit of private firms not being allowed more than 50 employees. As a result, already by the end of 1948 a very limited number of private firms with more than 20 employees remained. The further progress in establishing political control over economic activity is illustrated in Table 1.

A second pillar of the command economy was collectivisation, during which agricultural co-operatives with a strong state influence were established in Eastern Europe (see Table 2). Already in 1947, as part of the second stage of the land re-

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<td>99.2</td>
<td>99.5</td>
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<td>81.7</td>
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<td>99.5</td>
<td>99.7</td>
<td>99.7</td>
<td>99.9</td>
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<tr>
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<td>61.4</td>
<td>63.0</td>
<td>83.3</td>
<td>96.3</td>
<td>96.7</td>
<td>96.4</td>
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¹ 1950 figure refers to 1952.

¹⁸ For a brief but initiated overview, see Gregory (1990).
¹⁹ A detailed account for the process of nationalisation in 1945-48 is given by Mrázek (1968).
²⁰ Mrázek (1968), p. 98.
form, private ownership of land in Czechoslovakia was limited to 50 hectares; collectivisation proper was then initiated in February 1949. Various types of co-operatives were founded, differing mainly with respect to the degree of socialisation. The process, however, proceeded at a relatively moderate pace and private property was only gradually abandoned. Collectivisation proved more difficult in Slovakia than in the Czech Lands, and not until 1957 did state and collective ownership of land become predominant (54.4%).

The faster pace in the Czech Lands is reflected in the higher figures for Czechoslovakia as a whole in Table 2.

Formal resource allocation in this state-owned economy was strictly hierarchical with actual decision-making concentrated to the top-level of the party-controlled bureaucracy where priorities for the economic development were set. These priorities found their expression in a hierarchy of national economic plans (investment as well as production plans) prepared by the Central Planning Commission (CPC), although for operational purposes the detailed annual plans were the most important. From 1949, planning was no longer indicative but mandatory; direct contacts among firms, other than delivery contracts, were replaced by vertical contacts through ministries and planning agencies. In place of the market and (free) prices as mechanisms for allocation of scarce resources came central planning with material balances and centrally administered prices.

Table 2. Socialisation of agricultural land, 1952-1960 (per cent of total)

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<tbody>
<tr>
<td>Czechoslovakia</td>
<td>43</td>
<td>42</td>
<td>49</td>
<td>78</td>
<td>87</td>
</tr>
<tr>
<td>Poland</td>
<td>17</td>
<td>19</td>
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<tr>
<td>Hungary</td>
<td>37</td>
<td>31</td>
<td>39</td>
<td>29</td>
<td>77</td>
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<tr>
<td>Bulgaria</td>
<td>61</td>
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<td>85</td>
<td>91</td>
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<tr>
<td>Romania</td>
<td>-</td>
<td>24</td>
<td>38</td>
<td>55</td>
<td>84</td>
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22 The notable exception is Poland, which managed to retain a large private agricultural sector throughout the communist era. For an overview of agricultural policies and collectivisation in Eastern Europe, see Wädekin (1982).

23 On type I co-operatives ownership to land was retained, but machine-and-tractor stations established (abolished in 1960) and collective work encouraged; type II co-operatives meant that fields were united, but animal husbandry remained private; type III co-operatives were fully socialised units, but with a minor annual remuneration for the contribution of land; finally, type IV co-operatives were similar to type III co-operatives with the exception that no remuneration for the contribution of land was paid, see Kirschbaum (1995), pp. 234-235.

24 Kirschbaum (1995), pp. 234-236; by 1960 the figure had risen to 80.5 per cent, as compared to 87.4 per cent which applied for the country as a whole (see Table 2).

25 In the period 1950 to 1960 the rural population in Slovakia declined from 41.9 to 27 per cent, with most of the freed labour being absorbed by the expanding industrial sector.


27 Long-term targets for the economy were formulated in 5-, 15-, and 20-year plans. From 1969 there was established a separate economic plan for the Slovak Socialist Republic (SSR) by the national planning commission, however, the central plan remained the most important document.

28 Material balances can be compared to the credit and debit accounts of book-keeping where planned production and import was summarised in one column, and planned demand for the product was added in the other column; for a discussion, see Montias (1959). On Soviet-type planning in general cf. Hewett (1988), chs. 3-4; Kornai (1992), pp. 111-130 who in his extensive study provides the probably best and most thorough account of the workings of a socialist economy.
power and became tools of control for the planning agencies; the mere possession of money could not command real resources in the absence of an allocation order.  

A consequence, in addition to the loss of information normally carried in prices, was that imbalances could not be solved by means of price-rationing. When demand exceeded supply, as it often did, it was the task of the bureaucracy to set the priorities and decide which firms that should receive the needed inputs.

In practice all production and its use was planned in some detail in physical quantities. The allocation of inputs followed technical coefficients to estimate the necessary amount of input for a certain amount of output. The same went for labour, which was rationed by means of the size of the wage-fund allocated to different firms. The establishment of a state-monopoly over foreign trade was thus a natural extension of central planning since such a model requires planners to have full control over resources. The monopoly was controlled by the Ministry of Foreign Trade which ran some 30 different foreign trade enterprises, specialising in trade in different types of goods. These acted as intermediaries between the individual firm and its suppliers and/or customers with the effect that firms were insulated from international prices and competition. Also, the official policy was one of import substitution, i.e. to replace imports with domestically produced products if possible.

Initially, the system held its promises with respect to high growth albeit at the expense of private consumption, see Table 3. However, in the early 1960s growth decelerated substantially and in 1962-1963 there was a decrease even in official NMP in Czechoslovakia and industrial production declined in real terms in 1963. Shortages and imbalances were becoming more prominent; it was obvious that the system had serious flaws which no longer could be hidden by the extensive growth

Table 3. Selected economic indicators for Czechoslovakia, 1948-1989
(avg. annual real growth, %)

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<tbody>
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<td>National income</td>
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<td>7.1</td>
<td>7.0</td>
<td>2.0</td>
<td>6.9</td>
<td>5.7</td>
<td>3.6</td>
<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Gross industrial production</td>
<td>14.1</td>
<td>7.8</td>
<td>10.0</td>
<td>4.6</td>
<td>6.0</td>
<td>5.9</td>
<td>4.1</td>
<td>2.6</td>
<td>1.3</td>
<td>2.6</td>
<td>1.3</td>
<td>2.6</td>
<td>1.3</td>
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</tr>
<tr>
<td>Gross agricultural production</td>
<td>3.0</td>
<td>4.2</td>
<td>1.3</td>
<td>-0.6</td>
<td>4.6</td>
<td>2.2</td>
<td>1.9</td>
<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
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<td>1.8</td>
<td>1.3</td>
<td>1.8</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Gross financial investment</td>
<td>19.1</td>
<td>2.7</td>
<td>13.1</td>
<td>1.9</td>
<td>7.2</td>
<td>8.2</td>
<td>3.5</td>
<td>-1.1</td>
<td>2.5</td>
<td>2.0</td>
<td>4.0</td>
<td>2.0</td>
<td>4.0</td>
<td>2.0</td>
<td>4.0</td>
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</tr>
<tr>
<td>Inflation</td>
<td>.</td>
<td>.</td>
<td>-1.8</td>
<td>1.1</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
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</tr>
</tbody>
</table>


1 Average for the 1960s and 1970s, respectively.

29 For analysis of the role of money and prices in the communist economies cf. Bornstein (1964); Peebles (1991), chs. 2-3; Nove (1987), Ch. 7.
31 The state budget served as a buffer between domestic and international price levels.
32 This autarchic policy eased and was to some extent reversed with the adoption of the ‘Basic Principles of the International Socialist Division of Labour’ in December 1961, which sought to promote international (socialist) specialisation. For a discussion of communist economic co-operation in the 1960s, see Brabant (1989), pp. 63-80; for a translation of the ‘Basic Principles...’, see Butler (1978), pp. 14-32.
pattern pursued in the early years of communist rule. Resources were not abundant and there was thus a need to move towards a more intensive growth pattern. Reformers and policy-makers were forced to look at what kind of environment and incentives that had been established for the firms, i.e. at the institutional environment in which they operated. The time for reform had come (see Section 1.4).

1.2. Industrialising Slovakia

The command economy with its inherent political governance of resources was also the main tool when it came to the task of industrialising Slovakia. Industrialisation was in general made a top priority of communist economies and a strong emphasis was put on the expansion of heavy industry (Sector A), for example steel and machine-building, which was seen as the engine of economic growth. In Czechoslovakia, already the first five-year plan (1949-1953) gave priority to backward regions and aimed at an equalisation by means of centrally guided investment- and production plans. The expansion had a pronounced regional dimension with an aim to ‘guard against any excessive concentration of investment or production in any one region’.34 For Slovakia the plan foresaw an expansion of existing industry as well as the establishment of many new factories, including what was later to become the largest steel-mill in Eastern Europe, the Eastern Slovak Ironworks (Východoslovenske Zeleziarne a.s., VSZ).35 Although industry experienced an impressive expansion in the years to come the policies fell short of achieving a full equalisation between the Czech and Slovak lands. For example, even though industrial employment in Slovakia nearly doubled between 1948 and 1960 (up from 225 to 396 thousand) its share of total industrial employment only reached 17.8 per

![Figure 2. Slovak industrial and agricultural employment, 1948-1989](image)

Source: Statistická Rocenka CSFR 1990 [Tables 1.1-1.3]; own computations. For the underlying figures, see Appendix D, TABLE 5 (p. 321).

35 Carter (1987), pp. 105-106, 109. VSZ is the steel-mill included in our case study, see Chapter VI.1.
cent in 1960, up from 13.9 per cent in 1948 (see Figure 2).\textsuperscript{36} Slovak discontent with this state of affairs led to intensified efforts to bring the level of development in Slovakia to the Czech level in the 1960s and 1970s.\textsuperscript{37}

Intensification in the 1960s implied that the emphasis on diversification declined and gave way to efficiency criteria. This meant that low-cost establishments were preferred and that new industrial plants got more concentrated to already existing industrial areas in Slovakia.\textsuperscript{38} The industrial structure which was erected came to be one based on heavy engineering and machine-building with armaments making up a not insignificant share (Banska Bystrica, Martin and Nitra), steel (Kosice), aluminium, chemicals, food and beverages (Nitra), i.e. a radical shift from the agrarian economy that Slovakia once was. An implication was that the agricultural labour force in Slovakia decreased from 60.6 to 12.2 per cent during the 40 years of communism (1948-1989); the industrial labour force quadrupled during the same period, from 0.2 million (14.9\%) to 0.8 million (33.5\%). The growth of industrial production also outpaced the Czech one by considerable margin during the period (see Figure 3). However, even though the differences between Slovakia and the Czech Lands were greatly reduced during communism they were not eradicated. Still in 1989 the Slovak share of the total industrial labour force was five percentage points below its share of the population.\textsuperscript{39} The same year national income per capita was Kcs 33,947 ($2,376) in Slovakia, as compared to Kcs 37,714 ($2,639) in the Czech Lands, i.e. 90 per cent of that in the Czech Lands.

\textbf{Figure 3.} Gross industrial production in Czechoslovakia (CSFR), the Czech Republic (CR) and the Slovak Republic (SR), 1948-1989

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure3.png}
\caption{Gross industrial production in Czechoslovakia (CSFR), the Czech Republic (CR) and the Slovak Republic (SR), 1948-1989}
\end{figure}

\textit{Source: Statistická Rocenka CSFR 1990} [Tables 1.1-1.3]. For the underlying figures, see Appendix D, TABLE 6 (p. 323).

\textsuperscript{36} Slovakias population constituted 27.9 and 29.3 per cent of Czechoslovakia in 1948 and 1960, respectively, see Appendix D, TABLE 5 (p. 323).

\textsuperscript{37} See Steiner (1973), pp. 129-138 on the Slovak debate on policies for industrialisation and equalisation.


\textsuperscript{39} The figures are found in Appendix D, TABLE 5 (p. 323).
1.3. The enterprise in the command economy

The formal role of the individual firm in the command economy was severely circumscribed. The basic task assigned to management and the firms of which they were in charge was to carry out a plan which was a manifestation of the priorities held by the communist leadership and the technocrats within the planning hierarchy. For the manager this implied receiving an enterprise plan containing a bundle of norms and directives, including the amount of physical output, the amount of input at hand, a production schedule, wage rates, plans for centrally funded investment, profit targets, plans for the introduction of new products etc. Management and workers were then awarded through bonus-systems in accordance with the degree of plan-fulfilment, or, over-fulfilment. Formally, there was a four-tier structure for governance, or if one wishes, a four-layer chain-of-command, with from top to bottom, the CPC, branch ministries, chief administrations and the actual firms. In practice, monitoring was also carried out by many other actors at various levels, for example party members, trade unionists, the Ministry of Finance and the State Bank. In terms of property rights one may thus say that they were dispersed across a hierarchy of government jurisdictions.

The de facto situation, however, was one where firms and managers were indeed powerful, with a considerable degree of discretion at hand. It is also in their position, and the incentives facing them, that one has to look to understand the dismal functioning of the command economy. Managers possessed a strong comparative advantage relative to other parties in the bureaucracy with regard to information. A fundamental problem of the command economy rested precisely in the discrepancy between the immense formal authority vested with central agencies and their relatively limited actual capacity to obtain and process the information necessary to make enlightened decisions. Nove captured the dilemma well when writing that:

> 'in most instances the center does not know just what it is that needs doing..., while the management in its situation cannot know what is that society needs unless the center informs it.'

Planners thus depended on the information provided by managers who prior to fixing the final plan were to give their views on a tentative plan. The normal working order was that the branch ministries disaggregated the assignments (targets) given to them by the CPC to send them further down in the hierarchy to the trusts

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40 Cf. Gregory (1990), pp 22-23 [on targets in the enterprise plan].
41 The 1958 reforms (see Section 1.4) saw the replacement of the 24 Chief Administrations (which were functional parts of the branch ministries) by 383 Production Economic Units (Výrobné Hospodářské Jednotky, VHJs); these industrial boards constituted a middle-level in planning and were organisationally administered by one of the large enterprises in the sector in respect and brought together representatives from individual firms and the ministry. One quarter of VHJs were associations of firms; one quarter were major firms with subsidiaries; about half were normal firms, see Kyn (1975), p. 112; Clark and Soulsby (1995), p. 228. On the Czechoslovak economic structure and control mechanisms cf. Gates (1989), pp. 135-139.
43 Nove (1987), p. 76 [emphasis in original].
and firms in the realm of the ministry. Firms could then respond with respect to the targets and allocations before the figures were aggregated and returned to the CPC. Thus, all external monitors were, to a greater or lesser extent, forced to rely on information provided by the management of the firms.

This could have worked if planners and firms were guided by the same motivations. In practice, though, the institutional set-up provided planners and managers with quite contradictory goals. Planners wanted managers to produce the maximum amount of output, using a minimum amount of input. The prime goal of a rational manager, on the other hand, was to achieve plan fulfilment at close to any cost since the reward-systems were based on fulfilment of the output targets. This implied creating room for unexpected developments during the effectuation of the plan by minimising output targets while maximising the amount of allocated inputs by underestimating the capacity of the firm and/or by overestimating the use of capital, raw-materials and labour. This behaviour was indeed rational and what could be expected given that the managers were working in an institutional environment where they could not know: (i) what the final production target would be; (ii) whether the inputs allocated would actually arrive; or, (iii) what quality the input would have. Managers thus found themselves working in an hierarchic and autocratic institutional environment where, to make things work, they built informal networks which, for example, were used in order to re-negotiate production targets and input allocations, as well as to obtain inputs in an unofficial manner.

While the behaviour was necessitated by working in a system that relied on taut planning (i.e. maximum use of resources) and ratchet-effects (i.e. targets were never lowered) it was made possible by the soft budget constraints that faced firms. The implication of the latter was in effect that all expenses of a firm would somehow be accommodated for, for example if the allocation order for inputs was obtained the corresponding financial means would be extended by the authorities in case the firms did not have its own resources to cover the expenses. One consequence of soft budgets in combination with managerial incentives to stock-pile inputs, equipment and hoarding labour was that total demand would tend to chronically exceed existing supply. Labour shortages was thus a traditional result of the overstaffing made possible by soft budgets. Yet a consequence of operating in a supply-constrained

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44 In the case of trusts, there was a further disaggregation in order to establish what the tentative plan would mean for each individual enterprise.

45 Even after the plan was set there were possibilities for the rational manager for manoeuvring, for example by cancelling non-prioritised production; by tinkering with the quality; by barter-trade and bribes to obtain necessary inputs; or, even, by means of false reporting.


47 For a discussion of “planning from the achieved level” and its by-effects in terms of conserving the existing structures; its preclusion of a search for better alternatives; its “dependency” on general shortages; and, its relation to the hoarding of supplies and misreporting by management, see Birman (1978); on the causes and consequences of the “ratchet-principle”, see Dyker (1992), p. 24 ff.; see Kornai (1986) for a definition and discussion of the concept of soft budget constraints.

48 See Kornai (1980); for a brief and accessible account of the shortage economy see, Kornai (1979). It should be noted that the notion of chronic and system-related shortages has been contested, cf. Menshikov (1994). Portes and Winter (1980), among others, also refuted the chronic-excess-demand hypotheses claiming that shortages were signs only of temporary problems and irrational relative prices. A useful overview of the debate between those leaning towards Kornai’s shortage economy and those referring the problems to imperfections in planning and pricing (the disequilibrium school) is found in Brabant (1990).
system was that managers did not have to focus on quality, timely deliveries and other such factors which in a competitive market system, where choice is possible, are indeed important for customers, and thus for the survival of the firms.\(^{49}\) In a shortage economy, the manager could count on everything produced meeting a equal or higher demand, irrespective of quality.\(^{50}\) The shortage economy also lends itself to explanations in terms of property rights since shortages are exactly what would be expected with communal property rights which provide the systematic incentives to overconsume and underproduce. When agents cannot bear the benefits of their labour underproduction results, and if they can infringe on “others” assets (nominally) without bearing the corresponding costs, they will utilise these resources to a higher extent, i.e. the problem of the commons.

In conclusion the command economy, due to the information deficit, suffered from a grave principal-agent problem with respect to planners and managers.\(^{51}\) The system provided them with very different incentives and interests, while at the same time the institutional set-up resulted in very high transaction costs for monitoring and governance. To lessen the incentive problems the controlling bodies established various types of bonus-systems, all connected to the fulfilment or over-fulfilment of planning targets. Also, there were frequent changes in the type of targets. However, in effect, the system produced direct incentives for management to further distort the information provided to the planning hierarchy. In this way “planning” turned into a game where various interest groups fought for more input and lower output-targets, while planners sought to discover and unfold the hidden potential of firms.

1.4. Attempted reforms

The first attempts at some minor reform of the command economy took place in 1958 as part of the first period of reform to sweep over Eastern Europe. Reforms followed upon the 20th Soviet Party Congress in 1956, although in comparison the Czechoslovak attempts were modest.\(^{52}\) The 1958 reforms were above all an organisational change with the proclaimed aim of decentralising decision-making.\(^{53}\) The most important measure was a decentralisation of investment decisions.\(^{54}\) No concessions, however, were made to those in favour of introducing market elements and competition, the measures meant no more than an adjustment of the administrative apparatus with the purpose of lessening the work-load of the central authorities by decentralising some decision-making. The result of decentralisation without either improving the information available (qualitatively and quantitatively) by in-

\(^{49}\) Clark and Soulsby (1995, p. 231) conclude the characteristics of the socialist firm in the following noteworthy way: “a dominant production orientation, coupled with a lack of concern with costs;…power, influence and career development…through membership…of the Communist Party; paternalism, centralization and severely autocratic management;…experience and competence of certain managers in networking activities at home and abroad; strategic overstaffing;…”

\(^{50}\) There were of course exceptions, although often connected to the existence of close substitutes or alternative suppliers.


\(^{52}\) The major revolt came in Hungary where Imre Nagy had taken reform one step too far by defying communism.


\(^{54}\) See footnote 41 (p. 62) on the changes in the organisational structure.
roducing a market mechanism, or exposing the agents to the disciplinary force of
competition and hard budget constraints, was not encouraging. Thus, when not
paying off in the intended way re-centralisation followed, resulting in a further de-
terioration of performance. The lesson learned by some economists was that reform
and decentralisation had not been far-reaching enough. Kyn writes that ‘the idea of
abolishing the command system and restoring the market mechanism was born.’

The second period of reform followed upon the economic crisis in 1961-63 when
growth dwindled. A first blueprint was worked out in 1964 and approved in January
1965. However, not much happened with respect to implementation and a revised
blueprint, more comprehensive and radical, was put forth and approved in April
1966. The plan called for the re-establishment of a market mechanism to handle
the short-run co-ordination of the economy, the central plan was to take on the role
of a guide for the long-term development. Prices were to be partially liberalised and
there would be a partial devolution of the foreign-trade monopoly in order to bring
the firms closer to the international markets. The fiscal system was to change and
stable and uniform taxation implemented from 1967. The measures provided
growing freedom for firms in that annual targets were no longer binding, even
though the simultaneous organisational changes unintendedly came to strengthen
the upper echelons in the hierarchy.

The plan amounted to an early version of “shock therapy” in its calls for an im-
mediate implementation of the majority of measures. Even so, implementation
turned out to be both gradual and haphazard. One example is the tax reform which
indeed took place on schedule in January 1967, although the amount of “free”
prices were much lower than foreseen. Also, the extent to which economic agents
adapted to the new institutional set-up, for example the relative freedom of firms,
varied widely. Kyn writes that ‘firms with well-educated and flexible managers did
very well, attracted large demand, and substantially improved their income situa-
tion’ while some ‘enterprises shackled with rigid management…began to experi-
ence difficulties resulting from the stockpiling of unsalable goods.’

The lesson learned by the initial years of reform (1966-67) was thus that innovative and flexi-
ble managers could make a difference, but also ‘that it was not the obsolete price
system but rather the obsolete political system which was the main obstacle to the
development of market socialism.’

It was not until the political changes in January 1968, when Alexander Dubcek
replaced Novotny as First Secretary of the Communist Party, that these political
constraints on reform were loosened and the road laid open for experiments with
market socialism. On 5 March censorship was abolished and on 6 April the Action

56 The initial blueprint was named Main Directions for the Improvement of Planned Management of the
National Economy; the revised version was known as The Principles of Accelerated Implementation of the
New System of Management. A good review of the Czechoslovak reforms in 1965-1969 is provided
by Brus (1986c), pp. 207-216.
58 Kyn (1975), pp. 112-113. The number of VHJs were reduced to 99, each of which constituted a branch
monopoly, with the aim of having these strengthened VHJs replace some branch ministries. The minis-
tries, however, were kept intact.
59 Kyn (1975), pp. 118-119; quote on p. 119.
Programme of the Czechoslovak Communist Party was adopted, which was a platform that further extended the scope and depth of reform. The programme was truly radical and stated that the party was to lift its hands from the enterprise sphere in order to create the pre-conditions for true autonomy of firms. Small- and medium-sized firms were to be allowed (co-operative as well as private) and workers councils should be established, although with limited influence other than electing the directors. Annual central planning was indeed terminated in 1968 and workers councils were set up from April. In addition to economic reforms the “Prague Spring” is synonymous with a genuine attempt to democratise a socialist system, for example with more genuine elections and a federal system of government. During the spring and summer the demands for economic reform and political change were gradually heightened and in the end the reformist regime made the same mistake as the Hungarians 12 years earlier, they tampered too much with the political system. The process was thus cut short with the Soviet invasion on 20 August 1968.

A reversal and abandonment of all reforms followed, with the exception of federalisation; first the attempts at democratisation and then the economic reforms were rolled back, although initially there was some hope that part of the latter could be retained. This hope was shattered during the “normalisation” of 1969-1970 when the new leadership decided to ban the workers councils (May 1969), re-establish the mandatory plan, centralised decision-making and fixed prices. Brus writes that “[t]he stormy seven months of 1968 prior to the Soviet invasion brought little real progress…”, and indeed, by 1971 there were no longer any marked difference in the economic organisation as compared to the early 1960s – the command economy had been restored.

1.5. Concluding characteristics

Forty years of communism left Czechoslovakia at a substantial disadvantage when the country on the eve of the 1990s faced the great challenge of returning to Europe. At the end of the communist rule, one lacked most of the institutions which in the analytical framework were defined as conducive for growth and prosperity. In fact, many features of the Czechoslovak command economy constituted a clear negation of those associated with a well-functioning market economy. In

63 Federalisation, which at least nominally was established on 1 January 1969, brought with it the establishment of many new state bodies and ministries since many from now existed on the federal, Czech and Slovak level, respectively. A Czech National Council (200 seats) and a Czech Government was also established (the Slovak Republic already had its Slovak National Council with 150 seats). This meant that on a federal level there was a bi-cameral parliament with a House of Nations (150 seats) and a House of People (150 seats), complemented by the two national parliaments.
65 The phrase, borrowed from Berend (1996), aptly catches the core of what the ongoing transformations in Eastern Europe is about.
66 It deserves to be re-emphasised that the basic characteristics of the command economy were still essentially intact in the 1980s despite attempts at reform. The situation is aptly put by Carter (1987, p. 104)
place of free prices, competitive markets, well-motivated managers and clearly delineated property rights the command economy had established giant and inefficient monopolies which operated in an environment where all market-forces were effectively severed, prices centrally fixed and property rights unclear. In effect the situation more or less amounted to what was defined as “communal ownership” in the analytical framework. Symptomatic was that rights had been transferred and/or diluted without the corresponding responsibility, i.e. there were no effective mechanisms for corporate governance.67 The situation was not made better by the fact that Czechoslovakia had the most socialised economy in Eastern Europe with some 97 per cent of the produced value-added originating in the non-private sector.68

It is thus not surprising that the command economy bitterly failed in producing the incentives needed for economic actors to behave in a manner gainful for the economy as a whole. Rather, the system bred an industrial sector characterised by its wasteful use of resources due to the soft budget constraint; insensitivity for the needs and wants of the buyer, due to the existing seller’s market; and, a general insensitivity for the goals of “the owners” (i.e. the principals), since there was no mechanism that could bring the utility-function of the agents into harmony with that of the principals in this state-controlled economy. In this system “[m]anagement” was on the whole confined to bargaining with central administrators or planners for lower taxes or more subsidies, higher output prices for “new” products, larger input allocations, exemptions from import duties or quotas, cheaper credit, and other elements that softened the budget constraint in what was in effect degenerative administrative planning.69 A central problem of the system was also that it included no mechanism for endogenous change of its institutions; when existing formal rules proved insufficient the only solution was to introduce more and/or new formal rules through political fiat. This political character of the whole system precluded the existence of any self-regulating mechanism for endogenous change.70

It is these characteristics of the command economy, i.e. the lack of an appropriate institutional set-up, markets, competition, free prices and clearly defined and delineated property rights, that to a large extent dictated the agenda for post-communist economic reform which had to address all these issues and more. The who writes that ‘Czechoslovaks have had the occasional flirtation with market socialism…but the Soviet-style Command Economy…has been the usual form of management.’ 67 This holds true for all communist economies, although the extent and direction of reforms pre-1989 was decisive for where on the scale between “state” and “communal” ownership the respective countries found themselves. In for example Russia developments had given management de facto ownership in many cases; in Hungary laws adopted in 1988 gave managers the right to transform “their” companies into private companies, a situation which necessitated a “re-nationalisation” before privatisation proper could commence; in Poland workers had gained prominence in decision-making through the workers’ councils etc. Even though Czechoslovakia lagged behind most countries with respect to reform the situation was still far from adequate, especially not since the bureaucracy towards the end of the 1980s experienced a gradual demise both with respect to authority and with respect to their capacity to monitor and guide the agent-firms. What happened was that SOEs gradually increased their independence from the ministries and the planning hierarchy from 1987 onwards when the VHJs were being disbanded, see Clark and Soulsby (1995, p. 225). 68 By comparison Hungary had already in 1984 lowered its part of the value-added produced in the state-sector to 65 per cent, see Savas (1992), pp. 573-574.


70 See Major (1993), pp. 21-23, who concludes that ‘political regulation soon became the decisive form of economic guidance, overshadowing the importance of central plans.’ (ibid p. 22).
answer has been sought in institutional change involving, for example, liberalisation and stabilisation to establish functioning and competitive markets where prices regain their role as bearers of information on demand and scarcities. Privatisation was similarly seen as a *sine qua non* for the re-establishment of owners and functional structures for governance.

2. Towards a market economy: setting the scene

If the communist era can be characterised as one of limited, gradual and incomplete changes in policies and the institutional set-up of the economy, the opposite holds true for the years 1989-1996. Within this relatively limited time-period Slovak society would be living through a series of consecutive shocks which were to put the potential for adaptation and change to a real test. Firstly, in 1989, within a period of weeks, the communist monopoly of power was dismantled. The economic consequences were grave, without commanders no command economy, i.e. the economic system collapsed and domestic demand contracted sharply. Secondly, in 1990-1991 as a consequence of similar events in the whole of Eastern Europe, the CMEA market disintegrated when trade was to be conducted in hard currency as of 1 January 1991.71 Slovak industry, which had been erected with the outspoken aim of participating in the “international socialist division of labour” lost the market to which the majority of exports had been directed. Industry thus faced a situation where it had to compete on the international markets from which they had been practically isolated for 40 years. Thirdly, although many institutions of statehood were formally established during the federal period of the Czechoslovak Socialist Republic, Slovakia in 1992-1993 all of a sudden faced the need to: (i) establish all institutions and organs associated with state-hood; and, (ii) make those already in place truly functional as the country was set to split on 1 January 1993.72 The split also put a further downward pressure on demand for Slovak industrial output as more than half the domestic market became a “foreign” one.

The aim of this section is to provide an overview of how these shocks and changes were handled, i.e. what responses they provoked and their results. Since change has been all-encompassing it is also necessary to discuss the political setting in which these measures have been taken. The section begins with a short note on the political changes and the economic measures taken in 1990 (Section 2.1). Follows does an overview of the macro-economic policies of 1991-1996 and their re-

71 Since the trading regime among communist states, just like the economy in general, was a political system more than an economic system it was not unexpected that it collapsed when the political regimes which had propped it up fell. CMEA trade had previously been conducted in “Transferable Roubles”, a currency which only served as a regional book-keeping unit since trade was directed by long-term trade agreements among the participating countries, see Brabant (1987), pp. 280-282; this way foreign trade was no different from domestic, where money also basically only served a passive book-keeping device. For an overall view of the functioning of the CMEA market the reader is referred to Brabant (1980).

72 During the federal era one lacked key-organs relating to defence, foreign affairs and to some extent also finance. Further, those in place had *de facto* been subordinated to the federal organs, thus requiring substantial re-moulding of its actual operations before independence, cf. Pithart (1995), p. 217.
results (Section 2.2). Section 2.3 concludes with a brief account for the costs and achievements of this part of economic transformation.

2.1. Velvet Revolution and Velvet Divorce: the political setting

The 1980s saw little reform and the events that mark the start for what is of interest to this study proper is what happens in 1988 and 1989 when some signs of liberalisation began to appear. Demonstrations and protests in 1988 and 1989 with demands for human rights and reforms culminated with a brutal attack against a student demonstration on 17 November 1989, marking the beginning of the “Velvet Revolution”. A week later, following more demonstrations, the communist leadership resigned on 24 November. During this time two groups were established which channelled the demands for democratisation, in Slovakia it was the Public Against Violence (Verejnost Proti Nasiliu, VPN) led by Vladimir Meciar and in the Czech Lands the more well-known Civic Forum (Obcanske Forum, OF) led by playwright Vaclav Havel. On 10 December 1989, a coalition government with communist Marion Calfa as PM was installed and the very same day Gustav Husák resigned as President. Husák was replaced by Havel on 29 December, and the previous day Alexander Dubcek was rehabilitated by being elected Chairman of the Federal Assembly.

The provisional federal government immediately set out to fulfil some of the popular demands which had brought on the “Velvet Revolution”. During the early months of 1990 a number of laws, all relating more or less to human rights, were adopted, for example laws on free elections, free press, freedom of assembly, the right to citizenship for expatriates etc. These were issues where consensus was easy to achieve. In the economic sphere the situation was a little more complicated, with a clear division between those advocating swift and extensive reform with a focus on establishing macro-economic equilibrium on the one hand, and those who focused on government-directed structural change and thus opposed any kind of shock therapy as that practised in Poland from January 1990 on the other. The former view is personified by Vaclav Klaus, Federal Minister of Finance at the time, while the latter is connected to Valtr Komarek, Deputy PM with overall responsibility for economic reform. Likewise it became apparent that there was a markedly different conception with respect to the pace and extent of reform between Slovak politicians (Meciar) and their Czech counterparts (Klaus). Like some leftist forces in the Czech Lands Meciar foresaw a much more active role for the state with respect to for example industrial policy, and the gradual phasing in of some measures.

73 For industry, some hope had been connected to the adoption of the Set of Measures to Improve the System of Planned National Economic Management after 1980. These, however, meant only some minor decentralisation of the investment funds to enterprises or groups of enterprises although nothing that altered the basic functioning of the economic system.

74 Both VPN and OF were loosely knit organisations which mixed intellectuals, dissidents and reform-communists from a large political spectre. None of them were at the time established as formal political parties.

75 In this government only 10 of the 21 members were communists, and out of which 2 had been nominated by Civic Forum, see Wightman (1992), p. 138.
The political differences made it impossible to agree on a comprehensive reform programme before the June 1990 elections, even though a draft was presented in May.\textsuperscript{76} The main points of discussion were the programme for privatisation and monetary policy, for example how big the initial devaluation of the currency should be.\textsuperscript{77} However, with the April 1990 dismissal of Komarek, Klaus strengthened his position and thus managed to tighten fiscal- and monetary policy as a preparation for the reforms that were to come. In the spring the federal budget, adopted by the communist regime in November 1989, was abandoned in favour of a more balanced and reform-oriented budget which, with some minor cuts, reduced the planned deficit from Kcs 7 billion ($250 mn) to 5 billion ($179 mn).\textsuperscript{78} Consecutive expenditure cuts resulted in a Federal budget surplus of Kcs 4 billion ($143 mn) for 1990.\textsuperscript{79} Also, as the costs for food subsidies rose it was possible to muster a parliamentary majority on 24 May for doing away with the majority of them – despite the upcoming elections.\textsuperscript{80} The decision meant that food prices rose 24.6 per cent on average from 9 July, although compensation of Kcs 140 ($5) per month was paid to all citizens from 1 July.\textsuperscript{81}

Early micro-economic reform focused on unleashing the entrepreneurial spirit and talent previously locked into the straitjacket of the centrally administered economy by changing the formal institutions.\textsuperscript{82} A package of four laws were adopted at the end of April 1990, all effective as of 1 May 1990, with the dual purpose of promoting domestic competition and attracting foreign investment.\textsuperscript{83} The Law Concerning Entrepreneurship by Individuals removed the formal barriers of entry for would-be entrepreneurs by in principle giving the right to any individual, also foreigners, to establish and run a company engaged in trade or production; there were no longer any restrictions on the hiring of labour, a question which previously had been taboo.\textsuperscript{84} The Law Concerning Enterprises with Foreign Capital Participation amended the previous joint-venture law and did away with the previous limits on

\textsuperscript{76} Dyba for example wrote that ‘[t]he most important of these factors [for delaying the economic transformation, my remark] were the inability to achieve consensus on a specific economic program within the executive branch of the federal government...’, see Dyba and Svejnar (1992), p 6. An overview of the heated reform debate and the resulting inability to formulate a comprehensive reform programme prior to the Velvet Revolution is found in Myant (1993), pp. 156-167.

\textsuperscript{77} See Charap et al. (1992), p. 5; Kyn (1992), pp. 4-5.

\textsuperscript{78} Rutland (1992a), p. 141. Note that conversion to dollar figures in 1990 is done according to the end-1990 exchange rate given the extensive devaluation undertaken during the course of the year.

\textsuperscript{79} Expenditure cuts affected mainly state subsidies to industry and agriculture in the red which were slashed by close to 50 per cent from the initial level of Kcs 50 billion ($1.8 bn).

\textsuperscript{80} In 1989 the costs for food and fuel subsidies had risen from 7.5 to 12 per cent of total government expenditure and the situation got untenable as the relaxation of travel restrictions made it possible for Germans, Austrians and Poles to take advantage of these subsidies, see Myant (1993), p. 172; subsidies were thus cut by Kcs 27 billion ($964 mn), equal to 4.4 per cent of NMP, from an initial level of Kcs 35 billion ($1.25 bn), see Charap et al. (1992), p. 4.

\textsuperscript{81} Myant (1993), p. 174.

\textsuperscript{82} In terms of Murrel (1991) the measures can be termed as an attempt to achieve a privatisation from below (PFB), as opposed to the topic proper of this study, i.e. privatisation from above (PFA). For a discussion in these terms, see Chapter IV:1.

\textsuperscript{83} The below information on the content of the laws is given on basis of Bogdan (1991) which provides a good overview of the early legal reforms, and Czechoslovakia: Paving the way to a free economy (1991).

\textsuperscript{84} The law was as of 21 December 1992 replaced by the Act on sole proprietorship; all entrepreneurs pursuing business under its jurisdiction then had to re-register, see Central European Business Weekly, 15 January 1993.
foreign participation. Important was that it also removed barriers to profit repatriation. Further, a Law Dealing with Public Limited Companies replaced its predecessor from 1949 (Act no. 243/1949, Coll. of laws) whose objective it had been to liquidate all joint-stock companies. The new rules drew much on German and Austrian legislation and set the minimum capital requirement at Kcs 100,000 ($3,571). Finally, there was adopted a Law Dealing with Economic Relations with Foreign Companies which removed the last remnants of the foreign trade monopoly, from now on all firms were allowed to engage in foreign trade, although licensing or registering was still required. All four laws were important steps in encouraging private entrepreneurship, and judging from gross figures the reforms were successful with the number of registered entrepreneurs in Czechoslovakia rising from 80,000 in 1989 to 1.1 million in early 1992.

On 8-9 June 1990, the first post-communist elections were held. With a 96 per cent voter turnout it was a success for the reform-movement with VPN and OF together gathering 46 per cent of the votes cast, rendering them 170 of the 300 seats in the Federal Parliament. This, however, left them short of the three-fifths majority necessary for constitutional changes; the solution was a coalition with the Slovak Christian Democratic Movement (Krestansko-demokraticke hnutie, KDH) which had gained 25 seats. Marion Calfa was re-appointed PM over the three-party coalition and the parliament re-elected both Havel and Dubcek. In Slovakia VPN gained 38 of the 150 seats in the national parliament, the Slovak National Council (SNC). Also there a three-party coalition was established, involving VPN, KDH and the small Democratic Party (Demokraticka Strana, DS). Leading the largest of these groupings (VPN) Vladimir Meciar was thus elected Prime Minister of Slovakia for the first time on 27 June 1990. His Czech counterpart was former dissident Petr Pithart.

Even though the elections provided a majority for continued reform, they also put the issue of Czech-Slovak relations on top of the agenda. A first sign of its inherent explosiveness had come already early in 1990 when it was time to change the country’s name and the “hyphen-war” erupted. Havel had suggested “Czechoslovak Republic” as a new name, something which proved unacceptable to Slovak politicians. The name finally agreed upon was the Czech and Slovak Federative Republic (CSFR). However, when it came to how CSFR was to be governed it proved an even more difficult issue. In August Slovak PM Meciar initiated nego-

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85 The law opened the possibility to distribute shares, for free or at a subsidised price, to employees of the company. Shares distributed that way should be given a limited transferability in the sense that it could not be traded on the open market, it could only be traded in-between employees or former employees.
86 It should, however, be noted that estimates held that a mere 15 per cent were working full-time in their private enterprises.
87 The largest opposition party was the former communist who managed to get the confidence from 13 per cent of the voting population, something that gave them 47 seats in the Federal Parliament. On election results, see Appendix D, TABLE 2 (p. 321).
88 On the federal parliamentary system, cf. footnote 63, page 66. In terms of decision-making power, the federal government retained control over foreign policy, international relations, defence, federal legislation and macro-economic policy.
89 For a time it was even suggested that two different spellings would be used, Czechoslovak Republic in the Czech Republic and Czecho-Slovak Republic in the Slovak Republic – thus the “hyphen-war”, see, Zák (1995), pp. 250-251.
tiations on power sharing in the federation.\textsuperscript{90} This led to the adoption of the \textit{Law on Competence} in December 1990 which divided the powers between the three governments and whereby some economic decisionmaking was decentralised and formal control over state-owned enterprises was devolved to the republican level.\textsuperscript{91} Still, this proved a temporary solution and no genuine consensus could be achieved, the result was a dead-lock on constitutional issues in the Federal Parliament.\textsuperscript{92} The 23 April 1991 dismissal of Meciar as Slovak PM and the consecutive appointment of Jan Carnogursky (KDH) as PM made no difference to this infected issue, rather, mutual distrust continued to prevail as did this battle between republics.

It was hoped that the second post-communist free elections on 5-6 June 1992 would result in governments more apt to resolve the issues. However, by the time of the elections the costs of economic transformation were beginning to be felt by citizens, and more so in Slovakia where unemployment was higher and output falls had been greater than in the Czech Lands. There was a widespread dissatisfaction with the results of transformation and prior to the elections (April) support for a full-fledged market economy had dwindled to 39 per cent in Slovakia while still a majority (52\%) in the Czech Lands were in favour. In fact, 77 per cent of Slovaks wanted to see economic reforms either stopped or changed (!).\textsuperscript{93} Also, mistakes by Czech politicians had served to aggravate Czech-Slovak tensions. One example is the ill-considered and badly anchored move whereby Havel and Minister of Foreign Affairs (Jiri Dienstbier) decided to stop Czechoslovak arms export. The effect on the Slovak Republic was severe, considering that some two-thirds of total armaments production was located in Slovakia.

Vladimir Meciar, who after the split of VPN established his Movement for a Democratic Slovakia (Hnutie za demokraticke Slovensko, HZDS) as a populist-nationalist left-of-centre party, correctly read the political tendencies in Slovakia. HZDS’s platform for the 1992 elections was a challenge of the economic policies pursued by the Federal government, coupled with demands for greater autonomy for Slovakia. His populist and nationalist rhetoric clearly found a broader appeal under Slovak conditions than they would have in the Czech Lands. HZDS gained 74 of the 150 seats in the Slovak National Council and chose to form a government with the extreme nationalists of the Slovak National Party (Slovenska narodna strana, SNS) and Meciar was elected second-time PM. In the Czech Republic, the elections were a clear victory for Vaclav Klaus and his Civic Democratic Party (Obcanska Demokraticka Strana, ODS) who was elected PM.\textsuperscript{94} On the federal level, however, it proved impossible to form a stable coalition. Following negotiations between the two PMs a caretaker federal government was established with the mandate to dissolve the Czech and Slovak Federative Republic by the end of 1992!

The “Velvet Divorce” was negotiated, arranged and decided upon in less than six months by the political leadership. This was done despite the fact that only a mi-

\textsuperscript{90} See Pithart (1995), pp. 208-209.
\textsuperscript{92} A discussion of all proposals and actual changes in the formal arrangements between the two republics is found in Zák (1995).
\textsuperscript{94} On the election results, see Appendix D, TABLE 3 (p. 322). ODS had been founded when tensions within OF became too strong to keep the movement together.
nority in Slovakia and the Czech Lands supported such a division – Havel’s calls for a nation-wide referendum were left unheard.95 On 17 July the Slovak National Council passed a declaration of Sovereignty of the Slovak Nation, and on 1 September the new Slovak constitution was ratified. On 25 November a law on the break-up of the federation was finally passed by the Federal Assembly. Assets and liabilities of the federation were divided according to a 2:1 ratio and on 1 January 1993, when the two republics became independent states, all that was left of the federation was a monetary union and a customs union – both of which had been agreed to last for six months.

2.2. Liberalisation and stabilisation, 1990-1996

Despite diverging Czech-Slovak views on the distribution of power, macro-economic policy remained the responsibility of the federal government up to and including 1992. Thus, when Vaclav Klaus reclaimed the Federal Ministry of Finance with the backing of a popular mandate in the 1990 elections it rendered him a key position in the formulation and enactment of policy.96 Consequently, following the elections it was the Federal Assembly that was presented with a comprehensive reform programme, Scenario of the Economic Reform, which it adopted on 17 September 1990.97 The programme was based on four pillars: macro-economic stabilisation; liberalisation of trade, currency and prices; privatisation of the majority of productive assets; and, the building of a social safety net.98 The general tenet is spelled out already in the preface, stating that ‘[t]he greater the speed and the more radical the manner of the implementation of the reform measures, the lower the total social expenditure the process of transformation is bound to produce.’99 Since Czechoslovakia was among the first to attempt such a transformation this can be considered a rather bold assumption.

Objections from the five different academic institutes from which the Federal Assembly had requested “expert opinions” were quickly overruled. The problem with their suggestions was that they reflected five different opinions, so rather than being dragged in to a long debate, the government chose to overrule all of them, and within a short time law-proposals were worked out in accordance with the Scenario and put forth to the Parliament.100 The Scenario in itself was not overly de-

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96 The Slovak influence on this area was thus severely curtailed during the era of the Czech and Slovak Federative Republic, a fact which can serve to explain the rather expedient way with which the reforms were adopted and carried through (no constitutional changes were necessary for either adoption or enactment), as well as why the programme by many Slovaks was resented as a Czech product. A consequence of the latter was that the costs of transformation were partially blamed on Prague.
98 It is interesting to note that the content of the programme is very much similar to the early blue-prints for reform published by western scholars, cf. Blanchard et al. (1991); Fischer and Gelb (1990).
100 Cf. Rutland and Rutland (1991), p. 60; Klaus’ comment was that he without studying their replies was absolutely convinced that the assessments differ so dramatically that they would not be of much help anyway, although he added that it ‘would be very different if the entire Czechoslovak community of economists would clearly denounce the government’s reform package.’ [Interview in Kuehn and
tailed as to the more technical solutions, but both the programme and Klaus made clear that the cornerstones of reform initially would be price liberalisation and the establishment of the internal convertibility of the crown, coupled with policies for macro-economic stabilisation. Any discussions of an alternative “third way” was effectively put off the main agenda – for the time being.

2.2.1. Liberalisation

Liberalisation, defined as the host of policies aimed at increasing competition and replacing centrally administered resource allocation with market allocation, for example freedom of entry, liberalisation of prices, trade and currency, is at the heart of economic transformation. The essence lies in the re-establishment of market forces as the prime vehicle for resource allocation and the exposure of economic actors to these forces, i.e. in the establishment of competitive markets through a process of deregulation and/or reregulation. Liberalisation is thus a necessary, although not sufficient, precondition for the establishment of a well-functioning market economy.

With rational prices being a cornerstone of any market economy, and the lack thereof being among the gravest failures of the command economy, the first of these measures to be undertaken was price liberalisation. In accordance with the Scenario, the majority of prices were freed as of 1 January 1991. It was hoped that such a far-reaching liberalisation would minimise inflationary expectations. Initially, however, regulations were maintained for about 15 per cent of the total supply of goods and services. These were then gradually rolled back, and by October 1991 the share of goods and services subject to regulation was down to 10 per cent; what remained was mainly regulations on the price of housing, public transport and energy. The immediate impact was that prices soared by 40.9 per cent in the first quarter 1991 as the monetary overhang was turned loose. However, already in the second quarter, inflation lost momentum, with consumer prices up 49.2 per cent after six months, and then remaining relatively stable. The success in preventing hyper-inflation is attributable to a combination of the relatively bal-
anced consumer goods market; the fact that much of the accumulated savings had been eroded as a consequence of the partial liberalisation of prices in 1990; and, most of all, to the successful measures for macro-economic stabilisation which are discussed further below.

A problem with price liberalisation was that the lack of competition among domestic producers and retailers bore the risk of excessive price-hikes, meanwhile, however, the competition needed to reduce those tendencies could hardly be fostered in the absence of free prices. The strategy adopted to resolve the dilemma was to liberalise also foreign economic relations as of January 1991. The hope was that by allowing free trade, and establishing the institutions necessary therefore, one could “import” both a normal relative-price structure and the competition needed to force domestic producers to restructure and increase their productivity rather than merely increase their prices. The formal hindrances for foreign trade had to a large extent been removed already in 1990 (see above); still lacking though were the institutions which should make it practically and economically viable. The old system of quotas and licenses had to be done away with and was replaced by three types of tariffs, i.e. an import surcharge (20%), import-tariffs (4.7% on average), and the normal turnover tax for retail-goods. These rules have since gone through consecutive changes, with a general tendency to lower such barriers to free trade.

An environment suitable for efficient trade-relations also requires a functioning means of payments. Hence, on 1 January 1991 CSFR established the internal convertibility of the crown, implying that exchange to foreign currency was liberalised for firms with respect to transactions on the current account. Concurrently firms were obliged to sell foreign currency earnings in exchange for crowns at the given rate. For firms the internal convertibility functioned well, with all registered entrepreneurs getting access to the convertible currency needed for imports. The sustainability of internal convertibility would, however, depend upon the exchange rate to which it was connected. In preparing for internal convertibility, the crown was thus devalued three times during the course of 1990, by a total of 86.6 per cent. At a rate of Kcs 28/USD the crown was then pegged to a basket of five cur-

108 The supply of food-goods had traditionally been adequate, with shortages concentrated to various manufactured goods.
109 In 1990 personal consumption rose by 4.8 per cent, despite a fall in real wages of 5.8 per cent, see OECD (1991), pp. 17-18.
110 Foreign competition as a substitute for domestic competing companies is not viable in the long run, but to start with it was considered a lesser evil than postponing price liberalisation.
111 The change implied that 28 December 1990 saw the unification of the principal rate (= average cost of foreign exchange in exports) and the secondary rate (tourist rate) thereby only having one single exchange rate.
112 The arrangement fell short of current account convertibility (Article VIII) on two counts: firstly, the value of the crown was guaranteed only within the borders of CSFR (noticeable not least when the currency split was announced in January 1993 and big amounts had to physically be brought back from for example Vienna and Budapest not to lose its value); secondly, restrictions applied to private citizens who were allowed to exchange Kcs 2,000/annum ($68) in 1991 (a limit gradually raised).
113 Special provisions, made it possible to repatriate profits for foreign firms and it did not take long before a representative of White & Case wrote that ‘one almost never hears the question that was once the biggest hurdle to inbound investment – namely, “How will we get our money out?” ’ Source: Arbess (1991), p. 1.
114 Gabrielová et al. (1994), p. 18. The devaluations were preceded by heated debate with some proponents (e.g. Valtr Komarek) arguing for a much lesser devaluation and a rate based on purchasing power.
rencies, where the DEM and USD were the two most important.\footnote{The five currencies were the following, with relative weights in parenthesis: DEM (45.52%), USD (31.34%), Austrian Schilling (12.35%), Swiss Franc (6.55%), and the British Pound (4.24%).} With hindsight one can say that the authorities landed right, the exchange rate kept stable and soon gained international credibility (see Figure 6, p. 81).

2.2.2. Macro-economic stabilisation

The far-reaching liberalisation of economic activities would most likely have brought disastrous results had it not been accompanied by a consistent policy of macro-economic stabilisation. While liberalisation sets the market forces in motion, stabilisation, in turn, is necessary to create the pre-conditions for growth. The objectives of macro-economic stabilisation include crucial aspects of economic transformation such as preventing hyperinflation upon price liberalisation, imposing hard budget constraints on firms and thus forcing them to restructure, creating the prerequisites for sustaining a stable exchange rate, preventing unserviceable foreign debts to build up etc. Thus, stabilisation is more than a mere complement to liberalisation, rather it is in itself the \textit{sine qua non} for containing inflation within reasonable bounds and thus for creating an environment conducive for rational long-term micro-economic adjustment. The two policy tools at hand for achieving this are first and foremost tight money and balanced budgets, but these were complemented with temporary wage controls. When reviewing implementation and results, however, it is useful to make a distinction between the period before and after the division of Czechoslovakia.

When Czechoslovakia embarked upon their reforms, history carried mixed blessings. Positive was the low debt burden inherited from the communist regime and the tradition of balanced budgets.\footnote{Foreign debt at the end of 1989 amounted to $7.9 billion, which rendered the country among the lowest per capita debts in the region. At end-1990, Czechoslovakia had a gross debt of $8.1 billion, while the corresponding figures for Poland and Hungary were $48.5 and $21.3 billion, respectively. In terms of per capita debt this amounted to about $500, $1,200 and $2,000, respectively.} The Federal government attempted to continue these prudent fiscal policies and managed a countrywide surplus of Kcs 3.8 billion ($136 mn) in 1990 with respect to the net balance of the Federal, Czech and Slovak state budgets, equal to 0.5 per cent of GDP. For 1991 a total surplus of some Kcs 8 billion ($271 mn) was projected although overly restrictive polices resulted in an accumulated surplus of Kcs 21 billion ($697 bn) by May. As a reaction to this overshooting, spending was increased and taxes cut in the second half of the year, and by end-1991 the balance was a cumulative deficit of Kcs 17.5 billion (1.7% of GDP).\footnote{The deficits were all on the national budgets, with the Federal budget in surplus according to plans, see Appendix D, TABLE 10 (p. 326). On policy changes, see OECD (1991), pp. 35-37.} In addition to increased spending the deficit was caused also by a failure to fully take into account the effect of liberalised prices on state expenditures and a shrinking tax-base due to falling production.\footnote{Bulenova (1992) [interview].} In 1992 the government managed to reduce the deficit to 1.5 per cent of GDP. The shortfalls on the revenue side points to the negative aspects of the communist heritage, i.e. the lack of market-oriented parity (PPP); cf. Myant (1993), pp. 179-181 on the worries voiced about the potential negative effects of a too large devaluation. Estimates hold that the devaluations were about four times higher than would have been needed to maintain PPP for CSFR-goods, see World Bank (1996), p. 35.
institutions for taxation and tax-collection. The challenge is thus not only to cut expenditures, but to effect the institutional reforms needed to establish tax-systems suitable for a market economy, and which minimise the possibilities of tax evasion. Given that the system preferably also should be easy of to administrate, and not carry too strong disincentives for economic activity, it is clearly a difficult equation to solve.

The implementation of a monetary policy supportive of low inflation, internal convertibility and a stable exchange rate also presupposed institutional change; it is for example difficult to foresee a credible monetary policy without an independent central bank. The establishment of a two-tier banking system was accomplished with the banking reform in early 1990 (see Chapter VI:4.1) when the newly created State Bank of Czechoslovakia (Statní Banka Československá, SBCS) was put in charge of monetary policy. The bank indeed adhered to a policy of tight money, with broad money (M2) up an extremely modest 0.1 per cent in 1990. By end-1991 broad money was up by 27.4 per cent, and the cumulative increase in 1990-1991 (27.5%) could be compared to consumer price increases of 87.4 per cent in the corresponding period. The result of the credit squeeze was seen in numerous complaints from the private sector on the problems of financing new enterprises, regardless of the interest rate paid. During 1992, direct instruments of the SBCS gradually gave way to indirect instruments, and monetary targets were more easily met; the target was for an increase in M2 of 20 per cent and the outcome was growth with 18.5 per cent.

A restrictive central wage policy was also part of the efforts to contain inflation. Even if free wages are necessary for labour mobility, the risk of uncontrolled inflation was viewed as greater, especially for the still state-owned enterprises (SOEs). The basis for the centrally negotiated wage regulation for 1991 was that real wages should not be allowed to fall more than 10 per cent. The agreement put quarterly ceilings for accumulated pay-raises in accordance with actual inflation. Despite this, real wages fell by 26.3 per cent on average in 1991. The reason was not the wage ceiling per se, but rather decreasing subsidies to state firms which meant that they could not afford higher wages. Those that could, were in turn kept back by penalty taxes of up to 750 per cent on increases in excess of the centrally negotiated ceiling.

The results of these efforts at macro-economic stabilisation were however, on the whole, positive. Even though the credit squeeze in 1990/1991 may have exacerbated the fall in production, the combined policies were successful in containing inflation and maintaining a stable exchange rate. The basic indicator on the relative success of stabilisation remains the inflation rate. In the second half of 1991, after

\[119\] For a discussion of the monetary policies in 1991, refer to OECD (1991), pp. 38-44 which attributes the causes of the overly tight monetary policy to the inexperienced and monopolised banking-system which, put simply, stopped lending.

\[120\] The instruments which replaced the direct controls were minimum reserve requirements, the discount rate, auctions for refinance credits and the sale of SBCS-bills, see OECD (1994), pp. 27-29.

\[121\] The first quarter it was a maximum of 9 per cent; the second quarter 22 per cent; the third quarter 29 per cent; and by the end of the year wages had been allowed to increase by a total of 32 per cent.

\[122\] The corresponding figure in 1990 had been a decline of 5.7 per cent, see Table 5 (p. 84).

\[123\] Bulenova (1992) [interview]; OECD (1991), Annex I & chart 6, p. 27.
the initial thrust in inflation, prices remained more or less stable, bringing an annual average inflation of 57.9 per cent in Czechoslovakia as a whole. In 1992 inflation was significantly reduced and the corresponding figure was 10.8 per cent, which in a comparative context must be deemed a major success (see Figure 5, p. 80).124

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The Czech-Slovak differences over economic policy did however become acute after the 1992 elections; while Klaus emphatically declared that there was no such thing as a “third way”, Meciar was proposing exactly such a route under the heading of a “social market economy”. To this effect the new Slovak government adopted their Strategy of Economic Revival in November 1992. The declared intention was to loosen fiscal and monetary policies, as well as to actively engage in trade promotion (eastwards) and industrial restructuring.125 With independence in January 1993 the government also achieved the means to try this. However, the attempts to implement policies resulted in an economic crisis; reserves dwindled and the state budget deficit soared, reaching 12.7 per cent of GDP in the first quarter of 1993. The newly created National Bank of Slovakia (NBS) was forced to finance the deficits, in contradiction to its statutes,126 and the situation proved indeed untenable.

The grave fiscal imbalances were largely attributable to shortfalls on the revenue side. Firstly, the break-up of the federation imposed high direct costs on Slovakia, both in terms of the costs for establishing national organs and institutions, and in the loss of former federal subsidies. Although disputed among Slovak politicians, and impossible to pin-point in the national accounts, subsidies are estimated to have been in the range of 5-7 per cent of Slovak GDP.127 Secondly, Slovakia went through with a comprehensive and well-needed tax-reform according to the federal timetable on 1 January 1993 despite discussions about postponing the changes.128 Tax collection proved a problem though, partly attributable to incompetence and a lack of experience with the VAT, partly to higher production declines than foreseen and consequently less state revenue from corporate taxation. Meanwhile, drastically declining foreign exchange reserves had forced the pre-mature split of the monetary union on 8 February 1993.129 Slovakia de facto faced its first serious economic crisis as an independent democratic and capitalist state.

Against this background, the Slovak government was forced to backtrack on its policy ambitions in April 1993, when restrictive fiscal policies and a neutral mone-

124 Prices rose slightly more in Slovakia than in the Czech Lands, making for 1991 inflation (annual average) of 61.2 and 56.6 per cent, respectively. The pattern was reversed in 1992 when Czech prices were up 11.1 per cent, as compared to 10.0 per cent in Slovakia, see Appendix D, TABLE 11 (p. 326).
127 For a discussion of the extent and type of transfers, see OECD (1991), pp. 53-59.
128 The main components in the new system was the replacement of the turnover tax by VAT at a standard rate of 23 per cent and a 5 per cent rate for basic food-stuffs, household energy, medicines and most services; a corporate income tax (40%); pay-roll taxes for social security (38%); a progressive personal income tax; excise taxes and a road tax, cf. Gabrielová et al. (1994), pp. 10-11.
129 The customs union remained, and to lessen the impact on mutual trade the two states established a bilateral clearing agreement according to which any country could draw up to ECU 130 million, obligations larger than that were to be settled in convertible currency.
tary policy were re-emphasised. The deficits also made it necessary to turn to the International Monetary Fund (IMF) for assistance, and in July Slovakia was granted a Systemic Transformation Facility (STF) of $89 million to build up foreign exchange reserves. The agreement was however made conditional on intensified efforts at stabilisation through further spending cuts, increased taxes and a devaluation to counter the external deficits which had been growing at an alarming pace. Thus, in July an import surcharge (20%) was introduced and the crown was devalued by 10 per cent; and, in August the VAT-rates were increased to 6 and 25 per cent, respectively.

Having allowed these deficits to build up there was not much the government could do to soothe the pains of economic transformation, the budget deficits put definite limits on the room for manoeuvring, and in a sense stabilisation had to start over again. Hence, instead of a smoother policy Slovaks experienced further cuts in spending on education and health as well as enterprise subsidies during 1993. However, in retrospect most observers probably agree that Slovakia should be happy that the government faced such constraints with respect to policy choices, since the renewed stabilisation has paid off. Slovakia could enter a virtuous circle where improved control on the expenditure side created the preconditions for growth, which in turn was stronger than expected and thus raised government revenue. Thus, after the first year of independence, fiscal policy improved and the state budget deficits were drastically reduced.

Figure 4. State budget balances for Czechoslovakia (CSFR), the Czech Republic (CR) and Slovakia (SR), 1990-1996 (as per cent of GDP)


Comment: The figures refer to three “independent” budgets, but excludes local government budgets.

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131 Cf. Fisher (1994a), pp. 89-90. From January 1996 the highest VAT-rate was lowered to 23 per cent, and some goods were moved into the lower rate of 6 per cent, see OECD (1996), p. 34. In addition, the import surcharge was from 1 July 1996 lowered to 7.5 per cent, see OECD (1996), p. 155.
133 See OECD (1996), pp. 32-42 for a detailed account of the fiscal policies; see Appendix D, TABLE 10 (p. 326) on actual budget revenue and expenditure 1990-1996.
As for monetary policies these were tightened in the second half of the year after the NBS got its first proper Governor (Vladimír Masár) in July 1993. The bank has since pursued a prudent policy and succeeded with respect to its main goals, i.e. to reduce inflation and maintain the internal convertibility. Regarding inflation, however, the first year of independence brought a negative surprise with a December-over-December inflation of 25.1 per cent, up from 9.1 per cent in 1992. This jump in inflation was caused by the combined effects of new and higher taxes (VAT), the devaluation of the crown and price hikes on for example imported energy. A similar increase was experienced in the Czech Republic, which also reformed its tax system in early 1993, see Figure 5. From 1994 onwards, though, the NBS and its governor surprised many observers by keeping inflation just as low, or lower, than its former federal partner. In 1995 this meant a December-over-December inflation of 7.2 per cent, as compared to 7.9 per cent in the Czech Republic. A further deceleration took place in Slovakia in 1996 (5.4%) while the opposite happened in the Czech Republic (8.6%).

The second goal with monetary policy, i.e. to maintain the internal convertibility of the crown was also adhered to during the period of study, with the exception of a short period in early 1993 when exchange restrictions were introduced in conjunction with the drainage on foreign exchange reserves. Following the July devaluation, the exchange rate kept relatively stable until 1996 and functioned as a nominal anchor for monetary policy (see Figure 6). In fact, the exchange rate has experienced a real appreciation, even when taking into account the 10 per cent devaluation. Current account convertibility (Article VIII) was introduced on 1 October 1995 when the clearing agreement with the Czech Republic was cancelled and the remaining restrictions on transfers on the capital account did not pose any serious

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134 Prices were up by a high 11.8 per cent in the first quarter alone.
135 This trend was strengthened in 1996 when Slovak and Czech prices were up 2.2 and 5.4 per cent respectively after six months, see also Appendix D, TABLE 11 (p. 326).
136 See OECD (1996), Figure 6, p. 14.
obstacles for capital transfers. Also, with inflation under firm control the NBS has been able to gradually lower its discount rate which in January 1996 stood at 8.8 per cent. This is but one example which points to the importance of stabilisation in terms of creating the pre-conditions for long-term investment by lowering costs as well as uncertainty, thus fostering an environment more conducive for micro-economic restructuring.

2.3. Costs and achievements of transformation

The price paid for the economic transformation includes, among other things, dramatic declines in output, although far from the magnitude experienced by economies which opted for a more gradual approach and where the starting point in terms of imbalances, geographical location etc. were less favourable. In the period 1990-1993 Slovak GDP decreased a cumulative 25 per cent due to collapsing domestic and external demand as well as price hikes. Industrial production experienced an even steeper fall of 37 per cent (!) in the corresponding period, and as firms faced increasingly hard budget constraints and lay-offs came in its footsteps. Unemployment, which prior to 1989 was an almost unknown phenomenon in Slovakia, only during the course of 1991 increased from 1.6 to 11.8 per cent. When it first peaked in January 1994, it affected 15.2 per cent of the labour force. Overall, Slovakia was initially more severely hit by the recession with higher inflation and unemployment, as well as steeper falls in GDP, than the Czech Republic. This, of

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137 The rules for example stated the need for NBS-approval of foreign loans, although these were reportedly more of a consultative character.
139 There were, for example, dramatic price hikes on imported energy and raw materials as the CMEA trading system collapsed and the implicit subsidies extended by the Soviet Union to other communist states disappeared. Estimates held that Russian price subsidies to non-Soviet CMEA countries amounted to some $18 billion in 1990, World Bank (1996), p. 27.
140 In the Czech Republic the highest magnitude of unemployment experienced was 4.1 per cent in 1991, while by end-1996 it stood at 3.2 per cent, which by the way was the highest end-year figure since 1991.
course, increased the appeal of the populist although non-viable promises by HZDS of a more socially responsible economic transformation.

However, as can be seen in Table 4 the tightened policies pursued began to pay off in 1994 when growth was resumed with GDP and industrial production growing 4.9 and 6.8 per cent, respectively. In 1995 GDP growth was the highest in the region (6.9%), inflation the lowest with 7.2 per cent and unemployment decreased from 14.8 to 13.1 per cent during the course of the year. Resumed growth has been accompanied by responsible fiscal and monetary policies, as it has in most successful Eastern European economies. The state budget deficits were slashed from Sk 23 billion in 1993 (6.2% of GDP) to Sk 8.3 billion in 1995 (1.6% of GDP). The explanation lies partly in increasing revenues due to growth and partly in steadily weakening government consumption. The latter fell from 25.8 to 20.9 per cent of current GDP between 1992 and 1995, and decreased a real 11.2 per cent in 1994 amidst general growth of 4.9 per cent. The relapse with regard to budget deficits in 1996 was a reflection of the massive increase in public consumption (+20.3%) and publicly initiated investment programmes, for example motorway construction, which together with the investment boom in heavy industry resulted in gross fixed capital formation growing an extremely high 39.8 per cent during 1996.

Recovery was initially export-led with total exports up 22.5 and 27.7 per cent in current dollar value terms in 1994 and 1995, respectively. During the corresponding period imports grew by 1.8 and 27.0 per cent respectively, thus turning the 1993 overall trade deficit of $1.1 billion (9.7% of GDP) into a small surplus by end-1994. The export-boom was closely connected to a re-orientation of trade with exports to developed market economies up 47.2 per cent in current dollar value terms in 1994.141 Between 1990 and 1995 the share of exports to developed market economies increased from 45.6 to 63.2 per cent. Also on the import side developed market economies increased their share of total imports from 52.7 per cent in 1990 to 57.7 per cent in 1995.142 This longer-term re-orientation, excluding trade with the Czech Republic, is illustrated in Figure 7. From 1996 onwards, however, growth has instead been led by domestic consumption and investment, a change which is reflected in the very quick deterioration in the trade balance, the current account and the state budget deficits. The imbalances are perhaps most clearly reflected on the current account balance which swung into a deficit of more than 10 per cent of Industrial production and GDP experienced cumulative falls of 34.6 and 20.7 per cent, respectively, between 1990 and 1993 before growth was resumed.

**Table 4. GDP, industrial production and unemployment, 1990-1996**

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<tr>
<td>GDP (% real change)</td>
<td>-2.5</td>
<td>-14.6</td>
<td>-6.5</td>
<td>-3.7</td>
<td>4.9</td>
<td>6.9</td>
<td>6.6</td>
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<tr>
<td>Industrial production (% real change)</td>
<td>-5.9</td>
<td>-22.3</td>
<td>-9.6</td>
<td>-5.4</td>
<td>6.8</td>
<td>8.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Unemployment rate (% end-period)</td>
<td>1.6</td>
<td>11.8</td>
<td>10.4</td>
<td>14.4</td>
<td>14.8</td>
<td>13.1</td>
<td>12.8</td>
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141 This trend is also clearly visible amongst the case study firms, see Appendix A.
142 These figures refer to per cent of foreign trade excluding trade with the Czech Republic.
GDP in 1996, after having showed a positive balance during the two preceding years (see Table 5, p. 84).

The period 1994-1995 was nevertheless a success story regarding macroeconomic performance. The one indicator to disturb the picture is unemployment which remained high. Slovakia also received praise for their achievements from international agencies such as the World Bank, IMF and the OECD. The latter, in their first real country study solely devoted to Slovakia had a positive short-term outlook, but warned that ‘this does not imply that all the foundations for sustainable long-term growth are in place’, and that ‘a clear sense of policy direction is needed in order to create the right incentives and condition for restructuring the economy.’\footnote{OECD (1996), pp. 23-24.} The issue at stake is exactly whether this development is sustainable in the long run; a crucial component of this issue is the industrial structure and its potential for adaptation and restructuring. The sustainability was also cast into doubt with the growing external imbalances from 1996 onwards. It seemed clear that a small open economy like Slovakia had to rely on exports if it was going be able to combine high growth rates with macroeconomic stability.

The policy of export-oriented growth put high demands on the competitiveness of the industrial sector, and considering the heritage a restructuring of industry was indeed necessary. The industrial sector was at the beginning of economic transformation unbalanced, and its technology was dated. The initial growth was to a large extent driven by the economic upswing in western Europe and corresponding high demand and prices for many of Slovakia’s traditional products. However, these products were to a large extent semi-finished ones with a relatively low value-added, for example iron, steel, chemicals, textiles, paper and machinery. This made Slovak industry vulnerable to price fluctuations on the world markets, both with regard to the products produced and the necessary inputs, i.e. energy and raw materi-

\[\text{Figure 7. Direction of foreign trade, 1990-1996 (per cent of total export/import, excluding the Czech Republic)}\]

\textit{Abbreviations:} DME = Developed Market Economies; PTE = Planned and Transition Economies

\[\text{Source: Statistická Rocenka SR (1992-1997); Zahraničný obchod Slovenskej (1993-1997); own computations.} \]

\textit{Abbreviations:} DME = Developed Market Economies; PTE = Planned and Transition Economies

\[\text{Figure 7. Direction of foreign trade, 1990-1996 (per cent of total export/import, excluding the Czech Republic)}\]
als – both of which Slovakia lacks domestically. Thus, the initial Slovak upswing was built on shaky grounds that needed to be reinforced by restructuring and investments in new technology.

Further, the inflow of foreign direct investment has been marginal in Slovakia. The annual average inflow in 1990-1996 was a mere $142 million.\(^{144}\) The conclu-

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\(^{144}\) For data on the inflow of foreign direct investment, see Table 5 (p. 84) and Figure 21 (p. 228). For a discussion about the underlying causes for the minuscule inflows, see Chapter VI:2.3.
sion to be drawn is that Slovakia to a large extent is forced to rely on domestic ac-
tors and domestic capital for the necessary restructuring, especially since there is
little hope that the prevailing trend with regard to FDI is soon to change. This in
turn brings the issues of incentives, institutions and ownership structures back to the
forefront in that they will determine: (i) the incentives and motivations of owners
and managers in their pursuit of modernisation and restructuring, and (ii) the poten-
tial of raising the necessary financial means for investments by influencing the de-
velopment of the domestic capital markets. The latter are crucial with respect to two
issues, firstly to what extent they manage to attract savings, secondly whether they
are able to allocate the scarce capital to those that will put it to best use. Also, own-
ership and property rights will have an impact on to what extent existing resources
can be re-allocated, i.e. it is necessary to promote the transferability of property
rights and institutions for corporate governance if the Slovak Republic is to be able
to meet the 21st century with a restructured and modernised industry which has the
potential to adapt easily to the changing conditions on the world market.
CHAPTER IV
Establishing private property rights

‘Privatisation is the sale of enterprises that no one owns, and whose value no one knows, to buyers who have no money.’
Janusz Lewandowski, Polish Minister of Privatisation

‘It is grossly unfair, possibly corrupt, certainly political, but it should work.’
Michael Kapoor, Analyst

Following the fall of communism the state-sector found itself in a systemic vacuum with regard to governance, yet it accounted for virtually all production and controlled the vast majority of productive assets. It should not be surprising therefore that the conditions for a successful restructuring of industry mentioned in the previous chapter were going to be difficult to meet in Czechoslovakia at the outset of reform. Rather, having inherited the most socialised of all economies in Eastern Europe constituted one of the major drawbacks of the communist legacy. Consequently, the Scenario adopted in 1990 laid heavy emphasis on policy-driven ownership reform (privatisation), making it the third pillar of economic transformation. The ambitious target was to privatise more than half of all large firms by the summer of 1992. To achieve this, ownership reform would proceed along several avenues, namely: (i) restitution to former owners or their heirs; (ii) small-scale privatisation of minor and medium-sized businesses; and (iii) large-scale privatisation of large- and medium-sized entities.

The aim of this chapter is to provide a description and analysis of the process of privatisation on a macro-level as it has progressed up to and including 1996, with the main focus on industrial privatisation. This is done to shed some initial light on

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1 Janusz Lewandowski was in 1991 Polish Minister for Ownership Changes; as cited in Savas (1992), p. 576.
3 See Mejstrik and Sojka (1994), p. 68; still at the outset of reform, on 1 January 1991, the private sector (exc. co-operatives) accounted for only about 2 per cent of GDP created in Czechoslovakia.
4 Private ownership is pointed out as a ‘fundamental’ pre-requisite for a well-functioning market economy and privatisation thus as an ‘indispensable’ part of economic transformation, see Scenario of the Economic Reform (1990), p. 8.
the questions of the type of actors that became owners and how this was achieved. Thus it indirectly also illuminates what challenge is posed for the ensuing structures for governance if this new ownership structure was to result in the comprehensive restructuring which above was concluded to be necessary for sustained growth. The chapter also probes into the issue of which factors were decisive for the policy choices initially made and the rationale for the consecutive changes.

The chapter begins (Section 1) with a definition of the concept of privatisation as used in this study, and a brief discussion of the scale and scope of the problems inherited from the command economy, i.e. an outline of the actual dilemma which policy-makers set off to resolve. Section 1 concludes with an overview of the various goals that have been connected to privatisation (Section 1.2). Section 2 focuses on the alternative solutions for resolving the dilemma. In Section 2.1 the potential merits and drawbacks of alternative methods, standard and non-standard, for privatisation are discussed on an analytical level. Then, in Section 2.2, before turning to the privatisation of the large-scale industry, two other avenues for increasing the share of private ownership are briefly surveyed, namely restitution and small-scale privatisation. The reason for including them even though they fall outside the scope proper of the study is that they partially overlap with large-scale privatisation, but also that they have an interest of a more principle nature and well illustrate the complexity of economic transformation. Finally, Section 2.3 turns to the issue of large-scale privatisation in an attempt to outline the institutional set-up in terms of formal rules and organisations which governed and were active in the privatisation process in Slovakia. Section 3, constituting the major part of this chapter, is an analysis of how this set-up was applied, and to some extent changed, during the process of privatisation in 1991-1996, i.e. how privatisation actually took place. When doing this it is possible to differentiate between four distinct phases in Slovak privatisation, phases that to a large extent “coincide” with changes in the political setting. Section 4 concludes the chapter with a brief summary.

1. Privatisation: an overview

There are many senses in which the relatively new word *privatisation* has been and is being used, for example as to encompass everything from deregulation of markets, to the commercialisation and corporatisation of state-owned assets, as well as the outright sell-off of assets. It is therefore crucial to make as clear-cut a definition as possible. In this study privatisation is defined as those state-led activities which result in the full or partial transfer of property rights (*usus*, *usus fructus* and *abusus*) from the state or related public agencies to the hands of private owners, be they individuals or legal persons, thereby excluding half-way solutions such as leasing and

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6 The term privatisation was reportedly first coined by *The Economist* in order to describe the policies of the Thatcher government, see *The Economist*, 15 January 1994.

7 On definitions of privatisation, cf. Glade (1986), pp. 143-146 which aptly illustrates the confusion surrounding the concept, and where one can see a cultural difference with regard to what the term is set to include; Thiemeyer (1986), pp. 10-14 which attempts to classify the variety of measures which all result in “state-shrinking”.

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franchising of state-assets. One important consequence of adopting this definition is to analytically differentiate between privatisation and restructuring. Still, as will be shown below, a close linkage between the two is assumed. Ownership reform, however, is as mentioned in the introductory chapter a wider concept in that it entails many aspects of institution-building relating to the development of a modern market economy.

Having chosen a relatively narrow definition it is important to emphasise that this in no way implies a denial of the existence of routes other than privatisation for re-establishing private ownership. Rather, in practice there are two general resolutions to the dilemma of how to once again make private ownership the dominant mode of economic organisation in Eastern Europe. While privatisation in the sense here used refers to the restructuring of property rights pertaining to the resources incorporated in existing firms, the main alternative refers to the growth and development of new private firms which already from the beginning are adapted to a competitive market environment. Given that the former refers to a policy-driven process, whereas the latter is more of a demand driven one, they are provisionally referred to as “privatisation from above” (PFA) and “privatisation from below” (PFB), respectively.

Reliance on PFB is admittedly intuitively attractive for an economic historian in that it represents the “natural path” which the majority of today’s developed market economies have threaded, and one where formal and informal institutions gradually and in an evolutionary manner have developed in symbiosis. PFA and PFB are thus complementary, both in establishing a private property regime and in that PFB to some extent depends on the freeing of resources from state-control by means of PFA or bankruptcies. However, even proponents of PFB envisaged no major role for it in terms of the industrial sector, not least because the large-scale capital needed for industrial start-ups. Adding to this the scale of the process, which is highlighted below, the conclusion made by eastern policy-makers as well as the majority of western economists and policy advisors was that sole reliance on PFB to transform the industrial structures was unrealistic. Such an evolutionary approach would by its very definition take a long time before yielding the desired results on a scale large enough to compensate for the production falls in an unreformed and in-

8 The statistical use of the concept ‘privatised’ is however murky since there has been a political pressure for showing results; most oftenly, though, authorities state that they define as ‘private’ all assets which are majority-owned by private interests, regardless of whether the state retains a zero or 49 per cent interest, cf. SNAZIR (1994), p. 7.
9 A similar distinction is made by Hodjera (1991), pp. 274-275.
10 The main vehicle for promoting such an evolutionary path is the establishment of freedom of entry coupled with far-reaching liberalisation and macroeconomic stabilisation, although one can imagine also more targeted policies pertaining to credits and taxes etc.
11 For a distinction like this, see Jasinski (1990); in Brezinski and Fritsch (1996a) “top-bottom” and “bottom-up” privatisation are used to denote the same phenomenon, respectively.
12 See Brezinski and Fritsch (1996b), p. 254. The inflow of FDI has been far from sufficient to compensate for the relative lack of domestic capital; this holds not only for Slovakia but for Eastern Europe. The cumulative inflow into Central and Eastern Europe (15 countries) in 1991-1996 ($45,440 bn) equalled only 56 per cent of the inflow into Singapore, Malaysia and Indonesia in the same period ($81,250 bn); and a mere 29 per cent of the inflow into China ($154,970 bn). Source: UNCTAD (1997), Annex table B.1.; own computations.
efficient state-sector. Time, however, was a good in short supply for Eastern European policy-makers.

Hence, even though the growth of new firms is indeed important, there was not time to wait and Czech and Slovak policy-makers decided to push ahead on several fronts with privatisation, in the sense used in this study, in order to create at least a critical mass of private sector activities. Experience of such policies existed in the west, dating from the 1970s and 1980s. However, as with PFB there were compelling reasons, all more or less related to the scope and scale of the task, why a full adaptation of western practices for privatisation would prove unfeasible. Rather, national and historical conditions, heavily influenced by the path threaded under communism, rendered it necessary for eastern parliaments and governments to devise their own programmes, methods and mechanisms for privatisation.

1.1. Scale and scope of privatisation

As a wave of deregulation and sell-offs spread across the world, privatisation has from the late 1970s and onwards received enormous attention among economists and policy-makers alike. Even though the topic as such is young, a vast literature has developed in a relatively limited period of time which offers a great many lessons from for example Great Britain. Still, significant differences in scale and scope as compared to the western experiences rendered much of the insight gained insufficient or sometimes even irrelevant in the eastern setting. The most striking difference was quantitative and concerned the scale of the task ahead. While western governments aimed to marginally increase the role of an already predominant private sector, Slovakia had no private sector worth mentioning at the outset of reforms. In the latter case, privatisation amounted to nothing less than the re-establishment of the institution of private property per se. Such a process would thus involve thousands of firms as compared to the sell-off of some dozens of firms on a case-by-case basis, which was what western methods had been developed to cater for.

The differences were however not only ones of scale, equally important were some major qualitative differences which would have made it difficult to privatise even a single firm in a western fashion. Firstly, the institutional environment in which privatisation had to take place radically differed. While western sell-offs

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13 On critical mass effects, see Roland and Verdier (1994).
14 An overview of various country-experiences is provided by the individual contributions in the volume edited by Glade (1986).
15 For one of the best economic analysis of privatisation, especially in Great Britain, see the monograph by Vickers and Yarrow (1988). Among the numerous edited volumes which focus on the theory and practice of privatisation in the west (mostly) one can mention the following: Clarke (1994); Clarke and Pielis (1993); Ott and Hartley (1991); Bishop et al. (1994); Bős (1991); and Saleman and Waterbury (1990b).
16 Between 1979 and 1987 Great Britain with Mrs. Thatcher as PM cut the part of GDP produced by state-owned enterprises from 11.5 to 7.5 per cent, see Vickers and Yarrow (1988), p. 1.
17 A characterisation of ownership under communism is found in Chapter II:5 (p. 45 ff.). The difference in scale is testified to by the fact that in 1990-1995 former communist economies privatised more than 30,000 large- and medium-sized firms, to be compared to the less than 7,000 firms privatised in the rest of the world in 1980-1991 (when privatisation was at its peak in western Europe), see World Bank (1996), p. 4.
took place in a setting of well-developed capital markets and with due assistance of experienced financial intermediaries, neither was even existent in Czechoslovakia at the outset of reform. Also, western state-owned enterprises (SOEs) had been operating in a predominant market-environment, thus providing a rather straightforward evaluation of the assets to be sold. Given the lack of markets and competition, as well as relevant track-records for the firms, nothing of the like could be envisaged for eastern firms. Secondly, given the low level of savings, the process in Eastern Europe had to target a troublesome type of buyer, i.e. one who could not afford to pay for the assets to be sold. Major calculated official domestic savings in Czechoslovakia and estimated it to equal 6.1 per cent (!) of gross fixed assets in 1989. Even if adding unofficial savings, one must remember that much of these still small savings were eroded by the price-hikes and falling real wages in 1990-1993. Neither fiscal revenue nor major capital injections into firms could thus be expected if one was to target domestic buyers. Thirdly, given the massive scale of the process, i.e. a redistribution of the majority of fixed assets in the economy, elected representatives were forced to face the question of fairness (perceived and/or real) in privatisation on a wholly different level than their western counterparts. The process was thus “visible” in quite a different manner, and governments faced the continuing need to explain and defend the rationale of their measures if popular support was to be retained. The communist heritage and past injustices only accentuated the need for fairness to be taken into account.

Fourthly, and perhaps most importantly, the type and quality of assets to be sold in Eastern Europe (i.e. the industrial structure) bore little resemblance to what was put on the market in western sell-offs. In fact, the Slovak industrial structure (together with the extent of state ownership) probably constituted one of the more burdensome aspects of the communist heritage. As previously touched upon, industry was not only characterised by the fact that it was overgrown and chronically wasteful of scarce resources; rather the major problem was its structural misadaptation relative to the demands of an open and competitive market environment. Industry had been erected in accordance with the logic of the command economy with its traditional emphasis on large-scale heavy industry, and in Slovakia with a particular bias towards metallurgy, chemical industry and armaments production. The latter had been a corner-stone of industrialisation and at the end of the 1980s Slovakia accounted for some two-thirds of Czechoslovakia’s total armaments production. In addition, the mere size structure of industry meant that privatisation would prove

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18 Cf. Lipton and Sachs (1990), pp. 322-323. Estimates of the “real” value of eastern firms varied widely and seemed to depend on the policy-stance of the person asked; advocates of selling firms with the outspoken aim of raising fiscal revenue generally assessed the assets to have a high value, while those in favour of speedy privatisation by means of distributing the assets (e.g. Åslund [1991a]) held that most of the assets were practically worthless given the lack of responsible owners, see also Section 2.1.

19 It can be noted that this was the lowest savings:assets ratio in the region, corresponding figures for other countries were as follows: GDR (23.7%), Hungary (6.9%), Poland (7.0%), and the USSR (12.9%), see Major (1993), pp. 23-37 and Tables 2.1-2.6.

20 But one example of this is the process of restitution whereby former owners were either compensated for past injustices or rehabilitated by means of returning their property, see Section 2.2.1. For a critical view (on liberal grounds) of restitution, see Gligorov (1992).

difficult; the average industrial firm in Slovakia had 2,487 manual workers in 1989. These firms had, in turn, been grouped into even larger industrial associations, and in 1989 there were only 158 registered industrial firms.\textsuperscript{22}

Taken together these differences, and many others that can not be discussed in this study, leave us with two important insights about the nature of the process of privatisation in Eastern Europe. One is related to the specific constraints posed by the shortage of domestic capital, the political and economic demands for speed and fairness, the dismal condition of much of the assets, and the lack of an institutional infrastructure needed for western-type sell-offs. Given all this, governments and parliaments in Eastern Europe had to look for new and innovative methods if they were to be able to carry out the task ahead of them. As will be shown below, this is exactly what happened in Czechoslovakia, which chose to adopt among the most radical, heterodox and interesting privatisation programme in Eastern Europe.

A second lesson is that, given all other differences between east and west, the direct goals connected with any method for privatisation will also differ. The ultimate goal of economic transformation, of course, remains a comprehensive and far-reaching restructuring of economic organisations and institutions in order to boost efficiency and growth. However, while privatisation in the west often has had this as a \textit{direct goal} for each firm being sold off, there is good reason to differ between privatisation \textit{per se} and restructuring in the eastern setting at least on an analytical level and thus view privatisation as an \textit{intermediate goal}. Privatisation is according to this view a pre-condition for organisational, financial and technological restructuring of the individual firms since it is held to be unfeasible that government-agencies would have the capacity necessary to guide restructuring in an efficient way in thousands of individual firms.\textsuperscript{23} An implication of this view is that rather than direct intervention in restructuring the task of the government should be to pursue policies which create the preconditions for: (i) rational and long-term decision-making and investments by means of macro-economic stabilisation; and (ii) for the unrestricted trade in property rights by means of establishing and enforcing those institutions which enable such trade and which may serve to reduce transaction costs connected to this. With this in mind, attention will now turn towards the goals connected to privatisation in Eastern Europe and Slovakia.

1.2. Goals with privatisation

A variety of goals have been associated with the process of privatisation, often ambiguous, internally inconsistent and not seldom of an outright ideological and political nature. In the early days of economic transformation, privatisation was by some viewed as a “miracle-cure” apt to address most of the ills inherited from communism. Time, however, has shown this to be a misconception, partly due to a

\textsuperscript{22} While 12 per cent of industrial firms had more than 5,000 employees only 3.8 per cent had less than 500. On the size structure of industry, see Appendix D, TABLE 8 (p. 324).

\textsuperscript{23} This is in congruence with the World Bank (1996, Ch. 3) which concluded that 'privatization should be seen as the beginning, not the end, of a process of reorganizing the ownership and incentive structure of firms.' [Quote on p. 5.] An illustrative discussion of factors reducing the capacity of the state during transformation, thus making it directly unsuitable for deciding about restructuring, is provided by Åslund (1992).
misunderstanding of the essence of privatisation, partly due to a failure to take into account the trade-offs among various goals and methods. While privatisation indeed is crucial for a successful economic transformation it cannot in and by itself set things right.

The economic goals to which privatisation may serve as a means have been discussed at length in literature. In this study, however, it will suffice to highlight a handful, which as a common denominator have their focus on improving the incentive structure facing the economic agents in order to increase productive, allocative as well as adaptive efficiency and thus boost growth. The first of these is the ambition to harden the notoriously soft budget constraint by means of privatisation. The basic idea is that private ownership is necessary to cut the firms access to the state treasury, i.e. only when direct political influence and/or responsibility for the well-being of a firm is gone can the soft budget disappear. In the words of Stiglitz, a government cannot otherwise make credible ‘the commitment to competition and the commitment not to subsidiz...’ Likewise, as long as rent-seeking efforts directed towards the state stand to bring better rewards than does efforts at restructuring, the latter will not take place. A second and closely related goal is the establishment of profit maximisation as the main objective for firms, or at least a closer approximation of this theoretical goal than what was the case in the past. During communism, firms were not only supposed to produce goods, they were also the main suppliers of social security, recreational housing, kindergarten etc. Only private ownership in combination with a hard budget constraint can make firms immune to such demands from the state. In this sense, privatisation is a means to change the division between the economic and political sectors of society and thereby create the pre-conditions for a private property regime with independent firms where, as put by Major, ‘property rights of private owners cannot be constrained in any other way than by the constitution or by acts of parliament....’

A third goal is to enable and encourage the creative destruction and reallocation of resources connected to freely transferable property rights; only when property rights can be traded freely can such reallocation take place in an efficient way. In addition, since the ownership structure resulting from privatisation by definition will be imperfect it is important that such reallocation is catered for. This is in...
congruence with North who points to adaptive efficiency as the most important factor for growth, i.e. how well organisations and institutions (of which ownership is one) can adapt to the changing environment. Finally, and the main focus of this study, privatisation is a pre-condition for the establishment of mechanisms for corporate governance. The mechanisms for governance discussed in Chapter II:4.2 all presupposed, implicitly or explicitly, the ability to freely transfer control- and property rights. Discipline deriving from voice, exit and bank monitoring are examples where the importance of the property rights structure is explicitly recognised, not even bankruptcy can be considered a real threat for firms if state ownership remains dominant. In addition, the development of efficient capital markets will require that abusus (the right to alienation) is held by private owners. Further, even for effective discipline through competition on the markets for products and managerial labour it may be argued that privatisation is necessary, since it is difficult to imagine an effective managerial labour-market with the state as the sole/dominant employer; the same reasoning goes for the product market. Thus, governance by means of market pressure requires that there are independent actors on both sides of the markettable, something which privatisation seeks to establish – in this sense, as Grosfeld aptly put it, ‘the case for privatization is precisely the case for market environment.’

This brings us back to the notion of privatisation as a process (see Figure 8), where the actual transfer of property rights (method of privatisation) is a first step which in and by itself is far from sufficient when it comes to achieving the overriding goal of increased efficiency. It is necessary though in that it is conducive for achieving the economic goals mentioned above, i.e. hard budgets, profit maximisation, creative destruction and functional governance structures, but it is no guarantee for bringing proper incentives for managers and owners. Rather, privatisation has to be complemented with policies which enhance competition and support the creation of functional institutions for corporate governance, since it is only in combination with strengthening market competition (as firms grow independent) and

**Figure 8. Privatisation and restructuring as a process**

![Figure 8](image)

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30 North (1992), pp. 3-16. This is not meant to play down the importance of allocative efficiency, although in our view no such optimal allocation is to be expected.

31 It should be admitted that ownership in these cases is not of the same binding nature as above, one could also argue that market-pressure should be more or less functional irrespective of ownership. However, such a line of reasoning would then implicitly refer to the western experience where private ownership is dominant, something which is not the case in Eastern Europe.

the development of governance structures (as property rights become tradable) that privatisation can achieve the desired results. Together, the three may succeed in causing entrepreneurship and efforts of managers and owners to be directed towards the type of activities which society as a whole will benefit from and which lead to a long-term sustainable growth, i.e. they will then engage in restructuring, investments, modernisation and rationalisation. In this way the outcome will, as discussed in the analytical framework, be affected by the institutional set-up in a wide sense. Thus privatisation can but serves as a start, whose results depend on factors such as the degree and quality of competition, legal regulation, the development of financial markets, the behaviour of various market actors etc. This, however, is not to say that the method of privatisation is unimportant. Rather, as will be discussed below, one may expect trade-offs between the different methods, where they are more or less well suited for reaching certain objectives (cf. Figure 9, p. 98).

2. Methods and constraints

Although privatisation has been ongoing in Eastern Europe and Slovakia since the early 1990s, the heated debate about the virtues of the respective method for privatisation has continued. Given that trade-offs between various goals and methods were apparent, and given the political nature of the process with the state both as a rule setter and, for some time to come, one of the main players, this was hardly surprising. When formulating policy, governments and parliaments were forced to strike a balance between economic efficiency criteria and what was politically desirable and feasible. Thus, no matter what the relative strengths and weaknesses of the individual schemes for privatisation in terms of economic efficiency, it can safely be assumed that it was not these alone that in the end would determine the path chosen. Rather, the litmus test of any method remains its political as much as its economic feasibility. The dilemma is captured well by Batt when stating that:

‘[t]he choice of approach…is conditioned as much, if not more, by domestic politics as by economic arguments, as governments search for allies and struggle to maintain their credibility and authority.’

A thorough understanding of privatisation and the choices made must thus clearly take into account the politics of the process. This, in turn, requires that one fully acknowledge that the re-allocation of property rights amounts to a corresponding and unprecedented re-allocation of wealth, income and power. Further,  

33 See discussion in Parker (1993). The fact that market structure and competition are crucial variables only accentuates the problematic situation of Slovakia, which inherited a highly monopolised organisation of both production and distribution.  
35 The future distribution of income is naturally a function of many different factors, but it can be assumed that among the more prominent is found the following: initial endowments of wealth, growth of the economy, path of reform, regulations of markets and allocation of property rights, see Nee (1989). A common denominator for the four first mentioned factors is that they in the long run all are somewhat flexible, at least in comparison to ownership. Thus, strong efforts can be expected to be made in order to reap as much as possible of these rights during transformation.
given that the process takes place in a rather turbulent environment where few rules are non-negotiable, the stage is set for a potentially long and arduous struggle of power between various interest groups.36 Former Slovak Minister of Privatisation (1991-1992), Ivan Miklos, writes that the process evolves ‘in a social space that is substantially distorted, both economically and spiritually, morally and ethically.’37 A consequence is that it will be difficult to understand the privatisation process without taking into account the probability that all kinds of groups, for example former party officials and firm managers, will be attempting to take advantage of the situation in order to enrich themselves, in terms of wealth as well as power, often at the expense of general welfare. For the former political elite and incumbent management, it is for example of utmost importance to transform their former informal influence, based on connections and positions, into formal property rights if they are to secure their future positions. To minimise the welfare losses resulting from such behaviour it is important to set clear rules of the game and provide as much transparency as possible. Nevertheless, with such high stakes there is little wonder that privatisation became a very delicate topic in transforming economies.

2.1. Standard vs. non-standard methods

The economic and political debate, east and west, early came to focus on the relative merits of what in Czechoslovakia came to be termed standard and non-standard methods, respectively, for privatisation.38 The former refers to well-known methods such as initial public offerings (IPOs), public auctions, tenders and direct sales, while the latter came to designate the more innovative schemes for mass privatisation of state-owned assets which were drawn up and prescribed by economists of various persuasions.39 Both have been used extensively, not only in Slovakia, and both can be argued for in a rational manner. The basic argument in favour of applying standard methods where buyers pay for assets with “real money” is that they stand to bring the best owners for firms, i.e. those willing to pay the highest price for the entity will possess some additional skill or information that makes the purchase profitable in spite of the higher price paid (cf. Figure 9, p. 98). This, however, is subject to one very important qualification, it holds only if sales/tenders are openly announced and executed in a competitive environment – something that has not always been the case in Eastern Europe. Further, it offers an attractive solution to the problem of corporate governance since it may result in “core investors” who possess both the voting power and the incentives, in the form of high stakes in the firm, necessary for effective monitoring of management. An additional advantage is

36 Starr (1990) provides an interesting analysis of political forces and constraints on privatisation, and write that ‘[t]o be sure, it is possible to read each type of privatization program as enhancing the power of states, parties, or other powerful actors.’ [p. 46]. Major (1993) provides an early and thoughtful analysis of privatisation both from the viewpoint of power redistribution and the economic aspects.

37 See Miklos (1995), p. 11 who also provided an interesting discussion of the reasons for what he concluded to be a ‘predisposition’ for the spreading of corruption in Slovak society (pp. 11-14).

38 An overview of western proposals is found in Borensztein and Kumar (1991).

39 The first suggestion for mass privatisation in Czechoslovakia was presented by Czech-émigré economist Jan Svejnar (see Svejnar [1989]) in 1989 when suggesting to transform SOEs into joint-stock companies and distribute the shares for free to the population. On other early plans, cf. footnote 45.
that the method may bring fiscal revenue and that the eventual buyers may be ones who are capable of injecting new capital and skills into the firms.40

The flip side of the standard methods is first and foremost, as discussed above, that finding such cash-strong owners for thousands of firms in the Eastern European environment with its relative lack of capital would take decades. The time-consuming character of standard methods is only added to by the fact that such a case-by-case approach often requires a more careful evaluation of assets and/or cumbersome tender procedures.41 Such delays, however, may prove costly in terms of managerial slack given that the agency-problem turned acute following the collapse of the command economy, i.e. with the disappearance of formal authority the quantity and quality of information available to principals worsened, even compared to central planning. Thus, transformation is a period of more pronounced agency problems, while the counterforces of market-conform disciplining mechanisms and a new regime of clearly delineated property rights are not yet in place. Taken together, this amounts to a forceful argument for speedy privatisation.

The essence of any non-standard programme for mass privatisation is exactly the speedy give-away of state property to the general populace without any concerted effort to restructure firms in advance. The main argument for the approach is that it lessens the problems of evaluation of assets and removes the constraint on speed posed by the lack of domestic capital. Speed, in turn, is considered crucial as to avoid the dangers of a vacuum with regard to governance associated with a prolonged transformation.42 Proponents hold that it is more important to quickly establish the foundations of a new property rights structure with new incentives for economic agents than to search for the “best” owners and/or to raise fiscal revenue by selling firms on a case-by-case basis.43 It is argued that proper principals will evolve more or less naturally once the institutional arrangements for trade in property rights are established, something which the non-standard methods in themselves help to establish by making firms quickly and extensively publicly owned.

The major difference among schemes for mass privatisation in different countries is the way they envision the distribution of shares.44 Some prefer an administrative distribution of shares where they are allocated to intermediaries with the task

40 For an elegant argumentation in favour of selling companies as opposed to giving them away, see Kornai (1990), pp. 80-93, who argues that “state property must not be squandered by distributing it to one and all merely out of kindness.” [Quote on p. 81.]

41 An alternative, which may make standard methods less time consuming, is to sell the firms at large discounts to domestic investors in a non-competitive manner. This, however, would mean that many of the advantages of the methods discussed would be attenuated or even disappear.

42 Cf. Estrin (1994), p. 15 ff. Such a situation, with uncertainty for incumbent management about its future position, increases the risk for rent-seeking, shirking etc. – so, if the polity opts for extensive privatisation it is argued that there is a virtue in a relatively speedy process.

43 The argument for speed is made forcefully by Lipton and Sachs (1990) who, however, do not share the view (see below) that efficient matching of firms and owners can be left to the market for take-overs. For a truly eloquent argumentation against striving for revenue to reduce government debt the reader is referred to Major (1993), pp. 95-101. Fiscal revenue per se indeed has little to do with the over-all goal of raising economic efficiency of firms. It should also be noted that Czechoslovakia, with its relatively low internal and external debt, was a country well suited to disregard fiscal considerations which would pose a constraint on the speed.

44 An overview and brief discussion of the various mass privatisation programmes initiated in Eastern Europe and the former Soviet Union is provided by UN ECE (1993), pp. 210-213 and Table 3.6.11 (p. 209).
of restructuring firms in their portfolio and later dissolve themselves.\textsuperscript{45} In Slovakia such a proposal surfaced where industrial firms would be made part of a giant holding company in which private interests would be let in.\textsuperscript{46} An alternative is to divide the shares directly to the population, using some type of market mechanism, as would eventually be the case for non-standard privatisation in Czechoslovakia.\textsuperscript{47}

Both of these examples usually involve some attempts to lessen the agency-problem by establishing (by fiat or evolution) investment funds which are made responsible for the actual monitoring of management. Still, the potential draw-backs of the non-standard methods rests with their uncertain impact on governance and the fact that free distribution in general will result in owners with limited possibilities to inject new capital to firms. The latter may, however, to some extent be counterbalanced if widespread share ownership induces the speedy establishment of capital markets apt to provide low-cost equity financing for firms. Nevertheless, the implications of non-standard mass privatisation with regard to corporate governance and access to capital and skills, respectively, may not be concluded on an analytical level (see Figure 9).

As concluded above, the choice among methods will not only depend on the economic aspects of the alternative methods, but will be equally influenced by political considerations, domestic as well as international. In this respect, the pursuit of non-standard methods holds some potential advantages, not least with regard to fairness. Non-standard schemes are often designed in order to provide neutrality and equality among citizens, i.e. everybody is given the chance to obtain a share of the national property,\textsuperscript{48} and can thus lessen the \textit{ex ante} political constraints against

\textsuperscript{45} Cf. Blanchard and Layard (1991) which for Poland envisioned a system where firms were grouped holding-companies (HCs) in which citizens would receive 100 shares each; HCs would pay dividend taxes to the government and dividends to their owners and use profits to restructure firms in their portfolio and later dissolve themselves; a similar system was sketched by Åshund (1991a), pp. 20-21; also, see Lipton and Sachs (1990) pp. 313 ff. for a proposal on speedy privatisation combined with governance from a variety of institutional owners who are given blocks of shares, although they resented the idea of HCs (footnote 38).

\textsuperscript{46} Myant (1993), p. 235.

\textsuperscript{47} See Section 3.1.

\textsuperscript{48} Naturally, it is not perfectly neutral since knowledge about the firms and their potential will be valuable if presented with a choice of where to invest. These problems of unequal distribution of information may however be lessened by the use of intermediaries, for example investment funds.
privatisation by means of buying popular support.\textsuperscript{49} Even though, by the same token, it may heighten the \textit{ex post} constraints as firms begin to restructure and lay off workers, it can still be viewed as tactically correct in that privatisation before restructuring is a measure that will “benefit a majority and hurt a minority”.\textsuperscript{50} Further, any such \textit{ex post} discontent with the effects of privatisation may be counterbalanced by the fact that many will have been given a vested interest in private ownership and the protection of the same.

However, also the use of standard methods can be fair, if carried out in a competitive manner. Even though the general populace is not likely to become major shareholders in firms sold for cash, it should still be acceptable to the broad layers given that it: (i) may postpone the unpleasant experiences connected to restructuring; (ii) may result in state-revenue to be used for common purposes;\textsuperscript{51} (iii) may provide an ownership structure more conducive for growth. Still, the very indirect linkage between the sell-off of assets and, say, improved health care or long-term growth, may cause popular resentment about the method being unfair, thus raising the \textit{ex ante} constraints, especially since the buyers to a large extent can be expected to be persons belonging to the former \textit{nomenklatura}. Further, in practice it may prove difficult to keep to a policy of competitive standard methods if one is to make any substantial headway with privatisation. The alternative then is to resort to non-competitive sales to, for example, insiders. Such sales may be expected to be quicker given that it may remove the constraints on speed posed by the lack of capital. On the other hand, it will in such a case be expected to lose its appeal in terms of raising fiscal revenue. Also, it is hard to argue for such an approach on grounds of fairness, and its impact on corporate governance is uncertain (see Figure 9).

\* \* \*

In conclusion, both standard and non-standard methods have their specific advantages, drawbacks and trade-offs. Although these issues are not the topic proper of this study, the point to be made is that both may be argued for on grounds of equality as well as economic efficiency. Economic efficiency criteria of privatisation is to transfer property rights to those who are willing to pay the most for them – since these are the ones who will put the assets to the most efficient (highly valued) use. In a world of zero transaction costs, this would be the outcome irrespective of policy. However, since transaction costs are positive it can be argued either that the state ought to try to find the highest bidder by means of a system of competitive sales, or, when competitive sales are not considered a feasible option for one reason or another, attempt to minimise the costs for the subsequent reallocation of property.

\textsuperscript{49} Roland (1994), p. 35 ff. differentiates between \textit{ex ante} and \textit{ex post} political constraints, where the former are the ones facing the government whilst formulating policy and getting it through the legislature, and the latter are the considerations that must be made about a possible backlash when some negative results of the reform-measures become apparent.

\textsuperscript{50} Roland (1991), p. 52. Such a sequencing tactic may thus create a “window of opportunity”.

\textsuperscript{51} Depending on policy it will be either high-income households that gain the most (in cases when revenue is used to keep down progressive income-tax), or low-income households (when revenue is used to expand re-distributive systems that otherwise would not have come into being), or both (when revenue is used for investments that otherwise would not have taken place in infrastructure or collective goods).
rights after their initial distribution, for example by promoting efficient and liquid capital markets.

2.2. The first steps: restitution and small-scale privatisation

In Czechoslovakia, the unresolved balance of political and economic forces, in combination with the ambitious targets set up in the Scenario, led to the adoption of a rather diversified approach to privatisation which combined standard and non-standard methods. A number of programmes for privatisation were initiated and codified in a series of laws taken by the federal and republican parliaments in 1990-1991. These programmes differed with regard to the type and amount of property included, which group/type of buyer that was targeted, and, not least, which methods were employed. In the following, an overview of the three most important programmes is attempted. The three are: restitution, which is an example of a non-standard method being used for a non-standard situation; small-scale privatisation by means of auctions, a standard-method whereby a large share of the retail network was privatised; and, finally, large-scale privatisation where policy-makers chose to combine both standard and non-standard methods within one programme in order to find owners for the larger units within industry and construction. All programmes have in common though, that the actual implementation was characterised by a high degree of decentralisation and that it to a large extent was the communist heritage that guided the decisions made.

Table 6. Privatisation programmes initiated in Czechoslovakia 1990-1992

<table>
<thead>
<tr>
<th>Programme</th>
<th>Method</th>
<th>Main legal regulation</th>
<th>Type of property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restitution</td>
<td>Free transfer to former owners or their kin</td>
<td>Act. no. 403/1990</td>
<td>Real estate, farmland, church property (app. 100,000 units)</td>
</tr>
<tr>
<td>Small-scale privatisation</td>
<td>Auction to the highest bidder (assets only)</td>
<td>Act. no. 87/1991</td>
<td>Shops, restaurants, workshops etc. (app. 33,000 units)</td>
</tr>
<tr>
<td>Large-scale privatisation</td>
<td>Auction, tender, direct sale, or transformation to joint-stock companies (incl. vouchers)</td>
<td>Act. no. 92/1991</td>
<td>Large- and middle-sized companies (app. 4,000 units)</td>
</tr>
</tbody>
</table>

Comment: Most legal acts have gone through consecutive changes and amendments; an overview of the changes is provided by Erben and Novák (1996).

2.2.1. Restitution

The end of communism created an unexpected moral and political dilemma for the new democratic governments who were posed with the question of whether, and to what extent, they should attempt to make up for the wrong-doings of the previous regime with regard to unlawful and/or immoral nationalisations and confiscations of private property by either returning it in kind or by providing financial compensation to the previous owners. A problem was that far-reaching restitution bore the risk of resulting in investigations and legal processes that could delay other aspects of privatisation. The Czechoslovak government nevertheless made an ambitious attempt at restitution, not only to make up for past wrongs, but also because they
viewed restitution 'as one of the most efficient means of privatizing the economy.'

The process was governed in two laws passed by the Federal Assembly, the first being the Act on Alleviating Certain Consequences of Property Injustices (Act no. 403/1990, below Minor Restitution Act) on 2 October 1990, and the second being the Act on Extrajudicial Rehabilitations (Act no. 87/1991, below Large Restitution Act) on 21 February 1991. All laws excluded property nationalised in accordance with the Benes decrees in 1945-1948 (see Chapter III:1.1), as well as property previously owned by legal entities. Eligible claimants were previous owners or their heirs who were citizens and settled in Czechoslovakia when making their claim. The general approach was to be restitution in kind, with financial compensation being a supplement when damage or improvements had drastically altered the value of the property. Financial compensation was also prescribed with regard to property presently owned by foreign subjects, foreign governments or domestic private persons. These restrictions, combined with the fact that most of the nationalisations had taken place prior to the communist coup in 1948, and that the handling of claims would be decentralised, made the programme viable.

The Minor Restitution Act covered small businesses, workshops, restaurants and real estate previously owned by physical persons and expropriated between 1955 and 1961. According to the law, the state entity receiving a claim for “its” property had to return it to the claimant within 30 days. Claims could be filed from 1 November 1990 and were due on 2 May 1991, property not claimed rightfully or in time would be auctioned off in the small-scale privatisation. Initial estimates held that some 70,000 persons would be eligible under the act in the country as a whole. The Large Restitution Act extended the process to include all property nationalised between 25 February 1948 and 1 January 1990, even if in accord with the law of the time, given that the actions had been contradictory to basic human rights. It thus applied to many dissidents who had been forced to leave their property for one reason or another and for example governs property confiscated as a consequence of forced emigration for political reasons. The law was much more far-reaching than the Minor Restitution Act and was estimated to affect some 10 per

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52 Triska (1991), p. 24. Dusan Triska was at the time Deputy Minister of Finance and Director of Privatisation in the Federal Ministry of Finance.
53 An English translation is found in Czechoslovak Economic Digest (1991), No. 1, pp. 30-32.
54 A third law, on Restitution of Land and Other Agricultural Property adopted in May 1991, dealt with agricultural privatisation and thus fall outside the scope of this study, see Martin (1991). Also, while some church property was covered in the below described laws the majority of restitution pertaining to the church was regulated in separate laws adopted in independent Slovakia, see Fisher (1993). Good overviews of the restitution process are provided by Kupka (1992), pp. 31-37, who also discusses the effects of various amendments to the laws as well as the general philosophy of restitution, and Kotbha and Svejnar (1994), pp. 149-155.
55 Kotbha and Svejnar (1994), pp. 150-151. An alternative approach was chosen by Hungary where financial compensation was the rule, an overview is found in Fahidi (1994).
56 Cf. Obrman (1991), p. 12; Kastberg et al. (1992), p. 87; exempted was all farming land included in the co-operative farms, see Financial Times, 3 October 1990. The law thus covered approximately the same type of assets as small-scale privatisation, see Section 2.2.2.
cent of all state property at an estimated value of $10.7 billion, out of which the vast majority was to be returned in kind. The final results in terms of the amount of property privatised through restitution are close to impossible to specify, given the very decentralised nature of the process. What seems clear, however, is that there was a marked difference between the two republics with regard to the extent of the process. In Czechoslovakia as a whole there were some 30,000 claims filed in accord with the Minor Restitution Act, resulting in the return of more than 100,000 units. However, in Slovakia there were only some 5,000 claims filed, out of which 2,700 were deemed as justified. In addition, however, claimants could file for financial compensation from the Ministry of Privatisation, which received 10,700 claims – of which 769 had been accepted at end-April 1997. The differences are partly explained by the more negative attitude among leading politicians in Slovakia towards restitution, and partly by the fact that Slovakia at the time of the communist take-over was by far less developed than the Czech Lands. The results of the Large Restitution Act are even more difficult to assess. At the time of the 30 September 1991 deadline, more than 20,000 claims had been filed in CSFR as a whole, how many of these eventually were effectuated is not possible to say since many claims logistically were made part of the large-scale privatisation.

Most of these cases were in Slovakia covered by distributing shares in the Restitution Investment Fund (Restitucny Investicny Fond, RIF) which was set up and administered by the Fund of National Property (FNM). This fund (RIF) was endowed with approximately three per cent of shares in all firms privatised in the large-scale privatisation programme by means of vouchers (see Section 2.3). By end-1995 this meant that it been allocated shares with a nominal value of Sk 6.3 billion ($213 mn).

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60 Cf. OECD (1991), pp. 140-141; Financial Times, 16 April 1991; cash compensation was limited to Kcs 30,000, ($1,018), the rest would be covered by shares in the Restitution Investment Fund (RIF) which was established during large-scale privatisation (see below).
62 OECD (1994), footnote 133 (p. 158). The pace with which the process progressed also differed markedly, by end-March 1991 there were for example only 135 cases of restitution of retail trade cooperatives in Slovakia, while the corresponding figure in the Czech Republic was in excess of 5,000, see Kotrba and Svejnar (1994), pp. 152-154 and Table 3.
63 Act. no. 403/1990, § 14, 15 and 16.
64 ‘Priebezná informácia o stave riesenia uplatnených restitucnych podaní a pedpoklad plnenia na rok 1997’ (1997), Ministry for the Administration of National Property and its Privatisation. By then financial compensation from the Ministry to claimants amounted to Sk 218 million. The process of paying out these claims had however been ongoing since 1991 – with slightly more than 100 claims per year being settled. It was estimated that yet approximately 250 claims would be accepted by the Ministry.
65 The Slovak government for example initially rejected the Large Restitution Act, see Obrman (1991), pp. 12-13; see also Pehe (1991), pp. 5-7 on the problems of finding consensus on restitution.
66 For financial compensation the deadline was set at 1 April 1992, see Kotrba and Svejnar (1994), p. 150.
67 The Act on the conditions of transfer of state property to other persons stated that restitution claims had to be taken into account when privatising these firms. On the number of industrial firms that were actually restituted in kind, see Table 45 (p. 277).
persons, but the FNM was still the major shareholder of the fund with approximately two-thirds of shares.\(^{69}\)

### 2.2.2. Small-scale privatisation

In September 1990 Czech Minister of Privatisation, Tomas Jezek, made clear that a separate programme would be undertaken for privatising smaller ventures like shops, restaurants and workshops.\(^{70}\) The decision was a result of political, economical as well as practical considerations. Politically it was the type of privatisation that one most easily could muster the necessary popular and parliamentary support for, not even the communists were totally opposed to private ownership on a smaller scale. Economically it was seen as a way of quickly establishing a critical mass of an indigenous business class which hopefully could use their entrepreneurial talent to create a dynamic and expanding private sector and cater for better quality services as well as for new jobs.\(^{71}\) Practically, finally, this type of small-scale privatisation would be far less demanding in terms of administrative capacity needed for preparation and enactment than would the privatisation of large industrial firms. Also, given the relatively minor size and value of the units included in the programme it was thought that the general lack of domestic capital would not pose such a severe hindrance on speed as in the case of larger industrial firms; it was therefore decided that the process would be carried out by means of public auctions, i.e. a competitive standard method.

Three weeks after the adoption of the Minor Restitution Act the Federal Assembly on 25 October 1990 adopted the *Law on the transfer of state property of certain businesses to other physical or legal persons* (Act no. 427/1990) to govern the process.\(^{72}\) The law, which came into force as of 1 December, catered for the sale or lease of real and movable property included in ongoing business ventures. The law however excluded property in the possession of foreigners, agricultural property as

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69 Kniebügl (1997) [interview]. RIF was established on 3 May 1993 in accordance with the *Law on investment companies and investment funds* and the *Commercial Code* (§162) (neither of which is special for RIF but refers to investment funds in general). The reason for establishing RIF was to get a mechanism whereby one could compensate those injured 1945-1989. The objective of RIF is to manage the shares which were put in it on a commercial basis to create dividends for the owners of RIF-shares. Shareholders are thus those whose restitution claims were deemed legitimate by, for example, the Ministries of Privatisation, Finance and Economy, but where settlement could not be arranged in kind. The performance of the fund has in fact been above average (see Chapter V) and NAV at end-1996 was Sk 1.8 billion; and it has been the investment fund with the highest dividends. Sources: Annual Reports [RIF]; Kniebügl (1997) [interview].


71 A person talking about small-scale privatisation in almost loving words was Minister of Privatisation Jezek who said that ‘[p]roperty that nobody had taken responsibility for, that has been a burden to society, must now end up in the loving care of someone who is willing to take it up in the family. If not, they will be put in bankruptcy.’ Source: *Upsala Nya Tidning*, 25 January 1991 [my translation].

72 An English translation is found in *Czechoslovak Economic Digest* (1991), No. 1, pp. 26-29. The act was complemented by national laws which specified the functions of the various authorities involved, i.e. Act no. 20/1990 of the Slovak National Council and Act no. 20/1990 of the Czech National Council. On the consecutive amendments and executive legislation the reader is referred to Erben and Novák (1996), pp. 20-29. A thorough overview of small-scale privatisation in Eastern Europe, but without specific reference to Slovakia, is provided in the volume by Earle et al. (1993). However, as the principles for small-scale privatisation were the same in Slovakia as in the Czech Republic, which is given extensive coverage, it is still a most noteworthy contribution.
well as properties subject to restitution. Applying to basically the same type of property as the Minor Restitution Act, small-scale privatisation was to complement restitution by privatising the remaining small-scale assets, those unclaimed or those established post-1959. Responsibility for the enactment rested on the republican level with the actual work in Slovakia being carried out by 38 local privatisation committees, which were appointed and supervised by the Slovak Ministry of Privatisation.

The method used for transferring the assets was mainly public auctions with price as the only criterion. These were organised by the local committees who were obliged to look for objects to privatise, receive proposals for the same, evaluate the businesses, make sure there were no outstanding claims on the unit, issue catalogues with information about the units and finally to arrange the auction where the unit should be sold – subject to the approval of the Ministry of Privatisation. The auctions were announced at least 30 days in advance, often by advertisements on display in the city-hall or the like, and were open to all citizens who paid the entrance fee of Kcs 1,000 ($34). To take part in the actual bidding, however, one had to pay a deposit equal to 10 per cent of the starting price, calculated according to book value; minimum Kcs 10,000 ($340). The auctions were so-called Dutch auctions, implying that the final price was allowed to fall below the starting price, i.e. below book value, although not by more than 50 per cent. If no purchaser could be found under those terms the unit was withdrawn from the auction and put up for sale on a second auction. The second auction differed from the first on two counts: firstly, the committees had the option of lowering the starting price; secondly, also foreign citizens and firms were allowed to participate. The units auctioned were sold without any liabilities (labour contracts, debts etc), and the full price had to be paid within 30 days to the Fund of National Property (FNM).

In Slovakia, the first auction was held on 24 February 1991 and the process continued and accelerated throughout the year. In total there were 7,472 units auctioned in Slovakia in 1991, with a total of 21,437 units privatised in Czechoslovakia as a whole. However, due to pending or possible restitution claims on the real estate the vast majority were sold only with leases to the premises, until October 1991 for a minimum of two years, but from then onwards with a five-year lease.

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74 The law, under certain conditions, provided for the possibility of selling the businesses directly to those who had a leasing-contract established and in force as of 1 October 1990; thus, not all units were auctioned, see Act no. 427/1990, §16.
75 Since the law did not define exactly what property was to be included, it gave a large deal of discretion to the individual committees. At the same time, however, the process was demand-driven in that the committees were required to put up for sale those units which were suggested for privatisation, if there were no other formal hindrances for it to be included in the process, cf. ‘Privatization launched’ (1991), p. 8; The European, 18 January 1991.
76 For the price to be lowered by the auctioneer at least five persons had to take part in the auction, see Act no. 427/1990, §10.
77 The revenue was deposited at a special accounts where some 30 per cent was estimated to cover costs connected to the process and the remainder staying with the FNM, see Rutland (1992b), p. 7.
78 Kotrba and Svejnar (1994), pp. 157-158. The very first auction in CSFR took place on 26 January 1991 in the Czech Republic when 16 units were sold for a total of Kcs 22 million ($746,000), on average 10 times higher than the starting prices. Source: The Economist, 2 February 1991.
79 Kotrba and Svejnar (1994), p. 156 and footnote 12; by the fall of 1991 some 90 per cent of all units sold in CSFR as a whole had been without real estate, see OECD (1991), p. 139. It is thus questionable
some problems relating to the financing of purchases in that the banks were interested in collateral in the form of real estate or other property. Still, in Slovakia a larger share of the deals were covered by credits than in the Czech Republic.80 In 1992 the process gradually lost pace before being basically finished towards the end of the year, with only 42 sales in 1993.81 Thus, in total some 9,700 units were auctioned off in 1991-1993, at a total price tag of Kcs 14 billion ($481 mn). Of the auctioned units trade and catering accounted for 73.4 per cent,82 followed by services (13.5%), industry (8.7%), construction (1.7%) and other (2.0%). Noteworthy is both the higher average prices during the second year of privatisation and the fact that industrial businesses reaped more than double the average price than others, Kcs 3.8 million ($131,600) per unit compared to Kcs 1.5 million ($52,000).83

This brief overview of small-scale privatisation suggests that it cannot be described as anything but a success. Together with the process of restitution, it helped to recreate the virtually absent private sector in Slovakia in a very short time.84 Privatisation of retail trade, for example, implied that the share of private (and co-operative) ownership in retail turnover rose from 28.6 (1989) to 73.1 per cent in 1992.85 In CSFR as a whole, the private sector grew from about 2 to 8.4 per cent of GDP in 1991 alone.86 The new owners were a mixture of former employees and outsiders, whether this process is really “privatisation” in the sense that it is defined in this study, i.e. transfer of full, exclusive and transferable property rights.

80 Exact figures are difficult to come by, but Myant notes that some 70 per cent of Slovak buyers relied on loans and the investment banks granted credits ‘equivalent to nearly half the Kcs 11.5 billion paid’, see Myant (1993), p. 233.
81 Still at end-1995 the process of small-scale privatisation was not formally closed, although the figures referred to as regards the extent of the process are still the same as at end-1992.
82 In trade and catering there were in 1991-1992 a total of 6,866 (5590+1276) units sold, involving 33,171 employees (24638+8533). The total price paid for these ventures was Sk 8.355 billion ($286 mn) (6.708+1.648), i.e. on average 28 per cent over the starting price which had been set at Sk 6.513 billion ($224 mn) (4.601+1.912). Source: Statistická Rocenka SR 1993, Tables V.8-3 and V.8-4.
84 Private sector sales revenue quadrupled in 1991 and constituted close to 50 per cent of the total volume by the first quarter 1992, see Gács et al. (1993), p. 72.
85 Note that within this cumulative figure for private and co-operative ownership there was at the same time a substantial change in favour of private ownership as compared to co-operative. Source: Statistická Rocenka SR 1993, Table V.8-2.
although there was no preferential treatment of employees. As could be expected, however, the speedy process provoked some worries and controversies with respect to fairness. One point of public discontent was the fact that the method of “Dutch auction” opened for collusion among bidders to keep the prices down. Another often voiced complaint was that Slovak citizens acted as front-men for foreign investors since they were excluded from the first auction-round. Nevertheless, the new entrepreneurs proved that service, quality and supply quickly could be improved if they only were given the incentives and the chance to do so. With this brief discussion of small-scale privatisation and restitution concluded, the study now turns to the question of what could and was done with the major problem – the large-scale industrial sector.

2.3. Large-scale privatisation: the institutional set-up

The first two years of large-scale privatisation in Slovakia was a joint process of the Czech and Slovak Republics within the framework of former Czechoslovakia, regulated by the same laws and institutional framework and lead by the same agencies. In comparison to the programmes for small-scale privatisation and restitution, the process of establishing new owners for the dominant industrial sector represented a wholly different undertaking – in scope, complexity as well as implications for the future economic development. Large-scale privatisation was also a more centralised process with the federal government having the most influence, leaving relatively little room for the republican parliaments to influence the path of reform. The whole process began in earnest in April 1990 with the adoption of laws which made it possible for the government to break up the existing industrial associations (VHJs) into which the majority of industrial firms had been bundled. This way some 200 VHJs were transformed into approximately 4,500 SOEs in the country as a whole. The importance of this corporatisation, although not altering the ownership structure, should not be underestimated. Firstly, ‘it identifies and defines the assets belonging to the firm and makes clear to which state agencies they belong’ and ‘establishes Western-type managerial structures in the firm.’ Secondly, it provided some impetus for deconcentration and demonopolisation of industry.

Large-scale privatisation per se began with the adoption of the Act on the conditions of transfer of state property to other persons (Act no. 92/1991) on 26 February 1991, which with its subsequent amendments formed the cornerstone of the

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87 The adoption of the law was preceded by a heated debate, where insiders demanded discounted prices, instalment plans etc. There were even voiced demands that the owners of the property should be chosen in public elections, see ‘Privatisation launched’ (1991), p. 8.
88 Dutch auctions came to be used in 20 per cent of cases in Slovakia, as compared to one-seventh in CSFR as a whole, see Myant (1993), p. 233; OECD (1994), p. 58. This, however, is partially explained by the lesser quality and attractiveness of the property auctioned in Slovakia. A review of various methods for corrupt behaviour is found in Miklos (1995), p. 15.
89 A discussion of these problems is found in Gács et al. (1993) which also provides a regional overview of the practices and results of small-scale privatisation.
92 The actual legal status of the firms was changed into a joint-stock company once the SOE entered the process of privatisation.
The regulatory set-up. The adopted legislation spelled out four basic methods for privatisation, i.e. direct sale, public auction, sale by tender and transformation into a joint-stock company. In the case of transformation to a joint-stock company there were various ways through which the shares could be transferred to new owners (see 4a-f in Figure 10), two of which would be classified as non-standard methods. The first, and most common option, was that the shares were sold in exchange for so-called vouchers (investment vouchers), i.e. the much publicised mass privatisation programme (4a). The second non-standard alternative was to transfer shares free-of-charge to municipalities and pension funds (4e).

The whole programme started in early 1991 when the government tentatively earmarked more than 4,000 large- and medium-sized firms for privatisation (see Table 8), out of which some 1,200 were of Slovak origin with an estimated book value of Kcs 385 billion ($13 bn). To make the programme workable, it was divided into two “waves”, with close to 2,300 firms included in the first, and as history would show, the only federally administered wave (see Table 8). The book value of these firms amounted to more than Kcs 700 billion ($23.7 bn). On 4 October 1991, the input for privatisation was changed in Slovakia, and a more ambitious target of privatising 751 firms with a total book value of Kcs 166.5 billion ($5.6 bn) was set for the first wave. The corresponding target for the second wave

Figure 10. Alternative methods for large-scale privatisation

1. Direct sale of the company to domestic or foreign buyer, with or without debts
2. Public auction of the company to domestic or foreign buyer
3. Sale by tender (open or closed)
4. Transformation to joint-stock company where the shares can be sold/distributed in the following manners (or any combination thereof):
   a) sale in exchange for vouchers
   b) direct sale to pre-determined domestic or foreign buyer
   c) sale through banks or stock-exchange
   d) sale to employees (max. 5%)
   e) free transfer to local authorities or insurance funds
   f) transfer to the FNM (RIF) (min. 3% to cover possible restitution claims)

Source: Klvacova (1991), pp. 4-5.

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93 A chronological survey of all amendments and related legislation, covering changes up to and including 30 November 1994 is provided by Erben and Novák (1996).
94 A third alternative, which is difficult to classify, is 4f whereby all joint-stock companies established were to allocate 3 per cent of their shares to the Restitution Investment Fund (RIF) managed by the Fund of National Property (FNM). This fund would later be used for covering claims resulting from restitution, also see footnote 69 above. Please note also that our definition of privatisation make it doubtful whether alternative 4e is to be regarded as privatisation.
95 Miklos (1995), p. 10. This figure was later revised depending upon, among other things, a re-evaluation of assets. In general all figures relating to the number and value of firms to be privatised should be treated with caution since plans have been constantly changing and that many firms were split up during privatisation, thus changing the number of entities.
96 The initial, but as time would prove, overly ambitious goal was that 2,285 firms slated for the first wave should have been privatised by the summer of 1992, see OECD (1991), pp. 57-58.
97 OECD (1994), p. 36
98 See Brzica (1994), p. 55 on number of firms; Kudlác (1994), p. 16 on the book value. The total number included would later be reduced to 678 firms, see OECD (1996), fn. 59. The first wave was deemed completed in October 1993.
was to privatise some 600 firms with a book value of approximately Kcs 200 billion ($6.8 bn).\(^9\)

The major vehicle for executing privatisation were the so-called privatisation projects, which for a particular firm defined the method and terms of privatisation (cf. Box 2, p. 110). All firms slated for privatisation were obliged to prepare a “primary privatisation project” (PPP) where one of the methods catered for in the law (see Figure 10), or any combination thereof was suggested. In effect, it could thus be suggested that part of the shares would be distributed in exchange for vouchers and that part would be sold to a strategic investor. In addition to the actual method the project should include a business plan and various other information about the firm and its property, see Box 1.\(^{10}\) Responsibility for formulation of these privatisation projects formally rested with the founding ministries, although in practice it was up to incumbent management to prepare the PPPs.\(^{10}\) Hence, while

**Box 1. Basic contents of a privatisation project**

The following information was considered mandatory for all privatisation projects:

- the name of the enterprise and a definition of the property to be privatised
- information on how the state acquired the property to be privatised
- identification of property unusable for business purposes (i.e. debts, unusable fixed assets and stocks)
- value of the property to be privatised
- manner of transferring the property to be privatised, including the settlement of claims to entitled persons
- when establishing a commercial company, the definition of its legal form
- when establishing a joint-stock company, the distribution of shares and their value or type, as well as information on whether and how investment vouchers will be used
- if local property is to be sold, the location and method of sale, pricing, and the conditions and terms of payment
- in some cases, the share of the privatisation process proceeds to be handed over to the FNMs of the republics
- the manner of transfer of intellectual property rights, which must be discussed in advance with the Federal Bureau of Inventions
- the privatisation project implementation schedule

Source: Act on the conditions of transfer of state property to other persons, Article 6, para. 1.

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\(^{9}\) Gabrielová et al. (1994), p. 18.

\(^{10}\) The information should be analogous for all projects and was regulated in law, see Act on the conditions of transfer of state property to other persons, Article 6, para. 1 and 2.
the government decided what companies that were to be privatised, much of the responsibility for effecting the scheme remained decentralised.

To allow for some competition to these “insider-prepared” projects, it was after some hesitation decided on behalf of the government that any interested party would be allowed to prepare plans for the privatisation of the company, or a part thereof (for example one production site out of many). These plans were called “competing privatisation projects” (CPP) and can be viewed as a safeguard against incumbent management using their superior information about the company to get a preferential treatment during privatisation. However, a priori the primary projects were seen as the rule, although developments would prove otherwise. Deadlines for the submission of first-wave projects were initially set at end-October and end-November 1991 for primary and competing projects, respectively. For the second wave, primary projects were to be submitted by end-May 1992, and competing projects one month later. The deadline for the first wave was later postponed numerous times, partly because incumbent management proved reluctant to give out the information necessary for outsiders to prepare their CPPs. Nevertheless, by the final deadline there were a total of 1,398 projects submitted for the first wave in Slovakia, out of which 660 were PPPs and 738 CPPs.

The next step was a process of reviewing these projects; it was then that it would be decided what method for privatisation would be used. Responsibility for reviewing projects was shared between the different founding ministries, the Ministries of Administration of State Property and its Privatization (below Ministry of Privatisation) in the respective republic and the Federal Ministry of Finance, where the latter was involved in projects including foreign capital. In the first phase, projects were submitted to the founding ministry, which typically would recommend one or two projects that seemed feasible. After this evaluation, the projects were handed over to the Ministry of Privatisation in the respective republic, where the final decision would be taken, unless foreign capital was involved in a direct purchase, in which case a government decision was needed. Considering the amount of resources at hand of the founding ministries (for example staff, routine and information) in comparison with the ministries of privatisation, it could be expected that the recommendation of the founder would weigh heavily even though their formal

101 During the first wave there were only 22 cases in Czechoslovakia as a whole where the ministry itself developed the project, see Frydman et al. (1993), p. 74.
102 It is this possibility to hand in a project for privatisation of only a part of a company that explains that the total number of approved projects is higher than the total number of companies that were to be privatised. This in turn makes all references to the number of firms participating in privatisation difficult to assess, as there were many firms being split up prior to or during the process of privatisation.
104 Marincin (1995a), p. 4. In the country as a whole CPPs outnumbered the PPPs with a great margin, and in the Czech Republic 10,949 projects had been handed in by the 20 January 1992 deadline, out of which 73.7 per cent were CPPs, see Mejstrik and Burger (1992b), p. 1. On average in CSFR there were 3.8 projects/company, although some had more than 20 different projects, see Svejnar and Singer (1994), p. 44.
105 In CSFR at the time there existed 27 different ministries, 11 Slovak, 8 Czech and 8 federal. The single most important ministry during the first wave was the Ministry of Industry of the Czech Republic (MICR) which was the founder of 1,400 enterprises (!) with a total of 1.6 million employees, see Juracka (1991), pp. 6-8; Juracka (1992) [interview].
A debated issue concerned what criteria that the ministries used for evaluation of the proposals. There existed no written guidelines as to what factors should be given extra attention. The result was that transparency was difficult to achieve, or, as one adviser at the Ministry of Industry of the Czech Republic stated: "everything is completely ad hoc because there are so many variables and combinations of factors."

Finally, following the decision on how a specific SOE would be privatised the case was handed over to the Fund of National Property (Fond Národného Majetku, FNM) of the respective republic for realisation. The FNM is an organisation that was set up on the republican level with the purpose of acting as temporary owner until the shares could be sold or distributed. The organisation was established as an independent legal person, but where the parliament appoints and dismisses the Presidium of the FNM and its Supervisory Board. The Presidium, in turn, is the body that appoints the most important internal body of the FNM, the Executive Board. Parliamentary control of the FNM is executed through its approval of the annual report of the fund, its budget the plan for activities. In addition, there is a parliamentary committee for supervision of the economy and privatisation that should provide insight into the workings of the FNM. Initially the FNM was set up as a purely executive body with a relatively limited agenda. It was then not supposed to be engaged in the process other than as a vehicle for transforming (legally) and transferring property in accordance with the privatisation projects. Its tasks included the following: taking over state property approved by the Ministry of Privatisation for transfer to other entities; executing the corporatisation of the SOEs; executing the sale of property; settlement of restitution claims etc. In short, it was to

<table>
<thead>
<tr>
<th>Box 2. Organisations/institutions of importance in privatisation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Privatisation project</strong></td>
</tr>
<tr>
<td>The plan/prospectus which suggested how the individual SOE should be privatised, i.e. business plan, method, purchaser, percentage to be sold etc. Prepared both by incumbent management (PPP) and outsiders (CPP).</td>
</tr>
<tr>
<td><strong>Founding ministries</strong></td>
</tr>
<tr>
<td>Reviewed and “recommended” one or more PPPs and/or CPPs as suitable for companies within their jurisdiction.</td>
</tr>
<tr>
<td><strong>Ministry of Privatisation</strong></td>
</tr>
<tr>
<td>Took final decision what project should be adopted in cases other than direct sales and projects which involved foreign investment (see below).</td>
</tr>
<tr>
<td><strong>Federal Ministry of Finance (FMF)</strong></td>
</tr>
<tr>
<td>In charge of voucher privatisation; final decision in cases of foreign investment.</td>
</tr>
<tr>
<td><strong>Government</strong></td>
</tr>
<tr>
<td>Took final decision in cases of direct sales to pre-determined buyer.</td>
</tr>
<tr>
<td><strong>Fund of National Property (FNM)</strong></td>
</tr>
<tr>
<td>Executor of privatisation projects, and temporary owner of all state assets deemed for privatisation, incl. 3 per cent of shares in all companies for the Restitution Investment Fund (RIF).</td>
</tr>
<tr>
<td><strong>Centre for Voucher Privatisation (CVP)</strong></td>
</tr>
<tr>
<td>Executor of the process of voucher-privatisation, organised the rounds of bidding whereby the “price” was set (see Section 3.1.3)</td>
</tr>
</tbody>
</table>

jurisdiction was lacking. A debated issue concerned what criteria that the ministries used for evaluation of the proposals. There existed no written guidelines as to what factors should be given extra attention. The result was that transparency was difficult to achieve, or, as one adviser at the Ministry of Industry of the Czech Republic stated: "everything is completely ad hoc because there are so many variables and combinations of factors."  

Finally, following the decision on how a specific SOE would be privatised the case was handed over to the Fund of National Property (Fond Národného Majetku, FNM) of the respective republic for realisation. The FNM is an organisation that was set up on the republican level with the purpose of acting as temporary owner until the shares could be sold or distributed. The organisation was established as an independent legal person, but where the parliament appoints and dismisses the Presidium of the FNM and its Supervisory Board. The Presidium, in turn, is the body that appoints the most important internal body of the FNM, the Executive Board. Parliamentary control of the FNM is executed through its approval of the annual report of the fund, its budget the plan for activities. In addition, there is a parliamentary committee for supervision of the economy and privatisation that should provide insight into the workings of the FNM. Initially the FNM was set up as a purely executive body with a relatively limited agenda. It was then not supposed to be engaged in the process other than as a vehicle for transforming (legally) and transferring property in accordance with the privatisation projects. Its tasks included the following: taking over state property approved by the Ministry of Privatisation for transfer to other entities; executing the corporatisation of the SOEs; executing the sale of property; settlement of restitution claims etc. In short, it was to
However, as will be shown below the FNM would, via changes in the institutional set-up in 1995, develop into one of the most powerful and important actors in the privatisation process.110

In conclusion, the whole process whereby the “supply-side” in privatisation was defined is outlined in Figure 11. In short, incumbent management was obliged to prepare a primary privatisation project (PPP) for the firm in question, the timing of which depended upon whether the firm was slated for the first or the second wave of large-scale privatisation. In addition, outsiders could prepare alternative proposals (competing privatisation projects, CPPs). The projects were then assessed by the founding ministry in question, most oftenly the Ministry of Economy in Slovakia. These assessments were then passed to the Ministry of Privatisation, where the final decision would be made. Finally these decisions were communicated to the FNM, which were to handle paper work and prepare the property for privatisation, and, in the meantime, act as a temporary owner.

3. The Slovak experience: ever-changing policies

Large-scale privatisation in Slovakia have clearly followed the political seasons. Considering the highly turbulent political climate, especially following independence, this has meant that policies on privatisation have gone through frequent and radical changes as each new government has tried to change and adapt the institutional set-up which was established in 1991-1992 to better suit its own conceptions and priorities.111 Political developments can be divided into four different phases, as can the process of large-scale privatisation. The first phase was the time of the federally administered large-scale privatisation (1991-1992), a programme engineered and headed by Klaus, during which speedy privatisation with vouchers was the

Figure 11. Overview of the process for deciding on the method of privatisation

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110 Cf. discussion in Section 3.4 (p. 125 ff.).
111 Only between January 1993 and April 1995 the Slovak parliament passed eleven amendments and changes to the large-scale privatisation act (Act on the conditions of transfer of state property to other persons) and related laws, see OECD (1996), footnote 67.
dominant method. The second phase was the period of the second Meciar-led government, June 1992-March 1994, a period which meant a general slow-down and change of direction of the process. A third, rather short phase, coincided with the interim government led by Jozef Moravcik between March and December 1994 during which the government attempted to speed up the process by reawakening the all but formally cancelled voucher-programme applied during the first wave. Finally, following the return of Meciar to power again, a fourth phase of Slovak privatisation begun in December 1994. The voucher-scheme was then cancelled and speedy direct sales to insiders became the dominant method. The remainder of this section is thus an attempt to describe and analyse the ever-changing policies for large-scale privatisation during these years.


During the first wave of privatisation, which in practice was lead by Vaclav Klaus in his position as Federal Minister of Finance, the non-standard method of selling shares in exchange for investment vouchers was dominant. The basic idea was to provide the population with “fake” investment capital in order to overcome the constraints on speed posed by the lack of capital, the major hindrance for a swift privatisation by means of standard methods. In short, the scheme implied the selling of heavily subsidised investment-vouchers to the population with which they could bid on shares in firms that were put up for sale. The focus on speedy privatisation, with the ambitious goal of having completed the whole process within two to three years, was typical for the group around Klaus, including the first Slovak Minister of Privatisation Ivan Miklos. They pushed the idea that the majority of SOEs would be distributed in exchange for vouchers, with only a minor selection of firms to be sold to domestic investors with standard methods. The inflow of foreign capital was not expected to materialise until this initial voucher-privatisation had been settled and secondary markets for capital had been established.

The method was however far from undisputed. Many feared that ownership would become too dispersed to enable effective control and restructuring. The scheme was also criticised for not giving any preferential treatment to workers or managers. These critics, including former Federal Minister of Industry Jan Vrba, rather saw privatisation as part and parcel of a general and government-directed restructuring of industry. Many Slovak politicians, who felt that such an active industrial policy could benefit Slovakia, shared this view. A third view, somewhat overlapping, was that privatisation should indeed be undertaken, but primarily on moral grounds and thus by extending the process of restitution. Those in favour of speedy privatisation in the end had to make some concessions to get the voucher-

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112 Other names in this group was Tomas Jezek and Dusan Triska, both important in the formulation of policy. Triska (1991, p. 26) for example wrote that “generally, the Slovaks oppose the federal government in every possible respect; but for some reason that I do not understand, they came to love this idea and supported it strongly.”

113 Kyn (1992), p. 6; the Slovak position on privatisation was outlined in a document entitled Concepts and proposals for the further progress or large-scale privatization and was approved by the Slovak government in October 1991, see Lelovsky (1994), p. 18.

programme through parliament, for example that all methods would be given equal opportunity, at least formally.

3.1.1. Defining the supply

Like with the standard methods, the responsibility with regard to defining the supply rested primarily with the Ministry of Privatisation, which was to choose the best privatisation project. However, the very institutional set-up, leaving responsibility for the voucher scheme in the hands of the powerful Federal Ministry of Finance (FMF), meant there would be a strong pressure for giving priority to projects which included vouchers, not least as to ensure that the programme could take off as originally planned, i.e. in January 1992. The whole process of reviews in effect turned into a race against time where the FMF pushed for faster approvals while the Ministries of Privatisation found the scale and scope of the task to be such that the initial deadlines could not be adhered to. The political importance of having the programme started prior to the June 1992 elections should not be underestimated in this process. On the one side, it was hoped to muster some extra support for the man and the party standing as guarantors of the programme, Vaclav Klaus and his ODS. Secondly, and perhaps more important, it would severely complicate any subsequent attempts to reverse the process. The latter was especially important in Slovakia where Meciar’s negative view of voucher privatisation at the time was widely known, and where it was considered unlikely that the pro-reform coalition, led by PM Jan Carnogursky (KDH), would succeed in the elections. Klaus was thus supported in his ambitions by liberal Slovak Minister of Privatisation, Ivan Miklos (DS), who must have feared the potential influence on policy of a second Meciar-led government.

The outcome of these efforts during the hectic months of the winter and early spring 1991/1992 was nevertheless impressive; the programme admittedly was postponed twice, but the over-riding goal of having it launched before the elections was adhered to. Further, the property offer was increased in comparison to the 1991 plans. Then it was planned that Slovak authorities would allot Kcs 70 billion ($2.4 bn) worth of property and that the total offer would amount to Kcs 260 billion ($8.8 bn). In the end, however, the book value of Slovak property had risen to Kcs 90.1 billion ($3.1 bn) out of a total of Kcs 299.4 billion ($10.3 bn) in the federation as a whole (see Table 9). The result of the reviewal process in Slovakia was thus that 487 out of the 751 firms slated for the first wave, reorganised into 503 separate entities, would be issuing shares in exchange for vouchers. The corresponding figure for the Czech Republic was 943 firms, which after reorganisation turned into 988 entities. This gave a total of 1,491 companies to be fully or partially privatised with the help of vouchers. The whole process of defining the supply-side of voucher privatisation culminated with the publication of a list on 13 May

115 In the Czech Republic a fierce dispute evolved between Minister of Privatisation, Tomas Jezek, who had the tantamount task of reviewing and deciding on thousands of projects in the time-span of a few weeks, and Klaus who refused to accept any delays, see Martin (1991).
116 It was first set to start in January 1992, then delayed to March, but was finally launched in May 1992, see Mejstrik and Burger (1992a), p. 2.
117 Mejstrik and Sojka (1994), Table 5.1 (p. 83).
118 There were no restrictions which separated the supply from the two republics.
1992, with basic data about all firms included in the first wave of voucher privatisation. Five days later bidding would commence.

3.1.2. Creating a demand

What was peculiar about the voucher scheme was not only the way and the speed with which the supply was defined, but also the fact that responsibility for creating a demand also rested on a ministry, namely the Federal Ministry of Finance which to its aid set up a special agency to handle the practical aspects of voucher privatisation, the Centre for Voucher Privatisation (CVP), in June 1991. The basic idea of using vouchers to privatise, i.e. to distribute for a minor fee “fake” investment capital with which interested parties could bid on shares in any of the 1,491 firm supplied, may seem ingenious. Still, the FMF and the CVP faced the tantamount task of explaining and making attractive a rather sophisticated and essentially market-oriented system to a population which had been isolated from institutions like private ownership, stocks, investment funds, stock exchanges etc, for some 40 years. To make matters worse, the scheme was in itself complex when it came to the practical details, not least because it had to imitate those market institutions which at the time had not yet come into being. Thus, despite a publicity and information campaign launched by the CVP, public interest was at best lukewarm when the demand-side of the scheme took off in October 1991.

From 1 October every adult citizen residing in the country was able to buy a booklet (Kcs 35; $1.2) and registration stamp (Kcs 1,000; $34) at designated filing counters at the post-offices throughout the country. According to jurisdiction of respective FNM. According the seats of the respective firm; all shares with a nominal value of Kcs 1,000.

Table 9. Voucher privatisation: the supply

<table>
<thead>
<tr>
<th></th>
<th>Slovak</th>
<th>Czech</th>
<th>Federal</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms included (prior to reorganisation)</td>
<td>487</td>
<td>943</td>
<td>61</td>
<td>1,491</td>
</tr>
<tr>
<td>Number of firms included (after reorganisation)</td>
<td>503</td>
<td>988</td>
<td>0</td>
<td>1,491</td>
</tr>
<tr>
<td>Total book value of firms (bn. Kcs)</td>
<td>133.6</td>
<td>362.2</td>
<td>72.8</td>
<td>568.6</td>
</tr>
<tr>
<td>of which offered for voucher method (bn Kcs)</td>
<td>90.1</td>
<td>206.4</td>
<td>2.9</td>
<td>299.4</td>
</tr>
<tr>
<td>of which offered for voucher method (bn $)</td>
<td>3.1</td>
<td>7.1</td>
<td>0.1</td>
<td>10.3</td>
</tr>
<tr>
<td>of which offered for voucher method (%)</td>
<td>67%</td>
<td>57%</td>
<td>4%</td>
<td>53%</td>
</tr>
<tr>
<td>Total no. of shares offered (mn)</td>
<td>86.9</td>
<td>212.5</td>
<td>0</td>
<td>299.4</td>
</tr>
<tr>
<td>Number of workers employed in firms (000s)</td>
<td>344.2</td>
<td>864.4</td>
<td>49.8</td>
<td>1,258.4</td>
</tr>
<tr>
<td>Total output of firms (bn. Kcs) (1991)</td>
<td>196.3</td>
<td>592.9</td>
<td>112.9</td>
<td>902.1</td>
</tr>
<tr>
<td>Total profits of firms (bn. Kcs) (1991)</td>
<td>15.5</td>
<td>67.8</td>
<td>22.6</td>
<td>105.9</td>
</tr>
</tbody>
</table>

Notes: 1 According to jurisdiction of respective FNM. 2 According the seats of the respective firm; all shares with a nominal value of Kcs 1,000.

Part of the campaign was an ambitious handbook which aimed to, (i) explain the goals and logic of private enterprise per se; and (ii) to explain the logistics of voucher privatisation and even provide suggestions on investment strategies, see Kupónová privatizace. Informacní príručka (1991), [Coupon Privatisation: an information handbook]. The handbook was published in Czech, Slovak and Hungarian. Kcs 1,035 at the time equalled about one-quarter of an average monthly pay-check. There were 1,610 such filing counters in Slovakia and 5,102 in the country as a whole, see Centre for Voucher Privatisation (1995), p. 9. The issue and the use of investment vouchers was regulated in the Decree on the issue
took place at one of the 190 Slovak registration offices (Registracné Miesta, RM) established by the CVP. Once registered, the purchaser was the owner of a non-transferable security that would allow him/her to use 1,000 investment points to bid on shares (priced in points) of the 1,491 firms put on offer. Official estimates had held that some 2-4 million out of the 11.5 million citizens, which could participate, in the programme would choose to do so. Still, by end-December 1991 a mere 140,000 persons had registered in Slovakia and some 575,000 in CSFR as a whole.

The change in attitude came with the advent of investment funds (IFs) which were established as intermediaries and all sought to persuade citizens to entrust their investment points to them for collective investments. Their extravagant promises of, for example, a ten-fold return within a year on the citizens initial investment made the base-line logic clear and discernible for each and everyone, i.e. there was money to be made on this unprecedented scheme. This, in turn, heightened interest beyond any official plans, in the scheme as such as well as in the investment funds, and by end-January 1992 there were six-hour queues just to buy the booklet. When the deadline for registrations expired on 15 February 1992 2.59 million people had registered in Slovakia, with 8.54 million in CSFR as a whole (see Table 10).

Since there were no restrictions regarding investing in firms in the other republic each participant held in his hand a security with a theoretical book value of Kcs 35,100 ($1,242), purchased for the nominal sum of Kcs 1,035 ($37). The ordinary citizen then had two alternatives to realise this value. One was to keep the booklet and invest the points according to his/her own head in the firms he/she found most promising when the first round of bidding was to commence on 18 May 1992, thus becoming a direct investor, or DIK as they came to be called (Drzitel investicneho kuponu [holder of investment voucher]). The other was to entrust all the points, or part of them, to one or more of the 429 (!) investment funds that had sprung up in CSFR during the so-called zero-round (1 March-26 April). Being a very attractive alternative for the risk-averse average citizen, with no prior experience of investments in stock, many opted for the latter and the funds attracted a high 72 per cent of the outstanding points, out of which the 164 Slovak IFs attracted

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1.69 billion (65% of Slovak points).\footnote{This was slightly less than the share attracted by Czech IFs (74.8%), see Centre for Voucher Privatisation (1995), pp. 12-13.} Further, these holdings were highly concentrated, with the seven largest investment groups together controlling close to half of all points, see Table 10.\footnote{Investment companies (ICs) often established more than one investment fund (IF). The establishment and evolution of investment funds and investment companies is treated in detail in Chapter V:2.} With this, both aggregate supply and aggregate demand for shares in firms had been defined.

### 3.1.3. The market and the results

The final, and in terms of logistics, probably most daunting task was for the authorities to make this supply and demand meet. Since the government no longer could have direct control over the process it was necessary to create some sort of market mechanism; the goal was to initiate a market where both supply and demand could influence prices at the same time as it would induce some learning on behalf of the bidders. The marketplace established took the shape of a nation-wide computer network, established in a mere six weeks,\footnote{Centre for Voucher Privatisation (1995), p. 10.} run by the CVP. The system registered bids from DIKs as well as funds and compared it to supply in an iterative process of five different auctions (rounds).\footnote{The initial plan was to have 6 rounds; this was in the end changed to 5, partly because a large part of the shares had already been sold, partly because of the upcoming split of Czechoslovakia.} Subscription for the first round began on 18 May 1992 and the results of the last were announced on 22 December the very same year (see Table 11).\footnote{Kupónová privatizace. Informační príručka (1991), pp. 14-15.} With this, both aggregate supply and aggregate demand for shares in firms had been defined.

### Table 10. Voucher privatisation: concentrated demand, the investment points

<table>
<thead>
<tr>
<th>Investor</th>
<th>Points (bn)</th>
<th>Of total (%)</th>
<th>Of total (cum, %)</th>
<th>Of ICs (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available investment points: total</td>
<td>8.54</td>
<td>100%</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Investment companies (ICs): total</td>
<td>6.14</td>
<td>72%</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>7 biggest (&gt;200 mn pts) (26 IFs)</td>
<td>3.82</td>
<td>45%</td>
<td>45%</td>
<td>62%</td>
</tr>
<tr>
<td>6 big (&gt;100 mn pts) (23 IFs)</td>
<td>0.85</td>
<td>10%</td>
<td>55%</td>
<td>14%</td>
</tr>
<tr>
<td>39 medium (&gt;10 mn pts)</td>
<td>1.16</td>
<td>14%</td>
<td>68%</td>
<td>19%</td>
</tr>
<tr>
<td>All other small ICs (&lt;10 mn pts)</td>
<td>0.31</td>
<td>4%</td>
<td>72%</td>
<td>5%</td>
</tr>
<tr>
<td>Individual investors (DIKs): total</td>
<td>2.40</td>
<td>28%</td>
<td>100%</td>
<td>–</td>
</tr>
</tbody>
</table>

Sources: Brom and Orenstein (1994); Centre for Voucher Privatisation (1995); Mladek (1994); own computations.

Notes: \(^1\) One single fund, established by Ceska Sporitelna, accounted for 950 million points (11% of the total). \(^2\) In this group one finds 191 investment funds (IFs) with less than one million points.
mand exceeded supply there were two possibilities: firstly, if excess demand was
less than 25 per cent all orders of the DIKs were met by means of rationing the or-
orders of the investment funds; secondly, if excess demand surpassed 25 per cent all
orders were revoked and all shares of the firm were put on offer in the following
round at a higher price.\textsuperscript{134}

In the first round all shares were priced equally, three shares/100 investment
points. However, the bidding process led to substantial price differences where in
the end the most expensive shares were sold for 1,000 points each, more than 30
times the book value, and the cheapest sold for 1.8 points per share, a mere 6 per
cent of the book value.\textsuperscript{135} There was also a marked difference with regard to how
investors evaluated Czech and Slovak firms, where the prices of the latter on aver-
age was about 55 per cent of Czech firms in rounds 2-5.\textsuperscript{136} These differences are
illustrated in Figure 12, which on the right scale give the calling price in points and
on the left the cumulative number of shares (mn) in Slovak firms sold and the num-
ber of shares bought by Slovak investors, respectively.

Following the fifth and final round of bidding, in 291 cases (out of 1,491) all the
shares offered were sold. In more than half of the remaining firms, more than 90 per
cent of shares offered had found their buyer. Of the accumulated demand of 8.54

\textsuperscript{134} For a discussion of the adjustment of prices between rounds, see Svejnar and Singer (1994), p. 77.
\textsuperscript{135} PlanEcon (1992), p. 2.
\textsuperscript{136} This was reflected also in the fact that among the 100 highest priced firms were only 20 Slovak, while
there were 62 among the 100 lowest priced ones, see PlanEcon (1993), pp. 26-29.

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billion points, only about 100 million (1.2%) remained.\textsuperscript{137} These points were at the end of round five declared worthless. As regards the 21.7 million shares (7.2%) remaining, they were left in the custody of the respective FNM. Most analysts agreed that, on the whole, this was a very positive result; the process had gone smoother and faster than expected. The speed of the process was partly attributable to the higher than expected participation of IFs, and the fact that it was easier for the CVP to handle the large buy-orders of funds as compared to a situation where DIKs would have invested the majority of points.

The final phase of the scheme, the actual distribution of shares, was nevertheless delayed due to a dispute between the Czech and Slovak governments over the division of the assets and liabilities of the former Czechoslovak central bank. While in Slovakia the distribution was begun on 5 April 1993, PM Klaus delayed the distribution in the Czech Republic in an attempt to use it as a lever in the negotiations with the Slovak government.\textsuperscript{138} Finally, beginning on 24 May, shares pertaining also to Czech firms were being distributed. The system chosen meant that all shares were kept in dematerialised form at the central securities register (Stredisko Cennych Papierov, SCP), charged with registering all subsequent transactions.

\textsuperscript{138} Given that the registration had taken place without any information about nationality it was not possible to withhold only shares bought by Slovak citizens.
3.1.4. Competitive direct sales: a complement

The above extensive treatment of the voucher-method merits its place both because of the complexity of the scheme and the interest that it provoked, but also because it indeed was the dominant method during the Carnogursky government (see Figure 13, page 125). However, standard methods were also employed, although to a lesser extent. In total, there were 181 direct sales and eight public tenders approved before the June 1992 elections. These firms had a total book value of Kcs 11.7 billion ($0.4 bn).\footnote{Miklos (1995), pp. 17-19; the assessments only rarely resulted in a value lower than book value, see Miklos (1995), p. 18.} An interesting feature of the direct sales was the fact that they largely were rule-bound, making for a competitive element in an otherwise rather non-transparent method. Several factors contributed to this openness, one was that the government listed all firms which potentially could be sold by means of direct sales, thereby at least theoretically providing for free entry into the process. A second guarantor against excessive corruption was that the government publicly announced binding criteria according to which projects were chosen, with price as the most important one. Further, protocols were kept for all privatisation-related decisions made by the government, and as a frame of reference the market value of a firm had to be estimated in case of a direct sale.\footnote{The ratio of price to book value in foreign sales was 3.16:1, cf. Gabrilová et al. (1994), pp. 16-17.} Thus, direct sales under these conditions amounted to a form of public tender. A result of this approach to direct sales was that prices on average were equal to book value, and in the case of sales to foreigners significantly higher.\footnote{On election results, see Appendix D, TABLE 4 (p. 322).}

3.2. Independent Slovakia changes pace, 1993-1994

On 1 January 1993 Czechoslovakia was divided and second time PM Vladimir Meciar found himself leading an independent state and unrestricted in the implementation of a national policy on privatisation. However, already in the direct aftermath of the June 1992 elections it became clear that Slovak policy concerning privatisation was to change.\footnote{Gabrilová et al. (1994), p. 18.} One of the first decisions taken by the new ruling coalition was to cancel the deadlines for submission of privatisation projects for the second wave of large-scale privatisation, which had officially begun in the summer of 1992 and was to include some 600 firms with a total book value of Kcs 200 billion ($7 bn).\footnote{Gabrilová et al. (1994), p. 18.} Also, in September the new Minister of Privatisation, Lubomir Dolgos, laid down a new concept for the continuation of privatisation,\footnote{See Concept of the continuing process of privatisation in the Slovak Republic (1992).} which in short meant more power to the founding ministries and an increased emphasis on standard methods with priority for subsidised sales to managers and, to some extent, employees. The concept and the policies derived from it were thus to change both the goals connected to privatisation and the actual effectuation of the various standard methods discussed in Section 2.1 above. Privatisation was, for example, no longer viewed as a “first step”; rather the concept emphasised restructuring prior to

\footnotetext[139]{More on direct sales, and on factors of importance in the choice of method, below and in Chapter VI.}
\footnotetext[140]{Gabrilová et al. (1994), pp. 16-17.}
\footnotetext[141]{On election results, see Appendix D, TABLE 4 (p. 322).}
\footnotetext[142]{Gabrilová et al. (1994), p. 18.}
\footnotetext[143]{See Concept of the continuing process of privatisation in the Slovak Republic (1992).}
Consequently, the importance of speed was toned down. Further, with price no longer being declared the most important criteria when evaluating proposals for direct sales, the new approach opened up for preferential treatment of incumbent managers and other domestic industrial groups wanting to buy “their” firm. Such sales could then be effected by means of soft instalment plans, i.e. leveraged management buy-outs (LMBOs). Previously, the first instalment had been for some 30 per cent of the purchase price, now it was lowered to 10-15 per cent and the instalment period was extended from 5 to 10 years. The results in terms of speed were predictable, privatisation slowed down substantially during 1993. In the period from June 1992 to mid-February 1994 only some 100 projects were approved with a book value of about Sk 7 billion ($0.23 bn), a figure which can be compared to the previous government which during the first half of 1992 alone approved 676 projects with a book value of Kcs 101.8 billion ($3.6 bn).

The decreasing pace can be explained by a number of factors, but the wish for more governmental control over the process seems to be the most important. It was this desire that led the government to change the reviewal process, abandon deadlines for projects, and change criteria for evaluating projects as well as neglecting to evaluate already submitted projects. Also, the targets were changed and the indeed modest goal was put up that one-third of the assets included in the second wave should be privatised by end-1994, i.e. more than two years after it was begun. Taken together these changes paved the way for a slow and increasingly targeted policy with traditional insiders as the main beneficiaries. At the same time, the slow speed reflects hesitancy and internal conflicts on behalf of the government.

The conflict is well illustrated with the fate of the voucher scheme. Following the completion of the first wave of voucher privatisation, PM Meciar announced that voucher privatisation is ‘an action which is finishing and will not be repeated in Slovakia.’ However, the government was not unified and there was a struggle between Minister of Privatisation, Dolgos, and Meciar. Dolgos, who was at least partially in favour of the voucher method, on 9 January 1993 announced that he and Meciar had agreed not to discontinue the voucher privatisation. Two months later Meciar announced the opposite during a visit in London, stating instead that firms

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145 To what extent this intention de facto materialised is a different story, of interest is that it either reflects a more sceptic attitude towards the capacity of independent firms and markets to lead this type of restructuring, or, conversely, a will on behalf of the government to retain an active influence. Later developments, not least in 1995, leads us to lean towards the latter alternative, see Chapter IV:3.4.1.
147 The data regarding this is confusing and contradictory; the figure for the total amounts of projects approved during Meciar’s whole tenure, i.e. until 14 March 1994 varies from 133 projects with a book value of Sk 21.9 billion (50.7 bn) (Kimlik [1994], p. 14 [interview with later Minister of Privatisation Milan Jancina]) to 151 projects approved with a total book value of Sk 10.2 billion (50.3 bn) (Marcincin [1994], p. 3). However, of these 44 projects, with a book value of $96 million were approved during the last month, see Section 3.2.1 and Box 3 (p. 122).
149 See Marcincin (1994), p. 3.
151 Prognosis, 8 January 1993.
152 RFE/RL Daily Report, 11 January 1993. An interesting document with respect to these disagreements is the Concept of the continuing process of privatisation in the Slovak Republic (1992) where the position of then Minister of Privatisation, Lubomir Dolgos, is laid down.
would be sold directly to foreign firms in public competition [sic]. The feud intensified during the spring of 1993 with Dolgos coming out with direct criticism of Meciar for delaying privatisation, a conflict which lead to the dismissal of Dolgos when the leadership of HZDS passed a vote of no-confidence in him on 12 June. This was a turning point in that Dolgos not only had been advocating a, albeit limited, use of vouchers but had also been acting as a checking factor with regard to standard methods by still preferring competitive methods (tenders and auction) over direct sales. As replacement, Meciar wanted his close ally Ivan Lexa, a nomination vetoed by President Kovac on grounds of inexperience. The solution to this dilemma was that Meciar appointed himself as Minister of Privatisation, and from June 1993 the concentration of power in privatisation was total, with Meciar as PM, appointed Minister of Privatisation as well as head of the FNM. Hence it was also clear that, if used at all, voucher privatisation would be of marginal importance; even though the programme vaguely had been set to start in late 1994 there had by end-October 1993 not been approved one single project including vouchers. Therefore, in essence, voucher privatisation had been shelved for the time being.

3.2.1. “Midnight privatisations”
The slow pace and hesitancy with regard to privatisation would however not last forever. In the face of heightened political tension, defections from HZDS, disputes within the coalition, and the threat of a possible vote of no confidence on 16 February 1994, Meciar apparently changed his mind about the virtues of privatisation and set off to make use of the powers vested with him and his HZDS. Beginning with an all-night session on 15 February, when privatisation all of a sudden was made an issue of top priority, it was shown what this concentration of powers could “accomplish”. From that moment until the last hours of his reign on 14 March, the Cabinet kept clearing privatisation deals, despite receiving a vote of no confidence on 11 March. In total, 44 deals with a book value of $96 million were approved during these 28 days, most of which were sold at knock-down prices ($20 mn in total) to persons and groups affiliated with HZDS and SNS; some examples are provided in Box 3. The vote of no-confidence which brought the government down was supported by 78 of the 150 deputies, and concerned a distrust in Meciar’s

153 RFE/RL Daily Report, 10 March 1993. As there hardly had been any sales to foreign investors, and Meciar and his HZDS in general has taken a very negative stance against foreign investors, this statement should rather be interpreted as an attempt to please the foreign audience.
154 As can be seen in Figure 27 (p. 287), purchase prices were in 1993 still, on average, higher than book value.
155 In practice, however, Lexa ran the Ministry of Privatisation even though Meciar formally was the Minister, see Miklos (1995), p. 19. The most important branch ministry (Ministry of Economy) was also headed by HZDS-representatives. Initially it was Ludovit Cernak from SNS who held the post as Minister of Economy, in March 1993 he was replaced by Jaroslav Kubecka (HZDS), which in turn would be replaced by Jan Ducky (HZDS) in November 1993.
156 OECD (1994), Table 20 (p. 120). It had also been made clear that no stakes larger than 30 per cent would be included, see Schmögnerová (1995), pp. 238-240.
157 The Wall Street Journal Europe, 21 March 1994. Also one of the firms included in our case study was sold during this period (ZPA Krizik), see Chapter VI:2.2. A thorough analysis of these sales is found in Miklos (1995), p. 14; pp. 19-22. An overview of these and other controversial sales is found in Appendix D (p. 317).
Box 3. Some examples of “midnight privatisations”

- In VSZ a 9.5 per cent share was sold to a company set up by members of the VSZ’s supervisory board. The shares were sold at a $36 million discount compared to the price at the stock exchange. Some days later the then ex-minister of finance Julius Toth was made chairman of the VSZ’s Supervisory Board (also see Chapter VI:2.2).
- 50 per cent of Piestany spa was sold for a down payment of less than $3 million, despite profits of about $6 million in 1993. The buyer was a company whose silent partner was the former Minister of Health, Viliam Sobona.
- 67 per cent of the profitable glassmaker Skloobal Nemsova was sold for a mere $3.7 million to its management. The price could be compared to the $23 million in total assets of the firm. Mr. Meciar was the company lawyer in 1974-1989.


3.3. New government returns to vouchers, 1994

On 16 March, President Kovac approved a new coalition government led by Jozef Moravcik. Among the first privatisation related decisions taken was the 29 March cancellation of 13 of the 44 deals concluded during Meciar’s last weeks as PM. The decision followed the conclusion of a commission, set to review the controversial deals, that 12 of them violated the law; in addition, one buyer voluntarily withdrew his offer. The new coalition made economic reform, including privatisation, an item of top priority. The need for the latter was obvious given that by June 1992 30 per cent of state assets in Slovakia had been privatised, but after that only an additional 3 per cent. The formulation of privatisation policy was however not without controversies in this broad left-right coalition, which had little genuinely in common other than a wish to keep Meciar away from the seat as PM. Again, the is-

158 This vote of no confidence would have a far-reaching impact on the political landscape in Slovakia. Meciar was ever since unable to overcome the fact that President Michal Kovac, a former ally and co-founder of HZDS, sided with the defectors from the party (for example the next PM Jozef Moravcik) in a highly critical state-of-the-nation address, see Leff (1996), pp. 38-39. Also, the event brought to life truly xenophobic attitudes of party-members, MP (HZDS) and member of the Budget Committee Michall Baránik (1994) [interview] for example seriously claimed that the 18 defectors had been bought by foreign powers to bring the government down. With regard to the relations with Czechs and Hungarians he commented that ‘[t]hey did not lose their interest in our territory, that is why the representatives of these states are buying our politics to make their policy in this state…that was also the reason why there was a change in government in March this year – they bought the 18 deputies.’


160 See Miklos (1995), p. 20. However, in practice, only six of the projects were changed. State Secretary at Ministry of Privatisation, Juraj Plesnik, said that the government annullled some and ‘then again confirmed the old decisions.’ By November 1994 only the case of glass-maker Skloobaal Nemsova had not yet been settled. Plesnik also weathered a rather pragmatic attitude with regard to direct sales, stating that ‘[i]t is not my problem to find out whether somebody received some extra payment or money for promising to carry that project through.’ He also pointed to the severe problems of finding out whether bribes are involved or not and said that he admits ‘that Slovakia has learned to do business on the edge of the law and even beyond it.’ Source: Plesnik (1994) [interview].


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sue at stake concerned the use of non-standard methods, i.e. voucher privatisation. A revival of the voucher scheme was supported by the new Minister of Privatisation, Milan Janicina from the Democratic Union of Slovakia (Demokratička unija Slovenska, DU – formerly SNS), while Minister of Economy, Peter Magvasi from the Party of the Democratic Left (Strana demokratickej lavice, SDL) preferred auctions, sales and LMBOs. The need for getting reforms going again was however pressing, as was the need to improve the international image of Slovakia. With this common interest, a compromise was reached also with regard to privatisation; the new policy was in effect a return to the original model of privatisation on two counts, firstly, in that the government wanted to increase transparency with regard to direct sales and other standard methods, secondly, in the attempt to revive the voucher scheme.

Beginning with the voucher scheme, it was in the end of March 1994 announced that the programme would be re-launched in this the second wave of large-scale privatisation. Minister of Privatisation, Janicina, who declared privatisation to be ‘the most important part of the economic reform process’, was also under strong external pressure to show some progress. In a memorandum from the IMF, the fund urged the government to privatise assets with a value of Sk 220 billion ($6.9 bn), out of which about 40 per cent (Sk 88 bn) should be distributed through vouchers. In addition, a revival of privatisation was also one of the conditions for an Economic Facility Structural Adjustment Loan from the World Bank.

Time, however, was running short since it had been agreed that new general elections would be held 30 September-1 October the same year. Preparations thus started immediately and beginning in April 1994 lists with companies approved for privatisation were published, including information on which method would be used. The goal of Sk 88 billion ($2.7 bn), however, looked seriously at risk when in mid-May a mere Sk 6 billion ($0.187 bn) had actually been approved for voucher privatisation. Nevertheless, when finally the Economic and Budget Committee on 12 August approved a list with 632 firms included in the second wave of large-scale privatisation, with a total book value of Sk 262.9 billion ($8.2 bn), the value of assets slated for voucher privatisation had risen to Sk 51.3 billion ($1.6 bn). With this, it looked reasonable to expect that the additional assets needed to reach the target could be approved before bidding was to commence. Before leaving office, the Moravcik government had approved Sk 62.7 billion ($1.96 bn) worth of property for privatisation, including part or whole of 156 “new” second-wave com-

\[162\] Fisher (1994c), p. 63. It is interesting to note the difference between the two with regard to background, whilst Janicina was a Doctor of Law with no direct connections to the industrial sector, Magvasi was a technical engineer with previous as well as later positions in industry.


\[165\] In SNAZIR (1994), pp. 85-139 a total of 426 SOEs are briefly presented, providing information on how many entities that would be the result of privatisation and how shares were to be distributed among different methods.

\[166\] TREND Tyzdeník o hospodárstve a podnikaní, No. 24, 1995.

panies (Sk 51 bn, $1.6 bn), and shares in 139 first-wave firms left in the portfolio of the FNM (Sk 11.7 bn, $0.36 bn). On the demand-side, the programme was launched on 5 September when citizens could once again begin to register their voucher booklets, i.e. a little more than three weeks before the general elections. The rules governing citizen-participation in the second wave remained basically the same as in the first wave of voucher privatisation. The scheme was met with overwhelming popularity and by end-November, when registration closed, a total of 3.4 million Slovaks had registered, corresponding to a full 90 per cent of the eligible population. Although the so-called zero round (when individuals could actually assign their voucher points to funds) officially would not start until 15 December, the investment funds were very active in attracting these investors. With promises ranging from micro-wave ovens to cash-payments, the 166 investment funds established for the second wave attracted some 2 million DIKs (58% of the total), i.e. a slightly lower share than during the first wave (70.5%). The largest became Sporofond with some 700,000 DIKs, whilst the fund of VUB Invest (VUB Kupón Plus), whose first-wave fund (VUB Kupón) had been the largest in Slovakia (0.5 mn DIKs), received the interest of about 200,000. The heritage with regard to voucher privatisation of this third phase in Slovak privatisation was thus that 3.36 million DIKs, and 166 funds would be able to gain stakes in at least Sk 63 billion ($1.96 bn) worth of property in 295 firms. On average this meant that participants in exchange for their voucher booklets would receive property with a book value of some Sk 19,000 ($593), at least.

As regards standard methods there were also a number of changes during the Moravcik interim. Many of these changes in the institutional framework aimed to ease the process of privatisation and make it more transparent. There was for example an amendment to the law on privatisation that more clearly determined the rights and obligations of institutions such as the FNM. To enhance transparency, all decisions had to be made public and new regulations with respect to evaluation and approval procedures were introduced to make the process a more rule-bound one. Positive was for example that following the public announcement of a  

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168 TREND Tygodnik o hospodářství a podnikání, No. 16, 1995. Of the property approved, Sk 15 billion ($468 mn) was coming from privatisation of the electricity industry. 
169 A minor difference was that people born 1934 or earlier only had to pay Sk 700 ($22) to have their voucher book registered, others Sk 1,000 ($31). The issuance and registering of vouchers for the second wave was regulated by government decree (Decree no. 134/1994).
170 Pravda, 2 December 1994. However, of these an estimated 140,000 were multiple registrations which were later excluded after attempting to define the time of registration, leaving a total of 3,361,561 valid registrations, see Srámek (1995) [interview]. The figure can be compared to the 2.579 million which participated in the first wave.
171 Srámek (1995) [interview].
172 The fund was established by the investment company PSIS, see Chapter V:2.
173 See Sevcik (1995) [interview] and Oravkin (1995) [interview]. As time would show they were right in stopping their campaign after having reached that number, see Chapter V:2.
174 Act no. 60/1994 added items to be included in PPPs and CPPs, established penalties for incumbents not providing information to outsiders wanting to prepare a CPP, specified more clearly the decision-making process, expanded the jurisdiction of the Ministry of Privatisation etc., cf. Erben and Novák (1996), p. 25.
175 See SNAZIR (1994), pp. 7-17. However, with regard to the importance of price, and referring to the use of standard methods from 1993-1994, Schnögnerová (1995, p. 218) writes that ‘[p]roceeds from privatization do not represent a primary goal if domestic investors are involved. The increase of produc-
project-submission other parties were given 30 days to submit a potential competing project before any final decision could be made by the Ministry of Privatisation (public tenders, public auctions and voucher privatisation) or the government (direct sales). The results of these efforts with regard to standard methods was not in- substantial, in total there were decisions made which (if executed) would have meant that Sk 67 billion ($2.09 bn) worth of assets would have been privatised.  However, between decision and implementation there was in the case of many projects yet an election in Slovakia. Still, Figure 13, which shows the values of the privatisation decisions approved (i.e. not executed), reflects the ambitions and changes in pace taking place in 1991-1994. It also shows the shifting reliance on standard and non-standard methods, respectively. As can be seen voucher privatisation had been the dominant method.

3.4. Wrapping up privatisation: cronyism in direct sales, 1995-1996
The elections proved a miscalculation for the incumbent coalition, despite the voucher programme it could not muster enough votes to once again form a government. Instead Vladimir Meciar was designated to become third-time PM, although he did not have a majority on his own but was forced to seek at least one coalition partner. New governments in Slovakia had so far always meant changes with regard to privatisation policy, and preferably even some reversals of the respective predecessor’s decisions. The one difference this time around was that the

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Figure 13. Privatisation decisions of three governments, 1991-1994

Sources: Miklos (1995), pp. 9-10; own calculations
PM-to-be yet had to form a government when the changes began. His party (HZDS) and would-be coalition partners, SNS and the Association of Workers of Slovakia (Združenie robotníkov Slovenska, ZRS), flexed their muscle already during the first parliamentary session on 3 November, later to become known as the “Night of the long knives”. The meeting turned into a 23-hour marathon session during which Meciar took control of the FNM, Radio & TV as well as the key committees in the SNC. Two significant and indeed controversial changes concerning privatisation were made, codified in two laws. The first one was Act no. 369/1994, which was an amendment to the large-scale privatisation act (Act on the conditions of transfer of state property to other persons). The effect of it was that from January 1995 the FNM gained control over direct sales, its Executive Board could propose them and the Presidium could make the decision, previously a prerogative of the government. The same night HZDS also gained effective control over the FNM by recalling and replacing the members of both the Presidium and the Supervisory Board. The second law adopted was Act no. 370/1994 which revoked all direct sales approved by the outgoing Moravčík government after 6 September, claiming that they should have contravened moral codes of conduct.177 The law, to be effective as of 1 January 1995, applied to 54 deals, 5 of which legally binding contracts had already been signed for.178

The next victim of this change of policy in the making was the popular voucher scheme. When Meciar following prolonged negotiations formed a new coalition (HZDS, SNS and ZRS), presented on 12 December, its first move was to announce that the scheme would be delayed. This announcement came on 14 December, i.e. the day before the zero round was to commence. The reason given was that the programme was not well worked out and thus needed to be reviewed.179 The decision was followed by a protracted period of ever increasing uncertainty when the actual content of the voucher scheme gradually was being diluted. On 20 December, Deputy PM Sergej Kozlik said that the first possible starting date would be 23 January 1995,180 however, on 5 January State Secretary Jozef Magula (Ministry of Finance) announced that the rules might change since the zero round had not yet started.181 The month of January came and went and on 1 February the possible starting date was still declared to be as ‘foggy as a London morning.’182 Then, in what looked to

177 Cf. Erben and Novák (1996), pp. 26-27. 6 September 1994 was the official beginning of the election campaign. Interesting to note is that Meciar abstained when the vote was taken, refusing to explain why, see BBC Monitoring Service: Central Europe & Balkans, 17 January 1995.
178 Mikloš (1995), p. 23. About half of the deals were reportedly later re-approved by the FNM, see CTK-Business News, 27 February 1995. One of the cases, however, got an “interesting” post-script, it concerned Tesal s.r.o. which bought 100 per cent of the firm Tesla Strapkov a.s. This deal was approved and signed on 11 October 1994, revoked by Act no 370/1994, appealed to a Bratislava court by Tesla who on 8 February 1995 got a court which forbade the SCP to transfer the shares back to the FNM. On 15 February the director of SCP, Ms. Mojzisova was removed from her post, following her refusal to transfer the share back to FNM in contempt of the courts decision, see TREND Tyždenník o hospodárstve a podnikaní, No. 8, 1995.
179 Meciar had during the election campaign promised that ‘everything except the issuing of the booklets will have to be started all over again’, see The Prague Post, 7 September 1994.
182 Jozef Mach, spokesman of the Ministry of Finance, as cited in TREND Tyždenník o hospodárstve a podnikaní, No. 6, 1995.
be a final decision, the Ministry of Finance on 13 February stated that the zero round would finally commence on 1 July 1995.

Meanwhile, however, the supply side of the scheme was gradually being eroded. In February the Ministry of Privatisation reviewed all previously accepted projects which had allocated the maximum 97 per cent of shares to this method since it had been decided that only minority stakes would be put on offer in voucher privatisation. Following the above mentioned review, Minister of Privatisation, Peter Bisak, on 4 April 1995 “re-defined” the whole of the second wave of large-scale privatisation which he stated would embrace property with a book value of Sk 258 billion ($8 bn). Included now was more than 550 SOEs, which after privatisation was estimated to have turned into some 1,100 private firms. Bisak also proclaimed that “our interest is to sell the privatized properties to a previously determined domestic proprietor, who will have the majority share, while the coupon privatisation will be a minor measure.” A consequence was of course that the property offer plummeted; Meciar on 7 April said that the total offer now was for Sk 41 billion ($1.28 bn), making an average of Sk 12,000 ($374) per participant, i.e. the initial offer had been reduced by Sk 37 billion ($1.15 bn). At end-May, the total offer had shrunk further to some Sk 34 billion ($1.06 bn). For the investment funds which in many cases had taken loans to pay the registration fee in advance for its investors this decimation of book value (-50%) was a serious back-lash, and many began to doubt whether there would be any voucher privatisation at all. The sceptics were proven right when on 6 June 1995 Meciar, on live TV, launched what he termed to be a new concept of privatisation. What he talked about, however, was not ways to privatise property, rather it was about stopping the voucher scheme, which to date had been the most effective way of privatising state firms in terms of speed, and about that a large segment of the economy would either be excluded.

183 In addition some 30 projects which had been criticised by the influential Association of Entrepreneurs of Slovakia were being reviewed, see TREND Tydzenník o hospodárstve a podnikaní, No. 8, 1995.
184 To allow for comparison, dollar values in this section are calculated with the 1994 average exchange rate, i.e. just like in Section 3.3.
185 BBC Monitoring Service: Central Europe & Balkans, 13 April 1995.
186 TREND Tydzenník o hospodárstve a podnikaní, No. 15, 1995. The Ministry of Privatisation was to supply property worth Sk 35.5 billion ($1.2 bn), of which Sk 9.8 billion ($330 mn) was from the not very attractive water-supply companies not previously included in the scheme; the corresponding decrease in FNM property was from Sk 11.7 ($393 mn) to 5.7 billion ($192 mn) in a mere 81 firms, see TREND Tydzenník o hospodárstve a podnikaní, No. 16, 1995.
187 TREND Tydzenník o hospodárstve a podnikaní, No. 24, 1995. Meciar explained that one reason for diminishing the supply for voucher privatisation was to prevent the investment funds from gaining control of Slovak assets and channelling them out of the country, see BBC Monitoring Service: Central Europe & Balkans, 11 May 1995. In response to the steadily declining property offer for voucher privatisation former ministers of privatisation, Miklos and Janicina, in April started a committee seeking to collect enough signatures necessary to call a referendum on voucher privatisation, cf. Reuters News Service, 26 April 1995. However, despite the fact that a majority of citizens found the decrease in supply on offer as negative it was not possible to collect the 350,000 signatures necessary. Miklos explained this with that ‘people are afraid to put their name, address telephone-number and signature to a list’, see Miklos (1995) [interview] The reason quoted for the fear was the then on-going investigation of those who had signed election-lists for the Democratic Union (DU) (Meciar was trying to annul their seats in the SNC, claiming invalid signatures, the investigation was later dropped.) The committee was later supported by Kovac, following the passage of the act which actually terminated voucher privatisation, see CTK-Business News, 1 August 1995. (According to a FOCUS poll published on 4 July in Narodna Obroda, only 3.1 per cent of Slovaks found the governments privatisation policy “correct”, while 56.5 per cent found it “incorrect”, see OMRI Daily Digest, 13 July 1995.)
from privatisation altogether or that the state would retain a decisive influence in “privatised” firms.

3.4.1. A new policy formulated and contested

The new policy was codified in a number of laws taken by the SNC in July 1995. The first one, Act. no. 190/1995, was yet an amendment to the act on large-scale privatisation (Act on the conditions of transfer of state property to other persons) taken on 12 July, which would reinforce FNM-control over privatisation as well as put a decisive stop to voucher privatisation. Voucher privatisation was replaced by a bond-scheme under which all persons registered for the second wave who did not give back their voucher booklets by 30 September, would receive a FNM-bond with the face value of Sk 10,000 ($312). The bonds, with a 5-year maturity and an interest equal to the discount rate of the NBS, were registered on citizens’ accounts at the SCP as of 1 January 1996.

The government outlined a number of alternative uses for those not willing to wait until 2001 to cash in on the system, they were:

(i) to use the bond as payment when buying council apartments (later ruled illegal, see below);
(ii) to pay for complementary health or pension insurance (exactly how was not clear);
(iii) use it as payment when buying shares floated by the FNM on the stock market (which they seldom do);
(iv) sell the bond on the market to those who can use it to pay their debts to the FNM, i.e. the buyers of privatised property.

Common to all alternatives was that detailed regulation was initially lacking and that the information provided was partially contradictory. The bond-scheme met with strong criticism from the opposition, right and left. Former Deputy PM Schmögnerová (SDL) for example saw it as ‘an unconstitutional intervention into private ownership’. The one group greeting its introduction was not unexpectedly the Association of Entrepreneurs of Slovakia, whose members would prove the main beneficiaries of the scheme as the bonds could be bought at rock-bottom prices when trading finally commenced in August 1996. They could then use them to pay off debts to the

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188 BBC Monitoring Service: Central Europe & Balkans, 14 July 1995.
189 This was an option which few citizens used, during the little more than two weeks when it was possible a total of 31,747 persons unregistered their voucher-books and got the Sk 1,000 which they paid for registration before the end of the year. This equalled 0.94 per cent of all the persons registered for the second wave, and meant that 3,329,814 persons received the FNM-bonds, see Srámek (1995) [interview].
190 The idea of bonds had however been weathered already in 1991 by representatives of HZDS (Hvezdol Koctuch & Augustin Marian Huska) as an alternative to voucher privatisation but then fought down by Vaclav Klaus, see CTK-Business News, 8 June 1995.
191 The first to openly suggest such a solution was SNS on 22 May, but then the somewhat vague idea was that everybody would have an opportunity to exchange the bonds for stock, i.e. exactly what voucher privatisation was about, see TREND Tyzeno o hospodárske a podnikaní, No. 22, 1995 [emphasis added]. The idea of bonds had however been weathered already in 1991 by representatives of HZDS (Hvezdol Koctuch & Augustin Marian Huska) as an alternative to voucher privatisation but then fought down by Vaclav Klaus, see CTK-Business News, 8 June 1995.
192 Srámek (1995) [interview].
193 Important to note is that the bond is issued by the FNM, with no state guarantee, which means that on 31 December 2000 the fund is to pay approximately Sk 50 billion ($1.7 bn, 1995 exchange rate) (given the 1995 discount rate), a sum which it should cover with its own resources.
194 The major state-owned banks were later to be included in this group of potential purchasers of bonds, see Chapter V:1:2.1. p. 146 ff.
195 Srámek (1995) [interview].
FNM, where they were worth their full face value plus accrued interest, in a system that amounted to a further subsidisation of the direct sales.\textsuperscript{196}

A second effect of the changes was to reinforce the powers of the FNM, in this respect the act was the culmination of a long-standing battle for influence over privatisation fought between the FNM and the Ministry of Privatisation. Following the adoption of Act no. 369/1994 in November 1994 (see above) the Ministry of Privatisation initially accepted their diminishing influence; the Minister, Peter Bisak, in February said they had to respect the branch ministries when formulating policy since they were the ones who administered the firms.\textsuperscript{197} Bisak also said they would not use their right to revise projects submitted by the founding ministries, although they would still select the winner in tenders and retain the right to make suggestions to the FNM about firms to be privatised.\textsuperscript{198} However, in March 1995 the Ministry attempted to increase its jurisdiction by formulating a draft law which, if adopted, would have confined the FNM to only accepting or refusing proposals for direct sales made by the Ministry, i.e. strip the fund of its right to take the initiative to a direct sale. The draft was forwarded to the legislative council of the government but not heard of since.\textsuperscript{199} Instead the opposite happened on 12 July, when almost unlimited powers with respect to privatisation were put in the hands of the FNM. Thus, from 15 September, when the amendment became effective, the FNM could decide about direct sales of firms without any involvement of the Ministry of Privatisation or any other ministry.\textsuperscript{200} Previously the Executive Council of the FNM only had the right to put forth proposals to its Presidium for direct sales of shares in existing joint-stock companies, while the Ministry evaluated proposals for SOEs not yet transformed and then put them forth directly to the Presidium. After September all proposals were to be submitted to the Presidium by the Executive Council.\textsuperscript{201} The controversial part of this is that decisions by the FNM, which technically is neither a state body nor a public administration body, cannot be controlled or contested by any outside organisation, for example the Anti-Monopoly Office or the Supreme Control Office of the Slovak Republic. The only control mechanism available is indirect and consists of the appointments of members to the FNM Presidium, which in turn appoints its Supervisory Board. Thus, the opposition had no

\textsuperscript{196} Trade in these bonds, and its implications, are discussed in Chapter V:1.2.1, p. 146 ff.
\textsuperscript{197} Other ministries in effect means the Ministry of Economy, the founder of 90 per cent of the companies to be sold.
\textsuperscript{198} TREN\v D Tyzdenník o hospodárstve a podnikaní, No. 8, 1995.
\textsuperscript{199} TREN\v D Tyzdenník o hospodárstve a podnikaní, No. 15, 1995.
\textsuperscript{200} Mácay (1995) [interview]. The attitude of the FNM in the fall of 1995 was that the Ministry of Privatisation was no longer necessary; according to Karol Danys (Vice-Chairman of the Supervisory Board) the Ministry had ‘0%’ powers, whilst the fund had ‘100%’. Danys at the time claimed that the Ministry would be closed within a year, see Danys (1995) [interview]. The executive director of FNM, Ján Porvazník, explained that the ministry still had the right to propose for example a public tender for a firm, but given the right of the FNM to propose a direct sale for any firm it so wishes the ministry easily could be circumvented; Porvazník said that ‘we can announce them give us privatisation project because we want to sell the company by way of direct sales – and they are obliged immediately to send us [the project].’ Porvazník, however, held a more balanced view as regards the existence of the Ministry of Privatisation, explaining that the Ministry in practice took care of the majority of paper-work, i.e. dealing with the legal aspects, the status of the real estate (taking care of restitution claims), splitting the company, evaluating it etc. Source: Porvazník (1995) [interview]
\textsuperscript{201} Porvazník (1995) [interview].
insight into the privatisation process as the ruling coalition chose to only appoint “their own” representatives to the Presidium.

A second law adopted in July was the no less controversial Act on safeguarding the state interests in the privatisation of strategically important state-owned companies and joint-stock companies (hereinafter Act no. 175/1995 or Strategic Enterprise Act), initially passed on 13 July by 78 votes to 19 in the 150-seat parliament. The law, significant for the new policy, defined two groups of firms that would be fully or partially withheld from private control. As “important” it listed 29 firms with a book value of approximately Sk 105 billion ($3.5 bn); these were completely exempted from privatisation and were to be controlled by their respective founding ministry. The list included all significant companies within gas, energy, post- & telecom, railways, forestry as well as the major firms in defence industry (see Appendix B). For large-scale privatisation this, in combination with some other minor adjustments, meant that the number of firms included in the second wave was reduced to 603 while the book value of property offered was nearly slashed in half, from Sk 258 billion ($8.7 bn) to Sk 136.2 billion ($4.6 bn). The second group of firms was defined as “strategic” and included 45 firms in which the state retroactively gave itself a “golden-share” implying veto power on all important decisions in firms, for example increases in capital, dividends, changed number of seats in the governing bodies etc., irrespective of the state’s ownership participation. The list included almost every significant firm in Slovakia, with a total book value of Sk 112 billion ($3.8 bn). Minister of Economy, Jan Ducky (HZDS), defended the move, saying that “[t]he purpose of state participation is to prevent the new owner from, for example, closing down a major plant because we could not afford to do so for state economic or employment reasons.” The Strategic Enterprise Act thus meant the exclusion from private control, full or even partial, of close to Sk 220 billion ($7.3 bn) worth of property, i.e. much more than the amount so far (end-June 1995) privatised since the beginning of economic transformation.

Finally, also on 13 July, the SNC adopted an amendment to the act on investment funds and investment companies, which retroactively would reduce their influence over firms in which they held stakes.

Thus, within two days the ruling coalition pushed legislation that radically altered the rules of the game in this package of three laws. All laws were subse-

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202 Dollar values in this section are calculated using the average exchange rate for 1995.
203 The act thus implied the formal transfer of property rights from the FNM to the founding ministry, i.e. in most cases the Ministry of Economy.
204 The new figures were reported by Minister of Privatisation, Peter Bisak, in May 1996, see Slovak News Agency-TASR, 16 May 1996.
205 Cf. IMF (1995), pp. 59-62; both of the lists are found in Appendix B (p. 315).
206 Reuters News Service, 14 July 1995. It is significant to note that as of mid-1995 a mere 53 bankruptcy proceedings had been completed in Slovakia, even though there were in excess of 1,000 cases filed, see OECD (1996), p. 56 (who also points to the unwillingness of central authorities as a contributing factor for the low number).
207 By end-June a gross of Sk 264.2 billion ($8.9 bn) worth of property had been “privatised”, although of this only Sk 133 billion ($4.5 bn) had been privatised in our sense of the word, i.e. a full transfer of property rights to a private entity. The remaining property was still either controlled by the FNM (Sk 96 bn; $3.2 bn), transferred to municipalities (Sk 27.7 bn; $0.9 bn) or in other ways not yet completely privatised, see IMF (1995), Table V1 (p. 57).
208 This law is discussed in Chapter V:2.2.2.
quently vetoed by President Kovac and appealed to the Constitutional Court in Kosice, where they met different fates. Act no. 190/1995 (on FNM-bonds replacing the voucher scheme) was vetoed and returned to the SNC on 27 July which re-approved it on 6 September without changes. The very same day a group of 40 opposition MPs appealed the law to the Constitutional Court which on 20 December 1995 gave its approval to the bond-method per se, but declared as unconstitutional the provision that local councils must accept bonds as payment for council-housing (Article 24, para. 10).209 This meant that bonds could be distributed as planned from 1 January 1996. The other laws, however, did not meet the same understanding among judges.

Already on 12 January 1995 a group of MPs had appealed Act no. 370/1994 (annulling direct sales after 6 September 1994) which after a Presidential veto had been re-approved by the SNC. The Constitutional Court in its 24 May 1995 ruling annulled it on grounds of breaching the right to private ownership, the principle of division of powers as well as the principle that a law cannot be retroactive.210 The next major act to be scrutinised by the court was the Strategic Enterprise Act (Act no. 175/1995) which it on 3 April 1996 also declared as unconstitutional following an appeal of 36 MPs. The court pointed to the fact that paragraph 6, i.e. on a “golden share” in the 45 “strategic” firms breached the right to private ownership. The list of 29 “important” firms was nevertheless left untouched.211 Finally, in its maybe most significant ruling, the Constitutional Court on 21 November 1996 ruled Act no. 369/1994 (increasing the powers of the FNM) to be unconstitutional, i.e. all privatisation decisions taken by the FNM since “the night of the long knives” in essence had been unlawful in that they contradicted paragraph 119D of the constitution which states that such matters are the responsibility of the government.212 However, the ruling was not retroactive.213

3.4.2. The real policy: subsidised direct sales in a frantic pace

Meanwhile the effective policy of privatisation had crystallised itself. During the course of 1995 and 1996 the majority of firms that the government wanted to sell were sold to domestic investors by means of direct sales on soft terms, the whole of the process nominally controlled by the FNM. Beginning in February 1995, when the FNM reportedly held shares in 460 firms with a nominal value of Sk 98 billion ($3.2 bn), the pace of sales has at times been close to frantic. From mid-February to end-March 61 firms were sold;214 by 20 June the figure had risen to 132 companies

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210 Euroweek, 2 June 1995.
211 Slovak News Agency-TASR, 3 April 1996. The ruling did however not mean the end of the governments ambition to control the economy. In May 1996 Ministry of Economy spokesman, Josef Sucha, said that “[t]he intention is to ensure the spirit of the law at least by negotiation...” [Reuters News Service, 13 May 1996]. In practice this meant that the government in those firms where it still held sufficient voting power, or influence by other means, tried to change the statutes of firms so that the “state interest” was secured.
212 BBC Monitoring Service: Central Europe & Balkans, 22 November 1996.
213 Meciar’s comment to the ruling was the following: “[t]o those calling for a reversal of former acts of privatisation I say the government is ready to give its approval to those decisions.” [Reuters News Service, 29 November 1996.]
214 TREND Tyzdenník o hospodářstve a podnikání, No. 24, 1995.
with an estimated nominal value in excess of Sk 20 billion ($672 mn), sold at a combined price-tag of Sk 11.7 billion ($393 mn). Following the passage of the laws in July the pace picked up even more; in the few weeks between end-July and early September 1995 the FNM concluded no less than 160 direct sales. This kept on until the end of the year and the fund in its annual report for 1995 reported 376 direct sales, with a total price tag of Sk 36.7 billion ($1.23 bn). In addition, the fund concluded 77 minor tenders during the year, which sold for a total of Sk 3.4 billion ($114 mn). On the margin the fund also floated shares from its portfolio in 254 firms on the stock market (RM-Systém), although the combined nominal value of these sales was a mere Sk 1.2 billion ($40 mn), and given that they were only small packages in relatively unattractive firms they reaped a meagre Sk 127.6 million ($4.3 mn) at the market. In 1996 the process continued at a high speed. During the course of the year the FNM Presidium approved nearly 400 direct sales, with an estimated book value of Sk 50 billion ($1.6 bn).

Characteristic for all direct sales, which by far was the dominant method, is the lack of transparency. The FNM has consistently refused to disclose any detailed information about the terms of sale or who the buyer is. As time has passed, a routine developed where the communiqués following a sale contained only some rudimentary information on purchase price, name of the buying firm, percentage share sold and the amount paid in the first instalment. No information is however provided on background of the buyer, how and according to what criteria the buyer was chosen, the number of competing bids or book value of the property. The lack of the latter has not least made it difficult to accurately estimate the progress in privatisation since the amount of property to divest consistently has been expressed in terms of book value of the property. Even so, it is beyond doubt that the terms have been softened as compared to the situation under previous governments. Earlier prices for direct sales were seldom below the book value of the company and the first instalment was usually a minimum of 20 per cent of the purchase price, the rest being paid for a period of 5 years. In 1995, however, the purchase price had on average

215 TREND Tyždenník o hospodárstve a podnikaní, No. 31, 1995.
216 TREND Tyždenník o hospodárstve a podnikaní, No. 46, 1995.
217 The remarkable pace of the process is easier to understand if one compares the sales to the total Sk 38 billion (app. $1.26 bn) worth of property which the FNM sold by standard methods during the whole period of 1991-1994, see TREND Tyždenník o hospodárstve a podnikaní, No. 31, 1995.
218 RM-Systém is one of the two organised markets for stock in Bratislava, see Chapter V:1.2.
219 In the latter part of 1994 there had been a quite large number of floations in attractive firms, and the FNM during a few months sold shares with a nominal value of Sk 511 million ($15.9 mn) which together fetched Sk 620 million ($19.3 mn) on the market. However, the decision not to sell any larger packages seems to have followed the sale of a 6 per cent share of profitable Nafta Gbely to a foreign investor – a sale which Karol Danys at FNM commented upon saying it was a mistake given that that the buyer wants to influence the firms management [sic], see TREND Tyždenník o hospodárstve a podnikaní, No. 34, 1995.
221 Initially the fund was reluctant even to give the purchase price, arguing that it was a business secret.
222 It is somewhat ironic that the government in its January 1995 Manifesto stated its intention to increase transparency in privatisation (in addition to increasing the pace and to target domestic entrepreneurs and employees), see Miklos (1995), pp. 31-32. Further, Karol Danys, vice-chairman of the executive board of the FNM, actually claimed that one of the major advantages with direct sales was its 'transparency', see Danys (1995) [interview].
223 Máca (1995) [interview].
been lowered to 75 per cent of book value, with a first instalment of only 14 per cent of the purchase prices, and the rest payable over approximately 10 years. In addition the contracts often contain clauses where the buyer pledges a certain amount of investments over the coming years, provisions which are not fully disclosed. Further, the fact that many of the firms are sold to political allies of the government does not help in reassuring the opposition or the general public which slowly has begun to take an interest in what is happening, not least following the many scandals (cf. Appendix C); many lucrative firms were sold at ridiculously low prices. Then, in 1996, the sell-offs had turned into a garage-sale, with prices on average equalling only 28 per cent of book value, and with the first instalments having been lowered to 8 per cent (!).

Who then are the buyers? As with everything else concerning direct sales it is difficult to get a real and full picture of what is happening, although it is clear that foreign buyers have been discriminated against. Of the 376 direct sales in 1995, only five were sold to foreign firms. Thus, these majority stakes in firms (often 51-67%) have almost exclusively been sold to insiders, either incumbent managers or representatives of other industrial groups in the making. The Vice-Chairman of the Executive Board at the FNM, Mr. Porvazník, said that some 50-60 per cent of buyers are management or groups of management (1995). He explained that in the early days, 1992/1993, sales were almost exclusively to managers, although as the private sector has grown a new group of buyers have emerged. This view is confirmed by other officials at the FNM who explained that the need for bank guarantees when purchasing a firm results in a situation where much depends on the personal connections, especially given the general lack of liquidity.

4. Summary

The main theme of the chapter has been the description and analysis of the process of large-scale privatisation up until when the second wave was formally completed in 1996. Preceding the empirical study, however, some issues of a more principle nature were brought to the fore in order to guide the analysis. The chosen definition of privatisation as those "state-led activities, which result in the full or partial transfer or property rights from the state or related public agencies to the hands of private owners," was initially laid down. Focus has thus been on the existing firms and the policies and enactment of the same, which guided this process. Furthermore, and also on a principle level, the potential economic goals to which privatisation may serve as a means were laid out and discussed.

When discussing methods and constraints the inherently political nature of the process of privatisation was emphasised – in terms of the need for political support

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224 Porvazník (1995) [interview].
225 On terms of payments in standard methods, see Appendix D, TABLE 22 (p. 335).
226 TREND Tyzdenník o hospodářství a podnikání, No. 4, 1996.
227 Porvazník (1995) [interview]. Mr. Porvazník was at the time in charge of evaluation of privatisation proposals.
228 Lacko (1995) [interview].
for the policies as well as in the risks for rent-seeking inherent in such a process. It was stressed that in order to counter the rent-seeking efforts of various groups, transparency and clear rules of the game would be instrumental. Available methods for conducting privatisation policies were discussed in a dichotomy of standard (e.g. direct sales) and non-standard methods (e.g. mass privatisation through vouchers). However, in order to be able to analyse the distributive aspects of policies yet another dimension was introduced, namely the extent to which the methods were applied in a competitive manner. The potential merits and drawbacks in terms of economic as well as political goals were discussed and summarised in Figure 9.

The empirical part of the chapter (Sections 2.2-3) pointed to the relatively diversified approach initially taken to privatisation, with the process proceeding according to three different avenues – i.e. small-scale privatisation, restitution and large-scale privatisation. Although focus of this study is on the latter process, a brief review of the other two avenues was undertaken. As for small-scale privatisation, which focused on minor businesses (e.g. restaurants, shops, minor workshops etc.), it was accomplished by means of standard methods (public auctions). In this relatively uncomplicated manner, some 10,000 units were sold in less than three years. It was a very visible process undertaken in a relatively transparent manner – although there of course were cases when Slovak citizens acted as front-men for foreign business interests since the latter were excluded from the process. With trade and catering accounting for nearly three-quarters of all units sold it was also a process with a far-reaching impact on the everyday life of ordinary people.

In comparison, restitution was a much less visible process. Giving back assets in this way to their former owners must be considered a non-standard method. Furthermore, in Slovakia the process was much less extensive than in the Czech Republic as a consequence of being less industrialised at the time of the communist take-over; in fact, only a minor number of firms were restituted in kind. The vast majority which filed claims for restitution were to receive financial compensation, most oftenly in the form of shares in the Restitution Investment Fund, administered by the FNM, which accumulated shares in all firms privatised by means of vouchers in the large-scale privatisation process.

The large-scale privatisation process, finally, must in comparison with the other methods be considered the main vehicle for ownership reform in Slovakia. Focus in the analysis has been on the macro- and policy-level. The analysis of the process led us to divide it into four phases, rather than the official two waves of privatisation. These phases were all connected to changes in the government. The first phase was that of the federally co-ordinated large-scale privatisation in 1991-1992. The dominant method during this period was the non-standard voucher scheme. In addition, the Carnogursky government approved 181 direct sales and 8 public tenders, with a total book value of Sk 11.7 billion ($400 mn), before the June 1992 elections. These sales were relatively transparent and resulted in purchase prices above book value.

The 1992 elections brought Vladimir Meciar back as second-time PM and did not only mark the end of the Czechoslovak federation, but also the beginning of a second phase of Slovak privatisation. Initially there was a slowdown in the pace connected to internal struggles within the coalition, and the voucher scheme was
shelved. Nevertheless, from the summer of 1993, with more powers vested with the government, pace started to pick up – albeit at the expense of transparency. The pursued policy was that of direct sales to incumbent managers and other domestic industrial groups. However, mistrust in these non-transparent sales resulted in a vote of no-confidence in March 1994 – something which in itself served to spur a last thrust of speedy sales, i.e. the so-called “midnight-privatisations”. The caretaker left-right coalition set out to increase transparency as well as keeping up the speed of the process. It thus decided to re-launch the voucher scheme in a second wave. The programme was even more popular than the first time, with 3.4 million citizens signing up as compared to 2.6 million in 1992. Once again investment funds attracted the majority of points (58%), although less than in the first wave (70.5%). Before the elections the Moravčík government had approved Sk 130 billion ($4.1 bn) worth of property to be privatised, out of which Sk 63 billion through voucher and Sk 67 billion through standard methods.

Once again Vladimir Meciar mustered the support necessary to form a ruling coalition. This time around, however, changes to policy were to be more radical and far-reaching. The institutional set-up was in 1994/1995 altered so that powers were effectively concentrated with the government and its loyal allies at the FNM and the voucher scheme was called off. This formed the basis from which a new policy was enacted, namely the speedy and broad sell-off of large stakes in firms to incumbent management and political allies, at prices lower than ever before. These direct sales included large stakes in the most important Slovak companies, for example the Eastern Slovak Ironworks (VSZ) and Slovak refiner (Slovakia), and outside (foreign) investors were effectively excluded from the process.

* * *

North, among others, have pointed to the need for stable institutions, i.e. in the sense that the economic actors/agents perceive them as being long-term – or, at least, not too changeable in the short run, in order to promote economic growth. The recurrent politically initiated changes in the policies for privatisation, and the lack of stable institutions, have thus not created the best preconditions, neither for economic growth nor for entrepreneurial risk-taking. What consequences these political changes came to have will be more thoroughly analysed in the following chapters. Having laid out this macro-oriented perspective there are two further levels of analysis which need to be introduced. Thus, in the next chapter (Chapter V) we look at the markets and the group of actors that became dominant, i.e. the investment funds, on something which is best described as a meso-level of analysis. There it will be shown, amongst other things, that the radical change of policy in 1994/1995 was not limited to the privatisation process per se. Then, in the last empirical chapter of the study (Chapter VI) we turn to the micro-level, looking at the behaviour and responses of individual firms. The implications for corporate governance of these policies, as well as the question of “what type of owners” which ownership reform brought for Slovakia are both important questions, but ones which require more insight in the surrounding institutional set-up and the responses.

on the micro-level, and are therefore addressed in the concluding discussion (Chapter VII).
CHAPTER V

Emerging governance-structures: investment funds and the market

‘[i]t [voucher privatisation] does appear, however, to have created an extraordinary system of corporate governance.’

Richard Portes

The over-riding theme of Chapter V is the emergence, behaviour and relative influence of some of the new principals in the corporate sector in Slovakia and, not least, their interaction with the nascent capital market. Among the groups and organisations that became powerful as a result of privatisation is found, above all, the private investment funds and investment companies, but also the partially state-controlled banks. In this chapter, at the same time as we lower the focus somewhat from the macro-level to the meso-level we elevate the discussion – from the more narrow definition of “privatisation” which was in focus of the previous chapter, to the wider definition of “ownership reform” laid down in Chapter I. The latter thus entails many aspects of the institution-building relating to the development of a modern, capitalist, market co-ordinated economy – including many governance mechanisms. As mentioned also this level of analysis is necessary to be able to assess the process of privatisation and ownership reform as such. For example, of the four economic goals which privatisation may serve, i.e. hard budgets, profit maximisation, reallocation of property rights and as a pre-condition for the establishment of new mechanisms for corporate governance (discussed in the analytical framework) – this chapter relates more to the latter two – while Chapter VI will look at the behaviour of firms and the environment in which they work.

The chapter is divided into two main sections. The chapter commences with a brief overview of the establishment and development of the market per se (Section 1). The problems concerning regulation will form an integral part of the discussion in this section. The second part of the chapter presents the process by which the main actors emerged as agents in the governance process. The focus is on the rise and fall of the investment funds and investment companies that were charged with ownership rights in a large segment of Slovak industry (Section 2). A recurring theme throughout the section will also be how different interests attempted to change and adapt the institutional framework to better serve their own objectives.

As was apparent from the earlier analysis of the privatisation process, economic transformation in Slovakia quickly became very politicised, so it will not be surprising that these political interests were also prominent when it came to actually exercising the (economic) property rights they fought to secure. In fact, it will be shown that the changes in privatisation policy discussed in the preceding chapter were paralleled by changes in the regulation of investment funds. A brief summary concludes the chapter (Section 3).

1. The market and its regulation

The market for stock trading in Slovakia evolved as a direct consequence of privatisation. Voucher privatisation put titles of ownership in the hands of millions of Slovaks, either in firms directly or via investment funds (IFs) which were set up as joint stock companies to manage the shares. In early 1993, when shares were distributed to DIKs and investment funds, more than 500 tradable issues became available in the country, thus creating a great demand for organisations and institutions which could organise and regulate trade in these and other securities (e.g. bonds).

A stock market, as was discussed in Chapter II:4, is connected to a range of different functions, among them to establish share prices, and thereby an evaluation of company performance; to provide risk capital for companies; to encourage risk-taking and investment by spreading the risk; and, also, to correct managerial failure through a market for corporate control. Thus, these markets carry a great potential both to mobilise and channel savings into investment, and to improve firm performance by putting pressure on management. Further, as was also discussed above, these markets would be instrumental in reconstituting the ownership structure; even if firms had been privatised it did of course not imply that there would be no further need for changes. Quite the contrary, the transferability of property rights remains a corner stone for improving and/or maintaining an efficient property rights structure. In this, the stock market has an important role.

This chapter shows that the establishment of some of the basic formal institutions and organisations necessary for securities trading posed little problems in itself. Within a short space of time Slovakia had no less than four different “markets” for share trading, three “official” and one “unofficial”. However, as will also be illustrated, it would prove much more difficult to establish the necessary supportive regulatory framework and thus an environment conducive for low-cost trading, transparency and a correct evaluation of firm performance; that is, the type of market which could help to achieve the goals mentioned above. Making this institutional set-up congruent, transparent and relatively stable would, of course, be further complicated by the highly politicised nature of the Slovak state and society in the period we are studying.

The section begins with a brief presentation of the three organised markets (Sections 1.1-1.3). Their structure and relative importance will be analysed, as will the general development of securities trading. Three parameters will be given special

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attention, that is: (i) market capitalisation as a per cent of GDP, a measure which in transforming economies also indicates the extent of privatisation (in more mature economies it would only indicate to what extent equity historically has been used to mobilise capital); (ii) the turnover ratio (market turnover as a percentage of total market capitalisation), which is a good indicator of market liquidity; and (iii) the value of shares traded as a per cent of GDP, which gives an indication of to what extent liquidity is available on an economy-wide basis. The section concludes with an analysis of some of the problems that have been plaguing this emerging market, many of which are related to regulatory issues and the lack of a stable and coherent institutional framework (Section 1.4).

1.1. The Bratislava Stock Exchange

The Bratislava Stock Exchange (Burza cennych papierov v Bratislave, below BCPB) was established in early 1991 by ten leading Slovak financial institutions, basically the dominant and still state-controlled banks. Rules and regulations for the exchange were adopted late in 1992 and the first day of trading was 6 April 1993. BCPB is based on the principle of membership, i.e. only authorised representatives of members are permitted to trade on the exchange. At the end of 1993 there were already a total of 24 members, mostly banks and other financial institutions, but also three brokerages and the Fund of National Property (FNM); three years later the figure had risen to 53, out of which 12 were temporary members.

When trading commenced, only two listed bonds were traded, both bank issues, and consequently trading volumes were extremely low. Computerised trading began 1 July 1993, the same day as all types of listed securities were put on the market. Two weeks later, on 15 July, the big bulk of shares were added when all shares in Slovak firms from the first wave of voucher privatisation were put on the unlisted market together with the shares in investment funds. Another milestone was reached when daily trading began on 11 October the same year. Three years down the road, by end-1996, the BCPB had developed into the main organiser of the spot market for securities in Slovakia.

* * *

The Bratislava Stock Exchange is divided into three different submarkets/lists (three tiers), the Main market (1st tier), the Junior market (2nd tier), both only for listed securities, and a market for unlisted securities (3rd tier). Regulations for these markets differ, especially concerning disclosure rules. To have a security listed on

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3 BCPB Vyrocná správa 1993, p. 18.
6 The total trading volume for the first three weeks was a mere Sk 270,185 ($9,447), see Fisher (1994b), pp. 33-34. However, it was not until 11 October 1993 that daily trading commenced.
7 Žiadušné informácie, BCPB, Bratislava, 1997, pp. 2-3
the Main market (1st tier) a company issuing the security must have presented
audited annual reports to the BCPB for three previous years. In addition, there is a
minimum market capitalisation of Sk 100 million ($3.3 mn) for the publicly traded
part of the issue, and the firm is obliged to submit quarterly earnings reports to the
BCPB as well as any other ‘important facts that could influence the trading of their
respective issues.’ These requirements have held back the number of securities
being traded on the Main market. Initially only government bonds (6) were traded
(see Table 12). By end-1996, however, the total number of listed securities had risen
to 36, out of which 13 were equity issues.9

On the Junior market (2nd tier), the market for other listed securities, the re-
quirement is that companies must submit semi-annual reports; information which is
then dispersed by the BCPB through various media.10 At end-1996 a total of 13 is-
ues were traded on this market, out of which eight were equity issues – making for
a total of 21 “listed” equity issues.11 Companies failing to comply with these de-
mands on regular information are traded on the unlisted market (3rd tier) where the
only requirement is basic data about the stock issue, the issuer, and the basic annual
report which is mandatory according to the Securities Act.12 On this market, trade
was already in 1993 pursued in more than 500 equity issues, a figure that by end-
1996 had risen to an impressive 1,012 issues, out of which 949 were equity issues.13

On the BCPB, trade can be conducted either anonymously (floor trade) or di-
rectly between two parties (direct trade).14 In anonymous trade, the transacting par-
ties do not know from whom they are buying or to whom they are selling, thus the
price paid will be the “market price”. In direct trades, however, the price paid can
be either higher or lower than the “official” prices, especially so since most of the
direct trades are settled by the BCPB only on the property related side.15 Direct
trades have dominated trading activity on the BCPB, reaching as high as 99 per cent
(!) of total volume traded in 1995 (cf. Table 12), with obvious implications for
transparency. As regards equity issues in total, the volume traded anonymously has,
however, never exceeded 20 per cent; and among listed equity issues the level of
anonymous trades has been even lower (cf. Figure 17, p. 156).

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9 Základné informácie (1997) [quote on p. 6]; Stock exchange charter (1994); Listing rules (1995); Reg-
10 Out of the bonds 12 were government bonds, 6 corporate bonds and 4 bank bonds, see BCPB Vyrocná
správa 1996, p. 11.
12 This represents a reduction from 17 two years earlier, which is the result of more firms fulfilling the
requirements of three consecutive annual reports necessary to be on the Main market.
14 BCPB Vyrocná správa 1996, p. 11.
16 See BCPB Vyrocná správa 1996, p. 19. Once a deal is concluded, settlement (delivery vs. payment)
will be achieved on the day t+3 in the case of securities in dematerialised form. On t+2 the BCPB orders
the Bank Clearing Centre, where all members must have accounts, to secure payments – at the same time
the securities are blocked at the Central Securities Register (SCP). If stocks exist and payment is se-
cured, delivery will be the following day, (t+3). To guarantee payments in case of lack of financial
means on behalf of individual trade participants the BCPB started a Guarantee Fund, administered by the
Dutch ING-Bank. All participants are obliged to pay fees to the fund, see Guarantee fund rules (1995).
An official index of the BCPB was introduced on 14 September 1993; the SAX-index was then set to 100. 17 As can be seen in Figure 14 prices on the BCPB have been quite volatile, as one would expect on an emerging market. Initially, many analysts feared a strong downward pressure, due to many DIKs selling their holdings. However, this did not materialise, instead there was a huge price boom (+270%) during the first two months of 1994. The boom, in turn, was followed by a huge price correction (-28.2%) in 1995. The rise in prices was again followed by a drop in 1996.

Table 12. The Bratislava Stock Exchange, 1993-1996

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>TOTAL TRADE (Sk mn)</td>
<td>166</td>
<td>6,284</td>
<td>40,069</td>
<td>114,116</td>
</tr>
<tr>
<td>TOTAL TRADE ($ mn)</td>
<td>5.4</td>
<td>196</td>
<td>1,347</td>
<td>3,723</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity issues (Sk mn)</td>
<td>39</td>
<td>5,428</td>
<td>24,730</td>
<td>83,130</td>
</tr>
<tr>
<td>Equity issues ($ mn)</td>
<td>2.9</td>
<td>169</td>
<td>832</td>
<td>2,712</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Listed equity issues (% of total trade)</td>
<td>11.2</td>
<td>61.1</td>
<td>28.7</td>
<td>35.3</td>
</tr>
<tr>
<td>Listed equity issues (% of equity trade)</td>
<td>20.9</td>
<td>70.7</td>
<td>46.4</td>
<td>48.4</td>
</tr>
<tr>
<td>Anonymous trade (total Sk mn)</td>
<td>38</td>
<td>829</td>
<td>471</td>
<td>15,824</td>
</tr>
<tr>
<td>Anonymous trade (% of total trade)</td>
<td>22.8</td>
<td>13.2</td>
<td>1.2</td>
<td>13.9</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity issues (% of total anony. trade)</td>
<td>48.3</td>
<td>94.0</td>
<td>83.9</td>
<td>46.7</td>
</tr>
<tr>
<td>Equity issues (% of total equity trade)</td>
<td>20.5</td>
<td>14.4</td>
<td>1.6</td>
<td>8.9</td>
</tr>
<tr>
<td>Listed equity issues (% of total equity trade)</td>
<td>12.8</td>
<td>12.4</td>
<td>0.9</td>
<td>5.5</td>
</tr>
<tr>
<td>Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SAX (% annual change)</td>
<td>9.6</td>
<td>95.5</td>
<td>-28.2</td>
<td>15.8</td>
</tr>
</tbody>
</table>

No. of issues (end-year)

| Total | 518 | 539 | 905 | 1,061 |
| Bonds | 6 | 18 | 55 | 91 |
| Equity issues | 512 | 521 | 850 | 970 |
| of which | | | | |
| Unlisted issues (tier III) | 501 | 504 | 829 | 949 |
| Listed issues (tier I & II) | 11 | 17 | 21 | 21 |
| of which | | | | |
| Main market (tier I) | 0 | 0 | 12 | 13 |
| Junior market (tier II) | 11 | 17 | 9 | 8 |

Market capitalisation (end-year)

| Sk mn | 93,766 | 97,430 | 158,317 | 184,067 |
| USD mn | 3,053 | 3,040 | 5,323 | 6,005 |

Key indicators

| Market capitalisation (% of GDP) | 25.4 | 22.1 | 30.6 | 32.0 |
| Turnover ratio (% of market capitalisation) | 0.1 | 5.6 | 15.6 | 45.2 |
| Value traded (% of GDP) | 0.02 | 1.2 | 4.8 | 14.4 |


Comment: “Equity issues” in the table include also shares in investment funds.

1 Index-change for 1993 refer to the period 14 September 1993-end 1993.

An official index of the BCPB was introduced on 14 September 1993; the SAX-index was then set to 100. 17 As can be seen in Figure 14 prices on the BCPB have been quite volatile, as one would expect on an emerging market. Initially, many analysts feared a strong downward pressure, due to many DIKs selling their holdings. However, this did not materialise, instead there was a huge price boom (+270%) during the first two months of 1994. The boom, in turn, was followed by a huge price correction (-28.2%) in 1995. The rise in prices was again followed by a drop in 1996.

17 SAX stands for Slovensky Akciovy Index [Slovak Share Index] and it was developed in co-operation with Creditanstalt. The index is based on the most heavily traded securities, and computed daily. The securities receive their weighting according to their trading volume and trading frequency, see ‘SAX – Slovak Stock Index of the Bratislava Stock Exchange and Creditanstalt” (1995).
steep drop, resulting in a year-to-year increase of a still impressive 95 per cent (see Figure 14; lower X-axis and left Y-axis). 1995 was a poor year for the Slovak securities market, and prices plummeted by 28 per cent. In 1996, a minor upswing followed (+16%).

One problem is that prices on the BCPB have proven very sensitive to changes in the political environment, regulatory changes and changes in privatisation policy. In 1996, for example, prices initially climbed by 47 per cent until 20 August, only to fall back by 21 per cent during the latter half of the year. A number of factors help to explain this, not all related to firm performance (see Figure 14; upper X-axis and right Y-axis). Of course, the fact that half-year results were generally worse than expected took its toll. However, the announcement on 1 August of the direct sale of a controlling block in Nafta Gbely by the FNM (see Appendix C, p. 317) was at least as important, not to mention the drop which was experienced after the 7th amendment to the Securities Act was first passed by parliament in early November 1996 (see Section 1.4.3). Similar declines can be seen in connection with the abolition of voucher privatisation in early June 1995, and restrictions put on investment funds in the summer of 1995. This conclusion is also in congruence with findings by Morck et al. which indeed indicate that it may be a general phenomenon that share prices on emerging markets are less responsive to firm-specific information than they are to changes in the institutional environment.18

18 See Morck et al. (1997), who show that prices on emerging markets capitalise less firm specific information.

Figure 14. Price developments on the BCPB, SAX-index 1993-1996

Source: Daily price data communicated directly from the BCPB; own computations.
In comparison with the three other major exchanges in Central Europe, performance in Slovakia has been rather lacklustre (see Table 16, p. 153). Indeed the BCPB marginally outperformed the Prague Stock Exchange in the 1993-1996 period, but when compared to emerging markets like Budapest and Warsaw one must ask what is it that makes Bratislava different. A major contributing factor seems to be liquidity. Although the BCPB could boast a high number of issues and an impressive market capitalisation (Sk 184 bn [$6 bn] at end-1996; i.e. 32% of GDP), liquidity has been appallingly low. Liquidity, if measured as the turnover ratio has been the lowest in the region in Slovakia (see Table 16), although rising over time from 5.6 per cent in 1994 (0.1% in 1993 [sic]) to 45.2 per cent in 1996 (see Table 12). The reasons for this are discussed shortly, but in brief, must be sought among factors such as the regulation of markets and the lack of a trading monopoly. Also, the market has been overissued – looking at the turnover of individual issues it becomes clear that the majority of them render so little interest that it is difficult to understand why they are on the market at all. Further, the trade that has taken place has been non-transparent, and often more aimed at gaining controlling stakes in firms rather than profit seeking. These are general problems of the Slovak market that are returned to in Section 1.4.

1.2. RM-Systém\(^{20}\)

One of the competing organised markets is RM-Systém Slovakia, a.s. (below RM-S), established in March 1993.\(^{21}\) RM-S is an electronic trading system that came into being as a consequence of voucher privatisation.\(^{22}\) Unlike the BCPB, the RM-S was initially dedicated to trade in equity issues, and there was no trade in bonds until the end of 1995.\(^{23}\) RM-S is not based on the membership principle and a unique feature is thus that it allows every physical or legal person (foreign or national) to conduct trades in shares on an organised market without using a broker. Customers, however, have to register with the RM-S, something that was done automatically for all those who participated in the first wave of voucher privatisation. In comparison with the BCPB, the RM-S is small with less than one-third of BCPB’s equity trading volume in 1996, see Table 13.\(^{24}\)

\(^{19}\) Cf. Figure 26 (p. 267) in Chapter VI:4.4.

\(^{20}\) This section is, unless otherwise noted, based on information obtained in the following publications: Trading Rules (1993); Buying and selling on RM-Systém Slovakia market (1993); Technical conditions of RM-S operations (1994); Trading Rules (1996).

\(^{21}\) The internal workings of RM-S are regulated by the Trading Rules (1993) which were approved by the Ministry of Finance on 19 March 1993; consecutive changes are incorporated into Trading Rules (1996).

\(^{22}\) RM is short for ‘Registračné Miesta’ [Registration site], which was the name of the places established to handle the registration of voucher bids, so RM-S is in a sense a natural continuation of the voucher scheme and initially set up to cater for the “retail market” of ordinary citizens wanting to sell or buy shares. Every person who participated in the scheme was also automatically registered at the RM-S. A similar system was set up in the Czech Republic.

\(^{23}\) The first corporate and state bonds were introduced on the market in October 1995, but it was not until 1996 that volumes became measurable – then accounting for less than 0.3 per cent of total turnover (Sk 61 mn; $2 mn). In addition, however, trade was conducted in the very special FNM-bonds (see Section 1.2.1) where total turnover reached Sk 2.5 bn ($81.5 mn) in 1996, equalling 10 per cent of equity turnover. Source: Kniha Faktov 1996, Volume I, p. 13.

\(^{24}\) If one compares the total trading volume for the years in question, i.e. including the trade in corporate and government bonds conducted at the BCPB in 1993-1996 and the bonds traded at the RM-S in 1996
RM-S caters for anonymous trades as well as for direct trades. Anonymous trades are conducted in the form of real-time auctions for a specific security where RM-S a priori calculates a feasible price range, based upon the development of prices in the preceding auctions. 25 Orders are placed either through an order form (normal clients) or electronically (from brokers etc.). Orders can be made at any of its nation-wide network of offices. 26 Clients, in their orders, provide instructions for selling or buying and under what conditions (price-range) they accept a transaction.

25 Initially the RM-S ran only periodic auctions, a market form which, given that it could take up to three weeks for settlement, was outcompeted by the continuous auctions introduced in March 1994 and which for a time were arranged parallel to the periodic auctions, see Table 13. The periodic auctions were completely discontinued as of July 1995.

26 Initially there were some 200 offices connected to the system, a figure which by early 1997 had been reduced to some 60 offices, see Janovic (1997) [interview]

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Table 13. The RM-Systém, 1993-1996

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading volume</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (Sk mn)</td>
<td>43</td>
<td>1,970</td>
<td>18,052</td>
<td>23,806</td>
</tr>
<tr>
<td>Total ($ mn)</td>
<td>1.4</td>
<td>62</td>
<td>607</td>
<td>777</td>
</tr>
<tr>
<td>Total (% of BCPB equity trade)</td>
<td>48.4</td>
<td>36.3</td>
<td>73.0</td>
<td>28.6</td>
</tr>
<tr>
<td>of which Periodic auctions (Sk mn)</td>
<td>43</td>
<td>1,582</td>
<td>100</td>
<td>.</td>
</tr>
<tr>
<td>Continuous auctions (Sk mn)</td>
<td>.</td>
<td>388</td>
<td>17,952</td>
<td>23,806</td>
</tr>
<tr>
<td>of which Anonymous trade (Sk mn)</td>
<td>42</td>
<td>1,083</td>
<td>1,433</td>
<td>2,874</td>
</tr>
<tr>
<td>Direct trade (Sk mn)</td>
<td>2</td>
<td>887</td>
<td>16,619</td>
<td>20,932</td>
</tr>
<tr>
<td>of which registered direct trades (Sk mn)</td>
<td>–</td>
<td>–</td>
<td>14,286</td>
<td>19,372</td>
</tr>
<tr>
<td>registered direct trades (% of total trade)</td>
<td>–</td>
<td>–</td>
<td>79.1</td>
<td>81.4</td>
</tr>
<tr>
<td>Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RMS-100 (% annual change)</td>
<td>–</td>
<td>–</td>
<td>-14.4</td>
<td>18.0</td>
</tr>
<tr>
<td>RMS-Industrial (% annual change)</td>
<td>–</td>
<td>–</td>
<td>-12.8</td>
<td>12.1</td>
</tr>
<tr>
<td>RMS-Fund (% annual change)</td>
<td>–</td>
<td>–</td>
<td>12.3</td>
<td>14.1</td>
</tr>
<tr>
<td>RMS-100 (% cumulative change)</td>
<td>–</td>
<td>–</td>
<td>-14.4</td>
<td>1.1</td>
</tr>
<tr>
<td>RMS-Industrial (% cumulative change)</td>
<td>–</td>
<td>–</td>
<td>-12.8</td>
<td>-2.2</td>
</tr>
<tr>
<td>RMS-Fund (% cumulative change)</td>
<td>–</td>
<td>–</td>
<td>12.3</td>
<td>28.1</td>
</tr>
<tr>
<td>No. of issues (end-year)</td>
<td>566</td>
<td>695</td>
<td>824</td>
<td>878</td>
</tr>
<tr>
<td>Market capitalisation (end-year)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sk mn</td>
<td>52,421</td>
<td>85,103</td>
<td>147,276</td>
<td>195,416</td>
</tr>
<tr>
<td>USD mn</td>
<td>1,706</td>
<td>2,655</td>
<td>4,952</td>
<td>6,376</td>
</tr>
<tr>
<td>as per cent of nominal value of issues</td>
<td>.</td>
<td>50.7</td>
<td>60.7</td>
<td>69.4</td>
</tr>
<tr>
<td>Key indicators</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market capitalisation (% of GDP)</td>
<td>14.2</td>
<td>19.3</td>
<td>28.5</td>
<td>33.9</td>
</tr>
<tr>
<td>Turnover ratio (% of market capitalisation)</td>
<td>0.1</td>
<td>2.3</td>
<td>12.3</td>
<td>12.2</td>
</tr>
<tr>
<td>Value traded (% of GDP)</td>
<td>0.01</td>
<td>0.45</td>
<td>3.49</td>
<td>4.14</td>
</tr>
</tbody>
</table>

Sources: Kniha Faktov (1993-1996); data communicated directly from the RM-S; own computations (for BCPB-data, see Table 12).

Comment: Data in the table include also shares in investment funds.
to take place. Based upon the aggregate supply and demand an auction price is then calculated with the aim of maximising the number of transactions.

The other type of trade facilitated by the RM-S is direct trades, constituting by far the largest share of activity on the market (see Table 13). In this case, the RM-S only functions as a clearing central for executing trades already decided upon by the buyer and seller, who submit their orders for a direct transaction. There are however two types of direct trades, one where also the financial settlement is arranged by the RM-S (direct trades), and one where the RM-S has no control over the actual financial flows (registered direct trades). In the former case, the transaction must be concluded in the price range announced for the anonymous market and the transactions thus help in establishing a market price for the issue in question. In the latter case (registered direct trades), however, there is no way of judging whether the prices reported by the transacting parties have any resemblance with the prices actually paid. A representative of RM-S as an example explained that prices of one crown are sometimes reported for shares that trade at Sk 300 at the anonymous market.

Registered direct trades thus increase uncertainty on the market as is discussed below in Section 1.4.2. Like at the BCPB, these non-transparent registered direct trades predominate, accounting for more than three-quarters of total turnover (see Table 13). The somewhat lower ratio of non-transparent trading at the RM-S as compared to the BCPB is most likely a result of this market being the leading market for retail investors.

* * *

If one compares prices on the BCPB and the RM-S, one can find quite large discrepancies for some of the individual securities (see Table 14). For ZVL Bearings, for example, the maximum price paid in 1994 was 260 per cent higher on the RM-S than on the BCPB. This could be taken as a sign of market imperfections and/or that the officially reported prices may not always reflect actual prices paid. However, the low level of liquidity for many of the issues is an at least as important factor in explaining discrepancies. If one looks at the more traded issues in Table 14 (i.e. VSZ, Ozeta and Slovenske lodenice), the differences are much smaller. Rather, it is for the issues that are rarely traded (e.g. Cosmos and Hydronika) that the greatest discrepancies are found. Such a conclusion is also supported by a comparison of the general indices of the RM-S and the BCPB (RMS-100 and SAX) which

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27 After submission of the order, the RM-S conducts a pre-trade validation with the objective of guaranteeing the coverage of the order. If it is purchase order RM-S “blocks” funds on the deposit account of the buyer in the Slovak Savings Bank. If a sell order a similar “block” is put on the securities offered at the Securities Centre.

28 The auction price is the one according to which “it could be possible to transfer the highest number of securities from the assets of customers who are the beneficiaries of the submitted P-order [sell orders, my remark] to the assets of customers who are the beneficiaries of the submitted K-orders [buy orders, my remark], provided that all these orders would contain only a basic volume instruction...’ See Trading Rules (1996), §42:3c. This can have two basic results: either the purchase price is within the announced feasible price range (“equilibrium”) and then orders will be met to different degrees, or the price is higher or lower than the announced range and then no orders will be met (“imbalance”).

29 See Janovic (1995) [interview].

30 The scale of the problem is illustrated in Figure 17, page 156, where the relative share of the “uncontrolled” direct trades (BCPB) and registered direct trades (RM-S) of turnover is represented.

31 For a detailed overview of the volume traded of the case study firms at the BCPB, see Appendix D, TABLE 21 (p. 334).
shows a satisfactory correlation (0.929) in the 1995-1996 period. A longer-term comparison is however made difficult since it was not until January 1995 that RM-S introduced their own official indexes.

1.2.1. RM-S: the sole organiser of the FNM-bond market

In 1996 some activity was added to the RM-S as the FNM-bonds which were issued as reimbursement for the cancelled second wave of voucher privatisation began to be traded. Since there had to be established a market where citizens could cash in on their bonds, the RM-S had submitted a project to the government proposing to do exactly this. When the project was accepted in early 1996 it made RM-S the sole organiser of this type of bond trade. The system set up was similar to its normal trading system, although with two very important differences: firstly, the minimum price is set according to an agreement between the FNM and the Ministry of Finance; secondly, only a designated group of buyers, approved by the FNM, is allowed to purchase the actual bonds. With such pre-conditions, it is little wonder that the market has been weak.

On 31 December 1995, the Ministry of Finance delivered a list with some 3.3 million voucher holders who were to have a FNM bond transferred to their SCP-account on 1 January 1996. The potential supply side of the market was therefore very strong. The demand side, however, was held back by the licensing system applied by the FNM. By August 1996, the fund had approved a mere 111 buyers to acquire bonds and settle their obligations against the FNM. Indeed the first trading

Table 14. Price volatility on a selection of firms at the BCPB and the RM-S, 1994-1996 (price in Sk per share)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cosmos</td>
<td>1000</td>
<td>3688</td>
<td>975</td>
<td>130</td>
<td>320</td>
<td>160</td>
</tr>
<tr>
<td>Hydronika</td>
<td>1910</td>
<td>2000</td>
<td>500</td>
<td>630</td>
<td>1010</td>
<td>950</td>
</tr>
<tr>
<td>Slovenes lodenice</td>
<td>1350</td>
<td>1356</td>
<td>370</td>
<td>500</td>
<td>1700</td>
<td>1650</td>
</tr>
<tr>
<td>VSZ</td>
<td>740</td>
<td>721</td>
<td>195</td>
<td>212</td>
<td>490</td>
<td>485</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>740</td>
<td>721</td>
<td>195</td>
<td>212</td>
<td>490</td>
<td>485</td>
</tr>
<tr>
<td>ZVL Bearings</td>
<td>40</td>
<td>144</td>
<td>40</td>
<td>28</td>
<td>50</td>
<td>96</td>
</tr>
</tbody>
</table>

Sources: RM-S Database; data communicated directly from the BCPB; own computations.

Comment: Maximum and minimum prices on the BCPB refer to floor trade; for the RM-S the quotations used are those from the continuous auctions.

Three different indices were introduced, RMS-100 which is measuring the development of the 100 most traded issues; RMS-Fond which covers the trade in fund-shares; and, RMS-Industrial which covers trade in industrial shares. All three were set to 1000 on 1 January 1995 (see Table 13). RMS-Fond was discontinued in 1998 as a consequence of the demise of the investment funds discussed in Section 2.7.

TREND Tydzenník o hospodárstve a podnikaní, No. 3, 1996.
TREND Tydzenník o hospodárstve a podnikaní, No. 49, 1995.
TREND Tydzenník o hospodárstve a podnikaní, No. 36, 1996.
day (5 August) was a fiasco with no demand at all,\textsuperscript{37} and it took one week before the first actual transactions took place when 35 bonds were sold. By then, there were 58,350 sell-orders.\textsuperscript{38} The reason for the low demand was of course the stipulated minimum price of Sk 7,500 ($245) which had been established by the government in fear of a political back-lash if market prices turned out too low. This can be compared to the Sk 2,000-4,000 ($65-130) which analysts saw as a clearing price, given the restrictions which existed on the demand side and the high sell-pressure.\textsuperscript{39}

Over time, however, volumes began to pick up as buyers found loopholes to avoid the price-floor. Trades were conducted on the RM-S, which took care of the property transfer, but buyers used the possibility of direct financial settlement with the seller, thus reporting one price and paying the “market price”. As these practices started to be mentioned in the press, they caused a political uproar and the government reacted by making also financial settlement on the RM-S mandatory in October 1996, causing a contraction in trade. Towards end-1996, however, volumes grew since many firms had to pay their debts to the FNM by the year-end,\textsuperscript{40} resulting in a total turnover for 1996 of Sk 2.5 billion ($81.5 mn) (see Table 15).\textsuperscript{41}

It is these companies that are the major winners from the bond-scheme and the market in FNM bonds. The implications of this licensing system was twofold: firstly, prices were kept down by reducing the potential demand; and secondly, that the FNM was given discretionary power as to decide which buyers of state property that would be granted an implicit subsidy. That is, by licensing the buyers the FNM in practice chose which of their debtors that were granted a 25 per cent discount on their debts; and thus, even paying the stipulated minimum price was good business.\textsuperscript{42} For normal citizens, there has been no real alternative to selling at minimum price for those not willing to wait until 2001. Most likely the market would have looked quite different if an amendment proposed by a Democratic Union MP had not been voted down by the ruling coalition. The suggestion was to let all natural and legal persons in Slovakia purchase bonds,\textsuperscript{43} something that may have deepened the market. Likewise, the promise that the FNM would sell shares directly for bonds (see Chapter IV:3.4.1) took so long and when it finally materialised in 1997 it was, as could be expected, not a very enticing offer as most firms were loss-makers who were either in liquidation or going bankrupt.\textsuperscript{44} Thus, quite a different

\textsuperscript{37} At the first day of trading 10,473 sell-orders had been registered, although demand stood at zero, see \textit{TREND Tyzdeník o hospodárstve a podnikaní}, No. 33, 1996.
\textsuperscript{38} See \textit{TREND Tyzdeník o hospodárstve a podnikaní}, No. 34, 1996.
\textsuperscript{39} Janovic (1997) [interview].
\textsuperscript{40} As an example can be mentioned that more than 47 per cent of the total turnover on the anonymous market took place during the last trading session of the period in question, i.e. on 20 December 1996, see \textit{Kniha Faktov 1996}, Volume I, p. 920.
\textsuperscript{41} It can be noted that 1997 turnover was not much higher (Sk 2.9 bn; $87.5 mn) even though trade then spanned over a 12 month period, as compared five months in 1996.
\textsuperscript{42} In 1997 the minimum price was raised to Sk 8,600 ($270) in order to make an allowance for accrued interest on the bonds. However, the rather strict regulations have not prevented buyers from finding new loopholes, in 1996, for example, one could find advertisements offering a GSM-phone in exchange for two FNM-bonds.
\textsuperscript{43} \textit{TREND Tyzdeník o hospodárstve a podnikaní}, No. 40, 1996.
\textsuperscript{44} The long-promised list was published by FNM in the summer of 1997 and included a mere 23 firms. The highest priced share (Sk 250 per share) was for a firm with eight employees (INPROG Poprad, a.s.).
offer from what was proposed by the Democratic Party in July 1996, namely that bonds should be allowed to be used for purchasing the shares in the banks. Interestingly, it is exactly the banks, especially the Savings Bank and the General Credit Bank (Všeobecná Uverová Banka, VUB), that were among the major buyers – in addition to privatised firms indebted to the FNM. One explanation could be that they expect to be able to buy their own shares from the FNM once it is decided to privatise the banks.

1.3. Bratislava Options Exchange

An interesting feature of the Slovak capital market, even though it would turn out to be a short-lived one, is that the first options and futures exchange in Eastern Europe was set up in Bratislava. Already on 2 April 1993, i.e. before trading had begun on the BCPB, the Bratislava Options Exchange (Bratislavská Opcná Burza, below BOB) opened its doors. BOB, which was a joint-venture between a number of Slovak actors and Stockholm-based Option Market System International (OMSI), and an exception as it was one of few not in liquidation. Another “lucrative” offer for normal citizens was to spend their Sk 10,748 ($337) (which their bond was worth in the anonymous auctions arranged by the RM-S, and the bond could not be used to bid for shares in more than one emission) on shares in the engineering company Bardejovské strojárne a.s., in this case they could become the proud owners of 383 shares (Sk 28 a piece). The only problem was that the firm had not produced anything for years and had been in bankruptcy since 1993(!). The auction began on 7 July 1997, although as most shares remained unsold 16 of the firms were again put on offer in the fall of 1997. See ‘Predaj akcií za dlhopis FNM SR: anonymná aukcia’ (1997) and ‘Rozhodnutie generalneho riaditeľa RM-Systemu Slovakia, a.s. E. D97015’ (1997) [both RM-Systém]; TREND Tyždenník o hospodárstve a podnikaní, No. 28, 1997.

Table 15. The market for FNM-bonds, August-December 1996

<table>
<thead>
<tr>
<th>Indicator</th>
<th>No. (pcs.)</th>
<th>Value (Sk mn)</th>
<th>Of total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total volume traded</td>
<td>330,184</td>
<td>2,498.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Anonymous trades (25 trading sessions)</td>
<td>71,677</td>
<td>537.6</td>
<td>21.7</td>
</tr>
<tr>
<td>Direct trades (98 trading sessions)</td>
<td>258,507</td>
<td>1,960.6</td>
<td>78.3</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sold to debtors of the FNM</td>
<td>175,402</td>
<td>-</td>
<td>53.1</td>
</tr>
<tr>
<td>Sold to banks</td>
<td>81,255</td>
<td>-</td>
<td>24.6</td>
</tr>
<tr>
<td>Sold as payment for flat purchase/transfer</td>
<td>1,622</td>
<td>-</td>
<td>0.5</td>
</tr>
<tr>
<td>Sold as payment for additional health insurance</td>
<td>228</td>
<td>-</td>
<td>&lt;0.1</td>
</tr>
</tbody>
</table>

Comment: Prices are omitted for the individual components of the direct trades due to the uncertain nature of the pricing mechanism; only 68 per cent of the direct trades took place with financial clearing at the RM-S and there is, for example, a reported highest price of Sk 75,000 for a bond with a face value of Sk 10,000 (plus accrued interest, see Chapter IV.3.4.1) [sic]. On the anonymous market, however, all transactions were reported to have taken place at the legally stipulated minimum price of Sk 7,500.

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Comment: Prices are omitted for the individual components of the direct trades due to the uncertain nature of the pricing mechanism; only 68 per cent of the direct trades took place with financial clearing at the RM-S and there is, for example, a reported highest price of Sk 75,000 for a bond with a face value of Sk 10,000 (plus accrued interest, see Chapter IV.3.4.1) [sic]. On the anonymous market, however, all transactions were reported to have taken place at the legally stipulated minimum price of Sk 7,500.

An interesting feature of the Slovak capital market, even though it would turn out to be a short-lived one, is that the first options and futures exchange in Eastern Europe was set up in Bratislava. Already on 2 April 1993, i.e. before trading had begun on the BCPB, the Bratislava Options Exchange (Bratislavská Opcná Burza, below BOB) opened its doors. BOB, which was a joint-venture between a number of Slovak actors and Stockholm-based Option Market System International (OMSI).
soon became the most popular organised market among major traders.\textsuperscript{49} Trading on the BOB was daily, and took place in stocks and forward stocks (one day-, three- or six-month futures).\textsuperscript{50} The most successful product of BOB was the somewhat peculiar one-day futures, introduced on 1 July 1993, which soon accounted for more than 90 per cent of traded volume.\textsuperscript{51} This was a unique instrument, serving as an almost direct substitute for the underlying securities.\textsuperscript{52} Just like on the BCPB all trade was conducted through member-brokers.\textsuperscript{53} However, unlike on the BCPB (and the RM-S), all trades on the BOB were anonymous, a fact which boosted confidence in the BOB as a credible price setting mechanism.

Volumes were of course very low in the early days of the BOB, with a mere Sk 33 million ($1.07 mn) traded in 1993. In 1994, as the one-day futures began to attract some serious interest and the market was on its way up (see Figure 15) volumes, however, also picked up; resulting in a total traded volume for 1994 of Sk 1.7 billion ($53 mn), equalling 219 per cent of the volume of equities traded on the floor (anonymously) at the BCPB in 1994 (cf. Figure 16). The vast majority of the trades on the BOB was exactly in the one-day futures, available for some 80 equity

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure15.png}
\caption{Price (index) and turnover (Sk mn) developments at the Bratislava Options Exchange, 1994}
\end{figure}

\textbf{Sources:} Data communicated directly from the BOB; own computations (for BCPB-data, see Table 12).
\textbf{Comment:} As a consequence of the sudden closure of the BOB in 1995, corresponding data have been impossible to attain for 1995; the SAX-index was recalculated, first to show its monthly average, then re-calculated again to get the same starting point as the BOB-index for January 1994.

\begin{table}[h]
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\begin{tabular}{|c|c|c|c|}
\hline
\textbf{Year} & \textbf{Sk mn} & \textbf{Sk mn} \\
\hline
1993 & & & \\
1994 & & & \\
\hline
\end{tabular}
\caption{Turnover at the BOB and BCPB for 1993-1994}
\end{table}

\begin{table}[h]
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\begin{tabular}{|c|c|c|}
\hline
\textbf{Year} & \textbf{SAX index} & \textbf{BOB index} \\
\hline
1993 & & & \\
1994 & & & \\
\hline
\end{tabular}
\caption{Index developments at BOB and BCPB for 1993-1994}
\end{table}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
\textbf{Year} & \textbf{Sk mn} & \textbf{Sk mn} \\
\hline
1993 & & & \\
1994 & & & \\
\hline
\end{tabular}
\caption{Turnover at the BOB and BCPB for 1993-1994}
\end{table}

\textsuperscript{50} Although being an options and futures exchange BOB was in its 8 October 1992 license from the Ministry of Finance also granted the right to conduct trade in shares.
\textsuperscript{51} See Fisher (1994b), pp. 34-35.
\textsuperscript{52} By November 1994 BOB was pursuing trade in 10 different stocks on 6-month forwards, and trade in one-day forwards was conducted in no less than 84 different stocks, see Walter (1994) [interview].
\textsuperscript{53} In October 1994 there were 45 members, all of them either banks brokerage companies or investment funds, see Burzián, October 1994.
issues. Figure 15 also illustrates the close correspondence between the official index of BOB and that of BCPB (SAX); when re-calculated they show a correlation coefficient of 0.946.54

The expansion of BOB continued in 1995, but the exchange became a victim of the legislative changes initiated by the new Meciar-government. In December 1994 the Ministry of Finance declared the one-day futures to be illegal, requiring the BOB to cancel this instrument by February 1995. BOB did not comply with this order, and in May the Ministry of Finance threatened that they may revoke the license of BOB.55 The ban on one-day futures was then incorporated in the amended Securities Act, which was approved in mid-July and became effective as of 15 August. The amendment, among other things, set 15 days as the minimum period of any futures contract.56 With such a codification, the BOB could no longer avoid the demands from the Ministry of Finance, especially given that another provision of the Securities Act stated that all exchanges had to re-apply for their licenses. Thus, 12 October 1995 was the last day of trading in one-day futures. In an attempt to keep some business, the BOB tried to promote other more traditional options instruments, for example two-month options and fixed-term forward markets, but also introduced a new six-month American call-option.57 However, these meagre attempts to appease the Ministry of Finance was an example of too little and too late. On 2 November 1995 the Ministry of Finance published its decision to strip BOB of its license to act as public market, and from 13 November BOB ceased trading.58

* * *

The reasoning at the Ministry of Finance that led up to this decision can only be speculated about. However, the closure should not be seen as a move against derivatives trading per se, since the RM-S when it re-applied for its license was also granted exactly the same right to pursue trade in derivatives instruments. Rather, the reasons must be looked for with an eye to what the BOB had developed into during its short period of existence – namely the de facto spot market in Slovakia. Even though the volumes traded were small in absolute numbers, they did pose a serious threat to the BCPB. Already in 1993, the turnover at the BOB (Sk 33 mn) equalled 180 per cent (!) of the amount of equity traded on the floor (anonymously) at the BCPB. This figure rose in 1994 (Sk 1.7 bn) and 1995 (Sk 1.2 bn) to 219 and 299 per cent, respectively. Thus, as is illustrated in Figure 16, the BOB developed into the dominant spot-market – even though trade was in one-day futures – holding close to half of the spot-market transactions in 1993-1995.59 The BOB was also ef-

54 This correlation is even slightly better than that between RMS-100 and SAX for the 1995-1996 period (0.929), a period when markets were definitely more mature.
57 Reuters News Service, 10 October 1995. These options gave the holder the opportunity to exercise the option any time during it life span and were offered in 77 stock corporations, see CTK-Business News, 16 October 1995.
58 TREND Tyždenník o hospodárstve a podnikaní, No. 47, 1995. The sudden withdrawal of the license and the fact that SCP disconnected the exchange without any prior notice resulted in BOB owing clients some Sk 5 million ($168,000) for unfinished trades, see TREND Tyždenník o hospodárstve a podnikaní, No. 50, 1995.
59 The exact figures were 35, 48 and 39 per cent of total anonymous equity trading in 1993, 1994 and 1995, respectively (on data and calculations, see note for Figure 16); in conjunction with this should also
effectively the price-setter on the market, its prices often being taken as guidelines for the extensive off-market trading. This situation ran contrary to the expressed desires of the Ministry of Finance to concentrate trading – one positive change with the 1995 amendments to the Securities Act was for instance the ban on off-market trading (cf. Section 1.4.1).

The long-term consequences of the closure of BOB are difficult to assess. At the very least, the decision contributed to the general atmosphere of uncertainty that descended over the financial markets throughout 1995, when the market-index slipped considerably. Such uncertainty among market actors may also have been a contributing factor for a growing scepticism concerning the impartiality of capital market regulation. Moreover, the closure meant that a lot of the experience and human capital built during its existence was lost, something which representatives both of the RM-S and the BCPB regretted when in 1997 they were planning to re-launch derivatives trading. On the more positive side, however, it should be admitted that there was at least some formal improvement with regard to liquidity on the remaining two organised markets.

Figure 16. Anonymous trade at the three organised markets, 1993-1995

Source: Computations on data from the BCPB (see Table 12), the RM-S (see Table 13) and the BOB (directly communicated for 1994) and data communicated directly from TREND Tyzdeník o hospodářství a podnikání (on BOB in 1995).

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be remembered that in 1995 trade was only conducted up to mid-October – figures which are compared to full-year figures for the BCPB and the RM-S.

SAX declined by 28.2 per cent in 1995, the corresponding figure for RMS-100 was -14.4 per cent.

See Janovic (1997) [interview]; Kuníková (1997) [interview]. In addition it may be noted that it illustrated in a very steadfast manner the failure of the state to safeguard private property rights, BOB was after all a private venture where the property rights of the owners were severely violated.
1.4. Problems and prospects

As discussed in the analytical framework, the functioning of a market is dependent upon the interaction between a large number of economic agents, organisations and institutions. To a large extent the institutional set-up, i.e. the type and combination of formal and informal institutions, is critical in shaping the incentive structure facing economic agents. Consequently, the transaction costs connected to a certain market – and thus, in the final analysis, its “performance”, will be greatly influenced by the institutional set-up. Hence, when attempting to assess the development of the Slovak capital market in 1993-1996 it should be acknowledged at the outset that it was an achievement in and by itself that so soon after the collapse of communism there had been erected one of the preconditions of a functioning market. After all, much of the formal institutions and infrastructure necessary for conducting trade in equity issues, bonds and (to some extent) also derivatives had been created. At the same time, it should be evident from the above that the market was plagued by a number of problems, which together make it uncertain to what extent it fulfilled the functions normally connected to a stock market, for example to evaluate firm performance and establish equity prices, to mobilise savings, to cater for risk spreading etc. Rather, the Slovak capital market as depicted above can crudely be described as being volatile, overissued, underregulated, non-transparent and illiquid. These characteristics of the stock market will below be discussed and qualified.

1.4.1. Illiquid and/or “overissued”?

The problem of liquidity and “overissuance” are closely connected. To illuminate the relationship it is useful with a regional and international comparison, illustrating the state-of-affairs in 1996. Table 16 (p. 153) shows that there was a marked difference between countries which deployed mass privatisation programmes (Slovakia and the Czech Republic) and those that, at least initially, did not (Poland and Hungary) with regard to the number of equity issues on the market. In addition, the large number of equity issues tradable on the market in Slovakia and the Czech Republic is best characterised as “overissuance”, given the general level of development. This is highlighted by comparing these markets to the well-developed Stockholm Stock Exchange (SSE) which had “only” 229 issues on the market at end-1996. Further, and also on a general level, there seems in transforming economies to be an inverse relationship between the number of issues and the turnover ratio, i.e. the higher the number of issues – and thus market capitalisation – the thinner is the market, i.e. liquidity. In part, however, this is also attributable to the method chosen for privatisation in Slovakia and the Czech Republic which meant that a vast number of equity issues were put on a market at once, without the concurrent inflow of “real” capital since these firms were “paid for” by means of investment vouchers. Thus, as was pointed out in the introductory section, market capitalisation

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62 See Chapter II:4, page 34 ff. and Section 1, page 138.
63 The Stockholm Stock Exchange was the seventh largest in Europe according to 1996 turnover; of the 229 issues 128 were on the “A-list” and 46 and 55 on the “OTC-list” and “O-list”, respectively. Source: Stockholm Stock Exchange (1997).
64 Cf. EBRD (1998a), pp. 97-98.
in transforming economies says more about the method and extent of privatisation than it does about to what extent equity historically has been attracting capital investments, as in the case of the SSE.

Returning to the specific Slovak case and the problem of liquidity, it is necessary to probe deeper into the institutional set-up of the market to get a clearer picture. In fact, the picture painted in Table 16 for 1996 does not look very problematic at all with a turnover ratio only slightly lower than that of the SSE – and for the listed firms on the BCPB even higher than that of the SSE.\textsuperscript{65} However, to begin with, looking back to the 1993-1995 period, the turnover ratios were much more lacklustre for the BCPB (see Table 12, p. 141), and it was really not until 1996 that the

\begin{table}[h]
\centering
\caption{Stock markets in 1996, a regional comparison}
\begin{tabular}{lcccccc}
\hline
\textbf{Indicator} & \textbf{Slovakia} & \textbf{Czech Republic} & \textbf{Poland} & \textbf{Hungary} & \textbf{Sweden} \\
\hline
Market capitalisation ($, bn) & 6.0 & 19.9 & 8.9 & 5.6 & 251.7 \\
Turnover ($, bn) & 2.7 & 9.2 & 11.1 & 3.2 & 136.9 \\
\multicolumn{5}{l}{\textbf{No. of tradable equity issues}} \\
Total & 970 & 1,670 & 83 & 45 & 229 \\
"listed" & 21 & 96 & 66 & 45 & 128 \\
"unlisted"\textsuperscript{1} & 949 & 1,574 & 17 & . & 101 \\
\hline
1996 (12/95-12/96) & +15.8 & +26.7 & +189 & +170.4 & +38.2 \\
1996 (12/92-12/96)\textsuperscript{3} & +78.0 & +63.0 & +1,378 & +364.1 & +159.9 \\
\multicolumn{5}{l}{\textbf{Key indicators}} \\
Mkt. capitalisation (% of GDP) & 32.0 & 35.2 & 6.6 & 12.4 & 96.9 \\
Turnover ratio (% of mkt. cap.) & 45.2 & 46.2 & 124.0 & 57.1 & 54.4 \\
Value traded (% of GDP) & 14.4 & 16.2 & 8.3 & 7.1 & 52.4 \\
\hline
\multicolumn{5}{l}{\textbf{Memorandum items}} \\
Population & 5.4 & 10.3 & 38.6 & 10.2 & 8.8 \\
CPI 1996 (%-chg., Dec.-Dec.) & 5.4 & 8.6 & 18.5 & 19.8 & -0.4 \\
CPI 1993-1996 (ibid.) & 57.9 & 51.9 & 156.6 & 125.6 & 8.5 \\
GDP 1996 ($, bn) & 18.8 & 56.6 & 134.4 & 45.2 & 261.2 \\
Avg. ex-rate 1996 (local curr/$) & 30.6 & 27.1 & 2.7 & 152.6 & 6.7 \\
\hline
\end{tabular}
\end{table}

\textit{Sources:} BCPB Rocná statistika 1996; BCPB Vyrocná správa 1996; Stockholm Stock Exchange (1996); EBRD (1998a); SCB [on-line database]; International Financial Statistics; data communicated directly from the the Bratislava Stock Exchange [BCPB], the Prague Stock Exchange [PSE], the Warsaw Stock Exchange [WSE] and the Budapest Stock Exchange [BSE].

\textit{Notes:} \textsuperscript{1} Note that the 17 issues on the “Parallel market” at the Warsaw Stock Exchange fulfilled disclosure requirements and liquidity requirements significantly stricter than those for the “unlisted” markets in Bratislava and Prague – the same also goes for the firms traded at the SSE’s “OTC-list” (46 issues) and “O-list” (55 issues), respectively, which above also are included in the group of “unlisted” issues. \textsuperscript{2} The indices used for the five markets are, in order, SAX (BCPB), PX50 (PSE), WIG (WSE), BUX (BSE) and SX-General (SSE). \textsuperscript{3} Note that the SAX and the PX50 have 14 September and end-September 1993 as bases, respectively.

\textit{Comment:} All figures refer to equity trading only; the figures for Slovakia, the Czech Republic and Sweden include also trade in investment funds/companies.

\textsuperscript{65} At the SSE the turnover ratios were 54.0, 61.8 and 60.0 per cent for the three lists (A, OTC and O), respectively. At the BCPB the corresponding figures were 92.2 and 30.5 per cent for “listed” and “unlisted” firms, respectively. That is, at the SSE the main list (A-list) had the lowest turnover ratio while at the BCPB the listed firms had a turnover ratio more than three times higher than those unlisted.
figures improved. This fact is explainable primarily in terms of a regulatory and institutional failure.

Firstly, the authorities failed to establish a trading monopoly for securities. The granting of licenses to two different spot-markets, in addition to a derivatives market which functioned as a *de facto* spot-market, meant that there were three “official” exchanges fighting for market shares and thus dividing the little new capital available on this emerging market between three marketplaces. As an illustration, one may add the turnover volumes of BCPB and the RM-S for the 1993-1996 period, and arrive at quite different turnover ratios for the “market” as such since both exchanges were conducting trade in the same equity issues (see Table 17). If one in addition to this adds the volume traded at the BOB, since their underlyings were basically the same, the result is rather staggering with a “theoretical” turnover ratio of 9.3 and 27.8 per cent in 1994 and 1995, rather than the 5.6 and 15.6 per cent registered for the BCPB alone. However, a proper market evaluation of firms requires real rather than “theoretical” liquidity.

A second aspect of this lack of monopoly for trading, and initially much more serious, is that there was not even a monopoly for trading on any of these marketplaces. In fact, until the fall of 1995 the vast majority of all trades took place outside of any of the above discussed exchanges. Approximately 80 per cent (!) of all trades were concluded directly between buyer and seller and then only registered at the SCP (Central Securities Register), thus draining almost all available capital off the official markets. This fourth “market” for trading, or rather “off-market” trading, was made possible because the SCP was obliged to register transfers of

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>BCPB</td>
<td>53.9</td>
<td>0.10</td>
<td>59.7</td>
<td>5.6</td>
</tr>
<tr>
<td>RM-S</td>
<td>26.1</td>
<td>0.05</td>
<td>21.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Total spot-markets</td>
<td>80.1</td>
<td>0.14</td>
<td>81.3</td>
<td>7.6</td>
</tr>
<tr>
<td>BOB</td>
<td>19.9</td>
<td>0.04</td>
<td>18.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Total all markets</td>
<td>100.0</td>
<td>0.18</td>
<td>100.0</td>
<td>9.3</td>
</tr>
</tbody>
</table>

Source: Computations on data from the BOB, the BCPB and the RM-S.
Comment: Turnover ratios have been calculated as turnover as per cent of market capitalisation of the BCPB for each exchange; note that turnover for BOB in 1995 only covers the period up to approximately mid-October.

67 Exact figures for the whole period are impossible to obtain. However, in 1993 the SCP released figures which show that 91.2 per cent of the number of shares transacted during the year had been traded off-market, see *CTK-Business News*, 19 January, 1994. For the remaining period no such figures were published. However, in 1995 *Reuters* obtained figures for the week ending 6 of February 1995 which put off-market trading at 86.8 per cent of the number of shares traded. The remaining 13.2 per cent were divided between the three organised markets, RM-S (6.1%), BOB (4.7%), and BCPB (2.4%). Source *Reuters News Service*, 2 February 1995. This is quite in accord with estimates by market analysts. A BCPB official, for example, estimated it to have been ‘more than 60 and less than 90 per cent’, see Kuníková (1995) [interview].
ownership of securities irrespective of how, where or when the transaction took place. The main actors on the “off-market” were the institutional investors, brokers and investment funds that by doing this could avoid various fees and delays from the official exchanges. Further, and more importantly, the lack of transparency was both a cause and consequence of this type of trading. In effect it served as a very efficient vehicle for capitalising insider-information since one did not have to share this information by giving price-signals to other market actors. Also, for many actors it represented an ideal form of trading in their pursuit of secretly gaining large stakes in various firms (cf. discussion in Section 2.5, p. 184 ff.).68 However, in 1995 when the Securities Act was amended for the sixth time, it was decided to allow only trade mediated by any of the official exchanges.69 This prohibition of trades registered directly at the SCP is also an important factor in explaining the drastically increasing turnover ratios recorded in 1995 and 1996 on the official markets.

Although the rules were finally changed, it is still puzzling that the government sanctioned this unofficial trade for so long by accepting that the SCP registered transactions other than those carried out on one of the official exchanges. This is all the more confusing since the RM-S had been there all along to cater for the minor shareholders. Part of the explanation may be that the existing exchanges were engaged in such a fierce battle among themselves for market shares that they could not overcome the free-rider problem in order to put up a united front against the authorities. Another, and probably more plausible explanation, is that there were influential groups, for example the industrial groups and large investment funds aiming to gain control over certain companies, who had a lot to benefit from the continuation of off-market trading.

1.4.2. Transparency of the market

If the increased liquidity witnessed in 1995 and 1996 should have any positive effects with regard to risk spreading and firm evaluation, it is necessary that trading is transparent. In this respect, though, the institutional reforms of 1995 were far from sufficient, since the vast majority of trade on the two official spot-markets has been conducted either as “direct trade” (BCPB) or “registered direct trade” (RM-S). Neither of these types of trading help in establishing a market evaluation of equity, as the real prices paid in these transactions are not known. The development is depicted in Figure 17 where the two lines illustrate the percentage share of direct trades at the BCPB for listed and unlisted equity, respectively, in 1993-1996. The columns, in turn, depict the dominance of registered direct trades at the RM-S from their introduction in 1995. The somewhat lower ratio of non-transparent trades on the RM-S is, as mentioned, most likely a result of this market being the leading one with regard to retail investors. The figure nevertheless shows that the non-transparent direct trades predominate, on the RM-S as well as the BCPB.70 This is

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68 Also many small shareholders found their way to this market, often recruited through advertisements in the dailies and attracted by the uncomplicated manner of transactions.
69 See the Securities Act (Act no. 600/1992), Article 8, para. 3.
70 It may be noted that the slight increase in anonymous trades at the BCPB in 1996 was a temporary phenomenon; in 1997 the percentage of anonymous trades of total turnover (which grew by 44 per cent in current prices) had once again been reduced to 3.6 per cent. Source: Computations on BCPB-data.
indeed a disturbing fact since there is no information flowing from these types of transactions — nobody knows what price is actually paid, and thus the transaction offers little information to other market participants.\footnote{This, in turn, opens for the fraudulent behaviour of investment fund managers since it meant that they could bypass the requirement that investment funds cannot buy shares at prices higher than market prices or sell shares at prices lower than market price, see \textit{Law on investment companies and investment funds}, Article 17, para. 6.} This fact should also be kept in mind as a very important qualification when comparing liquidity between different markets, as was done in the previous section.

The conclusion to be drawn is that moving the transactions from the “off-market” to the official exchanges of course formally meant increased liquidity, but it did not make much of a qualitative difference with regard to transparency, since the majority of all trade is still in the form of trades where there is no proper monitoring of prices. Also, as long as the major traders themselves continue to act in a way which serves to reinforce this non-transparency, which they do (see Section 2.5), it seems difficult to reach a tenable solution. A problem is that the two remaining exchanges have continued to fight for market shares, thus offering the influential market actors what they desire, i.e. mechanisms whereby they can conduct their block-trades with a minimum of insight from other market agents. The lack of “real” liquidity and the lack of transparency are closely interrelated and self-reinforcing in the sense that the non-transparency works as a strong disincentive for new investors with fresh capital to enter the market. Thus, in the absence of a trading monopoly, rules which require all trades not only to be mediated on the property side by the exchange, but also that financial settlements are through the ex-

\footnote{\textit{Law on investment companies and investment funds}, Article 17, para. 6.}
change, and mechanisms in place to enforce these rules, it seems very difficult to overcome this problem.

Another contributing factor to the non-transparency of the Slovak capital market is the dismal state of disclosure. Disclosure can be divided into two parts, both important to the “performance” of the capital market but neither of which was functioning properly in Slovakia. They are, firstly, disclosure by firms of financial and operating indicators as well as other price-sensitive information, and secondly, information about market activities and current ownership and control-structures of firms. Beginning with firm disclosure, there has among Slovak managers been prevailing a general and widespread reluctance to provide the market with timely and relevant financial data. Managers often regard such information, which in more developed markets is generally and widely available to all market analysts, as “business secrets”. In such an environment, the formal disclosure rules laid down by the BCPB for its Main and Junior markets (see Section 1.1) have been rather “toothless”. Not that the rules in and by themselves have been flawed – rather the problem has been their very limited applicability and to some extent also their lack of enforcement. With a mere 21 firms (13 on the Main market and 8 on the Junior market) of 970 in 1996 being subject to these disclosure rules, their effect has been limited. A BCPB official explained that its listing department had, in an effort to raise the quality and attractiveness of the exchange, put great effort into persuading managers to have the firms listed. Managers, however, were very reluctant to use the stock exchange for raising capital – partly because of too little knowledge about the possibilities, but also partly because of a reluctance to give up influence (information) to outsiders. Thus, the vast majority of firms traded on the market are only obliged to provide the statutory annual reports – and, not even this information is available for many issues.

Regarding the other aspect of disclosure, i.e. information about market activities and ownership and control-structures, it has already been illustrated that the quality of information flowing from the organised market could be better. As for disclosure of ownership and control, the situation in the period of study was probably even worse. Formal rules have either been lacking and/or are badly enforced. It is telling that even a representative of the RM-S complained that they only had dated information to provide to clients. He explained that of the total amount of some 800 firms there were only about 50-70 firms that provided good up-to-date information. Further, even if the nominal and up-to-date data on ownership were available, it is still hard to see through the web of cross-ownerships and alliances between different groups. One much publicised example was when the steel-maker VSZ (a case study firm, see Chapter VI and Appendix A) in 1996 tried to take control of one of the larger banks in Slovakia (Investičná a Rozvojová Banka, IRB [the Investment and Development Bank]; see Chapter VI:4.1). In order to avoid the Banking Act regulations, which require NBS-approval when acquiring more than a 15 per cent stake in a bank, a whole range of companies related to VSZ were set up.

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72 Kuníková (1995) [interview].
73 It took until early 1996 before the RM-S stopped listing the firms which did not even provide this basic financial data to the exchange, see Janovic (1997) [interview].
74 Janovic (1995) [interview].
to buy IRB-shares. Together, they managed to gain a 43.7 per cent stake in the bank before there was any response from the supervisory authorities. The extent of their holdings was only revealed when an extraordinary general meeting was called in August 1996 and VSZ put three of their own people on the Supervisory Board—supported by shareholders holding 43.7 per cent of the equity. VSZ at the time held 14.64 per cent of equity; ARDS held 13.46 per cent;75 the remaining 15 per cent were held by various companies acting on behalf of VSZ, but none of them holding in excess of five per cent (and thus not officially reported by the SCP). To make matters even more complicated and non-transparent, some of the equity had been purchased as materialised shares—making it impossible for anyone not having access to the banks’ register to find out who the owners were (see Section 1.4.3).76 These cross-holdings are however not only used in cases where there, as in the case of the banking sector, exists a formal cap on holdings. They are also, and much more frequently, used in order to avoid the takeover regulations introduced, stating that once reaching the 30 per cent threshold the owner has to make an offer to buy out remaining shareholders.77

1.4.3. Misdirected regulation of the market

Given that much of the discussion above has directly or indirectly focused on regulatory issues, it will suffice in this final section to point to a couple of examples and then reiterate some of the main points from above. The basic regulation of the securities market was contained in the Securities Act, adopted in 1992.78 Between then and end-1996, the act was amended no less than seven times, something that could be taken as a sign of prudent regulation. And indeed, there are many markets that are less regulated than the market in Slovakia.79 However, in Slovakia there has been a tendency to try to directly intervene in the workings of the market rather than to try to establish an institutional set-up which in some sense is self-reinforcing and aims at protecting those with the least influence, i.e. the minor shareholders. Rather, it is not unusual to see the direct input from various influential interest groups incorporated into amendments, to the detriment of other groups with less political clout and often, also, to the detriment of the market in general.

One prime example of this was the seventh amendment to the Securities Act, proposed by an MP for HZDS. According to the amendment, it would be at the discretion of the issuer to decide whether to issue physical (materialised) or dematerialised securities; also, physical securities would not have to be traded at the official markets (!).80 The implications would have been that trade in such issues would

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75 ARDS is closely related to top management in VSZ, and co-owner of VSZ, see page 224.
76 Cf. TREND Týždenník o hospodárstve a podnikaní, No. 41, 1996; TREND Týždenník o hospodárstve a podnikaní, No. 6, 1997. After an appeal from the NBS in October 1996, ARDS indeed reduced their holdings in November— but only by transferring the shares to other companies associated with ARDS (!) and dividing the block in shares less than five per cent of equity.
77 See Securities Act (as amended), Section 79a, para. 2, which states that ‘[a] legal entity or a natural person may not come into possession of more than 30 per cent of publicly negotiable shares from the same issuer in a manner different from a public promise which is, as under this Act, an offer to buy all publicly negotiable shares of the issuer…’
78 Cf. OECD (1993), p. 73.
80 See TREND Týždenník o hospodárstve a podnikaní, No. 46, 1996.
have been totally out of control and that it would be impossible to get any kind of relevant ownership information. The main beneficiaries of such a regulation would be those owners preferring to be anonymous. The amendment was nevertheless initially passed in early November 1996 and caused an outrage among representatives from the organised markets. Also, the State Secretary at the Ministry of Finance, Jozef Magula, was angered and lined up with opposition MPs in his criticism of the changes, and pointed out that he was convinced that the amendment was in the interest of groups wanting to remain anonymous.\textsuperscript{81} He later resigned in response to what he thought of as a lack of support from his own party. Commenting on the amendment, he said to the government daily Slovenska Republika that:

\begin{quotation}
'\[u\]nfortunately, we have to witness the proposals from which will benefit only narrow groups of large entrepreneurial subjects. The amendment is supposed to ensure their interests against the rights of small shareholders. I have not been successful in guaranteeing those rights, so I am going to require protection of small shareholders at the European Court for Human Rights. In Slovakia, these rights are supposed to be guaranteed by the constitution, but unfortunately, small shareholders are being hurt illegally.'\textsuperscript{82}
\end{quotation}

The amendment was later vetoed by President Kovac and returned to Parliament on 20 November with suggestions for changes that would prohibit issuers from withdrawing shares from public trading.\textsuperscript{83} The milder version was later adopted but the implications for transparency have already been mentioned in the example of VSZ trying to buy IRB.\textsuperscript{84} An implication of the regulatory change is that it again opened for off-market trading, since physical securities were excluded from the requirement to be traded only on official markets. Further, the amendment put investment funds at a disadvantage as they were only allowed to own publicly tradable shares. Above all, though, the amendment illustrates how interest groups have been trying to dictate national legislation, and quite successfully so in many instances. In this context, it can be seen as a problem that there was established no "independent watch-dog" to supervise capital market activities. Instead it was the capital market section at the Ministry of Finance which was the main supervisor of the capital market; something which may have helped to give supervision a certain political slant and also non-transparency.

The above is not meant to imply that all regulations have been misdirected. Many of the changes have indeed been for the better. The sixth amendment in August 1995, which required all trades to go through one of the official exchanges, was a step in the right direction in that it at least showed an ambition, even if half-hearted, to do away with off-market trading. However, many issues were not addressed by legislators. For example, there were no efforts made to improve disclo-

\textsuperscript{81} Cf. \textit{Trend Tyzdennik o hospodarske a podnikani}, No. 46, 1996.  
\textsuperscript{82} State Secretary Jozef Magula, as quoted in \textit{Trend Tyzdennik o hospodarske a podnikani}, No. 46, 1996.  
\textsuperscript{83} \textit{Trend Tyzdennik o hospodarske a podnikani}, No. 48, 1996.  
\textsuperscript{84} IRB at the time already had 15 per cent of its outstanding equity in the form of physical securities; in later investigations it turned out that ARDS, owning 13.46 per cent in dematerialised equity, also held some 6 per cent in physical securities, making for a total of almost 19.7 per cent, see \textit{Trend Tyzdennik o hospodarske a podnikani}, No. 41, 1996.
sure rules from the central authorities (see also Chapter VI:4.4). Likewise, and underlining the neglect shown minor investors, there has been no effective rules on insider trading. Officially, of course they exist, but they are not enforced. As will be shown in the following section on investment funds, this has had great implications for minor shareholders.

* * *

Taken together, it is possible to identify the market as characterised by very high transaction costs. The non-transparency of the market served to drastically increase the value (and necessity) of insider-information. The market in many respects developed into a “playground for privileged insiders”. This, in turn, has kept many investors away and thus reduced liquidity. For firms this further lessens the incentives to provide information to the market (and thereby increase transparency) in an effort to perhaps raise capital and/or to support the prices of its shares. Furthermore, as long as the market can give no proper evaluation of firm performance, incumbent management can with a good conscience shrug off falling prices of their shares and explain it with the “general state of the market” rather than with firm performance. This is one way that potential corporate governance mechanisms have been undermined. In the final analysis, these developments points to what was discussed in Chapter II:2, namely that many formal institutions may be established by the stroke of a pen, while the establishment and development of other complementary institutions is much more of a long-term process where the self-interest of the various actors is an important explanatory factor. With this, we turn to one of the main actors on the Slovak capital market.
2. Investment funds: the rise and fall

The most influential actors on the market have been the investment funds and the investment companies that were established as a consequence of the first wave of voucher privatisation. The investment funds as institutions were an innovation of the market, evolving more or less spontaneously in response to the voucher privatisation scheme. They were expected by the government although not government-initiated in any sense. In total, 164 such funds were established in Slovakia, most of them with an aim to reap part of the profits resulting from the subsidised method of privatisation chosen for the first wave. Under conditions of a general lack of business information and an expected average book value of between Kcs 80,000-160,000 per participant ($2,830-5,660) they saw the opportunity to act as intermediaries. They were also the ones who attracted an initially reluctant public by promising a fixed minimum return of for example Kcs 10,000 ($350), thus making sense of the programme to the average citizen. Harvard Capital & Consulting (HC&C), run by young Viktor Kozeny, was the first investment group to introduce such offers (see Section 2.1).

Following massive advertising campaigns these investment funds were entrusted to invest 70.5 per cent of the investment points on behalf of the population in Slovakia, thus creating a basis to become the main actors on the evolving stock market. Further, like in Czechoslovakia as a whole, there was a great concentration among funds, and the five biggest funds/companies accounted for an estimated 41.3 per cent of the Slovak bidding “capital” in the first wave, compared to 29.5 per cent invested directly by individuals.

This concentration implied not only that funds would be important on the stock market but also, and more importantly, that they created a platform from which they could potentially become important agents in improving corporate governance. In fact, a goal of voucher privatisation had been to involve these funds in the governance of firms, although they were not expected to become as popular as they did. However, in Slovakia, this concentration was not unequivocally welcomed.

These investment funds were mentioned in April 1990 in a memorandum by the Ministry of Finance; also, they were accommodated for in the Act on the conditions of transfer of state property to other persons, Article 25, para. 1b.
These expectations were based on the initial government estimates of 2-4 million participants – something that the actual existence of the funds would help to change, thereby lowering the average value/voucher-booklet to approximately Sk 35,000 ($1,240).
That is slightly less than in the Czech Republic where the funds got 72.2%, making a nation-wide average of 72%, see Svejnar and Singer (1994), p. 57.
This was slightly lower than the concentration in the Czech Republic where the five largest held 51 per cent of outstanding points (see Table 18, p. 164); on the concentration on the nation-wide level, see Table 10 on page 116.
In the official information handbook, issued by the Federal Ministry of Finance, it was for example in the summary recommendations stated that ‘[w]e recommend the transfer of investment points to IPFs only for those HICs [DIKs, my remark] who are truly helpless…’, see Kupónová privatizáce. Informační príručka (1991), [Summary Recommendations; point a]; on the involvement of investment funds per se, see Kupónová privatizáce. Informační príručka (1991), Section 1.6.
Rather, their strong position would, from 1995 onwards, be seriously challenged by other interests.

As can be seen in Figure 18, the phenomenon of investment funds was short-lived in Slovakia, at least in their original form. The number of funds rose quickly in 1992 and 1994 but their decline was also equally fast.\(^{90}\) Looking at the net asset value (NAV) of funds the same story is told. Total NAV of funds peaked in 1993 at Sk 51.4 billion ($1.55 bn), and dwindled to a mere one-fifth three years later. This section will thus tell the story about the rise and fall of Slovak investment funds and at the same time analyse the forces that led to their demise.

* * *

The section on investment funds commences with a short presentation of the four investment companies chosen for the case study with regard to their establishment, organisation and relative size in terms of investment points collected (Section 2.1). Basic data about the funds that they established are also given. In conjunction with this, the legal regulation of investment funds and investment companies is noted (Section 2.2). After this, attention is turned to a short comparative analysis of their portfolio strategies (Section 2.3). This set the scene for the next topic covered in the section, namely a discussion of how funds used their potential influence with regard to governance (Section 2.4). There will also be analysed to what extent investment funds managed to live up to expectations with regard to the initial hopes about them playing an active role in corporate governance. The following section connects to the above discussion about the Slovak capital market, discussing the activities and contribution of investment companies to the development of the stock exchange.

\(^{90}\) The large increase in the number of funds between 1993 and 1994 is attributable to the planned second wave of voucher privatisation, which was later cancelled by the Meciar-government, see Chapter IV:3.4. The implications for investment companies is discussed further below, cf. Section 2.2.2 and footnote 191.
(Section 2.5). After that focus is turned to the question of governance of these funds and investment companies, and also to some extent what linkages these investment companies had with other established interests in Slovak society. This is discussed while raising the question of “who controls the controllers” and whose interests they have been pursuing (Section 2.6). Forming an integral part of this section is an analysis of fund performance with regard to their function as institutions for collective investment. It will be shown that their promises to DIKs in many cases were less than fulfilled and that funds in general have shown a lacklustre performance. A discussion of the mechanisms, causes and consequences of their demise (transformation) concludes the section (Section 2.7).

2.1. Introducing four investment companies

The four investment companies included in the case study represent a strategic choice with an aim to give as broad a picture as possible, given the limited number included. The selection meets this criterion in two respects. First, by including the dominant and most important players, a very large segment of the market is captured; the funds included represented 52 per cent of the bidding capital entrusted to Slovak funds (see Table 19, p. 166). Secondly, by choosing investment companies established by different interests, not only by the dominant financial institutions, there was a hope to get an idea of how these kind of connections influenced the behaviour and fate of investment companies.

A first and quite natural choice was to include the probably most renowned of all investment groups in Eastern Europe, the Harvard group. Harvard Capital and Consulting (HC&C) was founded in October 1990 by then 27-year old ex-émigré Viktor Kozeny. Kozeny, who in April 1990 had returned to Prague following a longer period of studies at Harvard, saw early on the economic potential of taking part in the restructuring of the Czechoslovak business sector. Initially Kozeny offered consulting services to firms needing assistance in order to adapt to the...
emerging market conditions; he was also made part of an advisory team drawing up the plans for Czechoslovak privatisation and thus realised the potential gains to be made from participating in the highly subsidised voucher privatisation scheme drawn up at the time. 93

In 1991, HC&C established Harvard Capital and Consulting Slovakia (HC&CS) as its main vehicle for Slovak operations. For the first wave, the Harvard group founded a total of eight investment funds, out of which two were based in the Slovak Republic. Together these eight funds attracted no less than 638 million voucher points from some 716 thousand DIKs, making it the third largest investor in Czechoslovakia as a whole and the largest non-bank investment group (see Table 18).94 The two Slovak funds, Harvard Dividend Investment Fund, a.s. and Harvard Growth Investment Fund, a.s. together attracted some 100,000 DIKs, providing the funds with a total of 73.5 million investment points (see Table 19, p. 166).95

Table 18. Distribution of investment points among the largest investment companies in Czechoslovakia and the Slovak Republic, 1992

<table>
<thead>
<tr>
<th>Investment Company (republic/country in parenthesis)</th>
<th>Pts.</th>
<th>IFs</th>
<th>Position in CSFR (% of)</th>
<th>Position in SR (% of)</th>
<th>Sponsor/founder</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>mn.</td>
<td>no.</td>
<td>All IFs</td>
<td>All IFs</td>
<td></td>
</tr>
<tr>
<td>Ceská státní sporitelna (CR)</td>
<td>950.9</td>
<td>1</td>
<td>11.1</td>
<td>15.5</td>
<td>– CSB</td>
</tr>
<tr>
<td>Prvni investicni, a.s. (CR)</td>
<td>713.8</td>
<td>11</td>
<td>8.4</td>
<td>11.6</td>
<td>– Investment Bank, IB</td>
</tr>
<tr>
<td>Harvard group (CSFR)</td>
<td>638.7</td>
<td>8</td>
<td>7.5</td>
<td>10.4</td>
<td>– Independent</td>
</tr>
<tr>
<td>VUB Invest, i.a.s. (SR)</td>
<td>500.7</td>
<td>1</td>
<td>5.9</td>
<td>8.2</td>
<td>19.3 VUB</td>
</tr>
<tr>
<td>IKS KB Spol, s.r.o. (CR)</td>
<td>465.7</td>
<td>1</td>
<td>5.5</td>
<td>7.6</td>
<td>– Komercni Banka, KB</td>
</tr>
<tr>
<td>Kapital. invest. Spol, a.s. (CR)</td>
<td>334.2</td>
<td>1</td>
<td>3.9</td>
<td>5.4</td>
<td>– Ceska Postovna</td>
</tr>
<tr>
<td>Slovenske investicie, s.r.o. (SR)</td>
<td>188.0</td>
<td>1</td>
<td>2.2</td>
<td>3.1</td>
<td>7.3 IRB</td>
</tr>
<tr>
<td>Creditanstalt, a.s. (Austria/CR)</td>
<td>138.9</td>
<td>1</td>
<td>1.6</td>
<td>2.3</td>
<td>– Creditanstalt</td>
</tr>
<tr>
<td>Cassoviainvest (SR)</td>
<td>168.9</td>
<td>4</td>
<td>2.0</td>
<td>2.8</td>
<td>6.5 10.0 VZS &amp; SSB</td>
</tr>
<tr>
<td>PSIS (SR)</td>
<td>137.4</td>
<td>3</td>
<td>1.6</td>
<td>2.2</td>
<td>5.3 8.1 Independent</td>
</tr>
<tr>
<td>HC&amp;CS, a.s. (SR)</td>
<td>73.6</td>
<td>2</td>
<td>0.9</td>
<td>1.2</td>
<td>2.8 4.4 Independent</td>
</tr>
<tr>
<td><strong>Total ten largest in CSFR</strong></td>
<td>4,237</td>
<td>32</td>
<td>49.6</td>
<td>69.0</td>
<td>– 8 Financial sector</td>
</tr>
<tr>
<td><strong>Total five largest in SR</strong></td>
<td>1,069</td>
<td>11</td>
<td>12.5</td>
<td>17.4</td>
<td>41.3 63.2 3 Financial sector</td>
</tr>
</tbody>
</table>

Source: Adaption and recalculation of Kotrba et al. (1999), Table 1.11 (pp. 23-24); also see Table 10 above and Table 19. Abbreviations: CSB = Ceska Sporitelna Banka (Czech Savings Bank), IRB = Investicni a Rozvojová Banka (Investment and Development Bank); VUB = Vseobecná Uverová Banka (General Credit Bank); SSB = Slovenska Sporitelna Banka (Slovak Savings Bank).

1 In these figures are included also the two funds established by HC&CS in Slovakia, which formally was a separate investment company, but which for all practical purposes was part of the same concern. The figures for the two Slovak funds are shown at the bottom of the table – figures which made it rank number five in Slovakia.

It was in December 1990 that Kozeny was appointed to the Legislative Board of the Federal Government – its role was to advise the government on suggested legislation, later to be presented to parliament. For a detailed account of the foundation and activities of HC&C and its many different daughter-companies, see McIntyre et al. (1994). 95

Only the funds established by Ceska Sporitelna (Prague) and Prvni Investicni (Prague) were larger, collecting 951 and 714 million points, respectively. Although being managed by different companies all funds within the Harvard group were working as a group, not as separate entities, see Jaros (1995), p. 9.

The General Manager of HIS, Ms. Matysová, estimated that of the initial investors some 60,000-65,000 DIKs remained shareholders in October 1995, see Matysová (1995) [interview].
funds were later to be managed by the Harvard Investment Company, Inc. (Harvardská Investična Spolocnost, a.s.) in Bratislava, below referred to as HIS. 96

The basis for the success in attracting the initially reluctant public was the buy-back guarantee extended by the Harvard Group. The offer, according to which they bought back the funds’ shares at Kčs 517.50 ($18), implied a minimum return of Kčs 10,350 ($366) for any DIK that invested his 1,000 points with any of the Harvard funds, should they choose to withdraw their interest from the fund; that is ten (!) times the initial investment for purchasing their voucher booklet and having it registered. 97 In this sense, the Harvard Group was groundbreaking, opening the field for other funds to come with similar, and better, offers. 98 To reach out with their offer, the Harvard group initiated a massive advertising campaign in November 1991. In addition, the group hired thousands of part-time agents to solicit DIKs. 99

The second investment group included in the study was the one that turned out to be the most successful in Slovakia, making it by far the largest Slovak investor. VUB Invest, i.a.s. was set up in 1991 by the dominant commercial bank in Slovakia, VUB. 100 The company established only one voucher fund, VUB Kupón, although one which by collecting a high 500.7 million points made it the largest Slovak fund and the fourth largest investor in Czechoslovakia as a whole. 101 These points were provided by more than half a million of DIKs (see Table 19), many of whom were attracted by an even more generous minimum return than the Harvard funds (Sk 12,000; $425). This way the largest bank in Slovakia, still state-controlled, assured itself of a significant, let be indirect, influence also on the equity side in many of its creditors.

The third investment company studied, is one which is interesting because it was established by the largest industrial corporation in Slovakia, VSZ, with the more or less outspoken aim of buying as many shares in the steel-mill as possible. 102 Thus, in February 1992 VSZ established Cassoviainvest, which in turn established four

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96 When the Law on investment companies and investment funds came into force in 1992 (see Section 2.2, p. 167 ff.) HIS was established as the investment company managing these funds, founded and previously managed by HC&CS.
97 Those who invested their full 1,000 investment points with a fund received 20 shares in the same. The buy-back guarantee was reportedly still in force in October 1995. Estimates hold that approximately 30 per cent of the initial investors have used this option so far, see Jaros (1995), p. 7.
98 It was only two funds among the top-10 investment groups in Czechoslovakia that did not offer cash returns to their clients, the first one was Creditanstalt founded by the Czech subsidiary of Creditanstalt Bankverein, the other was Komercni Banka (the largest commercial bank in the Czech Republic), see Finance East Europe, Vol. 2, No. 11, 1992, p. 6.
100 The below information relating to VUB Invest and its funds is, unless otherwise noted, based on the information and insight gained during interviews with Lubomir Sevcik, Vice-Director; Assistant to the General Manager and Jozef Oravkin, Director of Funds Management of the VUB Invest, a.s., in Bratislava, see Sevcik (1995) [interview] and Oravkin (1995) [interview]. Also, the study would not have been possible without the written information subsequently provided by courtesy of VUB Invest.
101 In addition to VUB Kupón and two mutual funds (see Section 2.5.1) the investment company also managed the assets of a small voucher-fund (the Slovak Engineering Investment Fund, a.s. Martin) established by another company, which was not able to manage it. NAV was as of 31 December 1994 a mere Sk 3.4 million ($108,700).
102 VSZ is, as mentioned above, one of the firms included in our case study on privatising firms, see Chapter VI:2.2.
different funds. The funds collected a total of 168.9 million points from 202,642 DIKs, equalling one-tenth of that offered to all Slovak funds. Ferrofon I turned out to be the biggest, with 78.4 million investment points to bid on shares for. The three other funds, established in co-operation with the state-controlled Slovak Savings Bank (Slovenska Sporitelna) with its nation-wide network of offices, Sporitelna-VSZ I, II and III gained 31.5, 37.8 and 21.2 million points, respectively. The offers to potential investors were less generous than for example HIS and VUB Invest. Still, the backing of the largest industrial firm in the country and the largest retail-bank sounded sufficiently re-assuring for many people, at least enough to make it the ninth largest investment company in Czechoslovakia as a whole.

The First Slovak Investment Company (Prva Slovenska Investicna Spolocnost, a.s., PSIS below), finally, is also an interesting investment company, not least because:

(i) it was relatively independent from any of the major banks and the state;
(ii) it well illustrates the high degree of uncertainty facing the Slovak capital market as a consequence of erratic regulation; and, (iii) it came to administer three unit funds, one of which functioned as the actual market-maker on the Slovak capital market.

Table 19. Overview of investment funds and companies included in the case study

<table>
<thead>
<tr>
<th>Investment company</th>
<th>Fund/funds</th>
<th>Pts collected (mn)</th>
<th>DIKs (04/1992)</th>
<th>NAV (Sk bn end-1993)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIS</td>
<td></td>
<td>73.6</td>
<td>73,554</td>
<td>2.667</td>
</tr>
<tr>
<td></td>
<td>Harvard Dividend Investment Fund</td>
<td>40.5</td>
<td>40,531</td>
<td>1.196</td>
</tr>
<tr>
<td></td>
<td>Harvard Growth Investment Fund</td>
<td>33.0</td>
<td>33,023</td>
<td>1.471</td>
</tr>
<tr>
<td>VUB Invest</td>
<td>VUB Kupón</td>
<td>500.7</td>
<td>526,000</td>
<td>12.205</td>
</tr>
<tr>
<td>Cassoviainvest</td>
<td>Ferrofon I</td>
<td>168.9</td>
<td>202,642</td>
<td>7.553</td>
</tr>
<tr>
<td></td>
<td>IPF I. Sporitelna-VSZ</td>
<td>31.5</td>
<td>40,152</td>
<td>1.076</td>
</tr>
<tr>
<td></td>
<td>IPF II. Sporitelna-VSZ</td>
<td>37.8</td>
<td>43,793</td>
<td>1.969</td>
</tr>
<tr>
<td></td>
<td>IPF III. Sporitelna-VSZ</td>
<td>21.2</td>
<td>27,565</td>
<td>0.693</td>
</tr>
<tr>
<td>PSIS</td>
<td>Prvy Privatizacny Investment Fund</td>
<td>116.7</td>
<td>99,712</td>
<td>2.344</td>
</tr>
<tr>
<td></td>
<td>Garantovany Investment Fund</td>
<td>12.1</td>
<td>19,946</td>
<td>0.410</td>
</tr>
<tr>
<td></td>
<td>Zlaty Investment Fund</td>
<td>8.6</td>
<td>15,779</td>
<td>0.240</td>
</tr>
<tr>
<td>SR total</td>
<td>164 funds</td>
<td>1,690</td>
<td>1.69 mn</td>
<td>51.4</td>
</tr>
<tr>
<td>Case study IFs</td>
<td>10 funds</td>
<td>880.5</td>
<td>937,633</td>
<td>25.4</td>
</tr>
<tr>
<td>as % of SR</td>
<td>6.1</td>
<td>52.1</td>
<td>55.5</td>
<td>49.5</td>
</tr>
</tbody>
</table>

Sources: Annual Reports; data communicated directly from ASIF/Ministry of Finance; Centre for Voucher Privatisation (1995); interviews; own computations.

Figure is estimate based on the number of shares issued.

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103 The below information relating to Cassoviainvest and its funds is, unless otherwise noted, based on the information and insight gained at an interview with Valéria Ondíková, Head of the Foreign Trade Department, and Karol Mizla, Financial Analyst at Cassoviainvest, a.s., in Kosice, see Ondíková (1995) [interview] and Mizla (1995) [interview]. Also, the study would not have been possible without the written information subsequently provided by courtesy of Cassoviainvest.
104 For many of its investors Cassoviainvest paid the Sk 1,000 needed to buy the voucher-stamp, in addition there was a buy-back guarantee, although without a minimum price, i.e. Cassoviainvest bought back shares from DIKs at market prices. It is however reported that a guarantee of Sk 15,000 ($530) in minimum return was offered to some investors who entered Ferrofon, see Marcincin (1995a), p. 7.
market (see Section 2.5.1). PSIS was set up to administer the three voucher-investment funds established for the first wave which together attracted the interest of about 200,000 DIKs who entrusted them with a total of 137.4 million investment points. The group was thus the largest “independent” investor in Slovakia, close to double the size of the Slovak Harvard funds (73.5 mn points). The largest of the funds established was the First Privatisation Investment Fund (Prvy Privatizacny Investicny Fond, PPIF) with 116.9 million investment points.

* * *

In conclusion, the selection of investment companies represent a significant portion of the investment fund market created as a consequence of voucher privatisation, having gathered 34 per cent of the points held by Slovak citizens (2.59 bn) and representing 52 per cent of all the points allocated to Slovak investment funds (1.69 bn). In addition, the diversity with regard to their origin provides some basis for comparative analysis. The basic data about the four investment companies and their different investment funds is summarised in Table 19, which also includes information on the value of their portfolio at end-1993, i.e. after voucher privatisation but prior to any real changes through trade at the secondary markets.

2.2. Legal regulation of investment funds and investment companies

A major problem throughout the existence of the investment companies and investment funds has concerned their legal regulation. It is important to note that although the funds were partially anticipated, there was no specific legislation in force to regulate their activities at the time of their establishment, with the exception of the short passus in the large-scale privatisation act which catered for the participation of investment funds in voucher privatisation by stating that in addition to use the vouchers to purchase shares directly they could be used for the ‘acquisition of the participation in commercial companies founded specially for this purpose, after the previous approval of the competent authority of the Republic.’

2.2.1. Initial regulation: late and vague

The first kind of regulation of their activities was introduced in the form of a federal government decree (by-law) on 5 September 1991. The decree, however, was neither detailed nor comprehensive; there were only four basic requirements set up for investment funds. Firstly, they should have a minimum capital of Sk 100,000 ($3,400) – a figure later raised to Sk 1 million ($34,000). Secondly, management should have certain, although largely unspecified and non-enforced, professional

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105 The below information relating to PSIS and its funds is, unless otherwise noted, based on the information and insight gained at an interview with Vladimir Rajcak, at First Slovak Investment Company, Inc., Bratislava [Prva Slovenska Investicna Spolocnost, a.s.] in Bratislava, see Rajcak (1995) [interview], and subsequent contacts with staff at the First Slovak Investment Company, Inc.

106 The two other funds, the Guarantee Investment Fund and the Golden Investment Fund, were much smaller, having attracted 12.1 (Garantovany Investment Fund, GIF) and 8.6 million points (Zlaty Investment Fund, ZIF), respectively. See Investment funds in Slovakia (1995), pp. 8-14.

107 Act on the conditions of transfer of state property to other persons, Article 25, para. 1b.

qualifications – including a “good reputation”. Thirdly, the fund should contract with a bank to act as its depository. Fourthly, and finally, the fund had to obtain a formal license from the Ministry of Finance. Then, in January 1992, as the fund-market expanded rapidly, temporary regulations were introduced in response to the lavish cash-promises by funds to the effect that a fund was allowed to invest a maximum of 10 per cent of its capital in any one security (in order to create some risk-spreading). In addition, it was stipulated that funds were allowed to buy no more than 20 per cent of any one company. These temporary rules/decrees were the ones codified on 28 April 1992 when parliament finally – only 20 days before bidding was to commence, and two months after the deadline for registering investment funds – passed the Law on investment companies and investment funds.

The law aimed to regulate the activities of both funds and investment companies, as well as to protect shareholders and to set the standards for government supervision. As regards the organisational aspect, the law accommodated for two types of organisations, investment companies (ICs) and investment funds (IFs). The former could be set up either as a joint-stock company (a.s.) or as a limited liability company (s.r.o.), while the funds had to be organised as joint-stock companies. A problem, however, was that all the funds established for the first wave had been founded under a different set of rules; they were all called investment privatisation funds (IPFs) and founded as joint-stock companies, something which made it necessary for a transitional period of adaptation to the law. During this period existing IPFs were transformed to investment funds, and the founders and managers of the funds were transformed into investment companies. An important change was that the property of an IPF could be managed only by itself (self-management) or an investment company, which meant that the founders either had to set up an investment company or contract with one to take over management of the assets of the fund.

As regards the portfolios of funds, the law codified the temporary regulations from January, establishing a ceiling on the maximum holdings of any one fund to 20 per cent in any one issue. It did, however, imply a change in that it also applied the same 20 per cent ceiling on assets indirectly controlled by any one investment company – even though it had established more than one fund. Table 20 summarises some of the changes in regulation introduced in April 1992. Regarding charges


110 See Law on investment companies and investment funds, of April 28, 1992.

111 See Law on investment companies and investment funds, Art. 10, para. 1-3. The law also stipulated that investment companies could create stock funds (SFs) that were either open-ended or closed-ended, although it was too late to realise this opportunity for wave one. In the former case the number of issued stock certificates was unlimited and the investment company was obliged to buy back stock certificates from the shareholder. In the latter, there were limits on the number of stock certificates or on the time when they are sold, and there is no obligation on behalf of the investment company to buy them back. Stock funds is the legal term for what otherwise would be called mutual funds. The inner workings of these types of organisations are, like any other companies, regulated by the Commercial Code, see Commercial Code, of November 5, 1991.

112 Please note that still the term Investment Privatisation Fund (IPF) is used in literature interchangeably with the more correct terms of investment company (IC), investment fund (IF) and stock fund (SF).


114 Law on investment companies and investment funds, Art. 24, para. 3.
it was, for example, stipulated that an investment company could charge a maximum of 2 per cent of the net-asset value (NAV) of the funds property, or a maximum of 20 per cent of its profits.\footnote{Law on investment companies and investment funds, Art. 27.} Another change was that IPFs that had been founded by banks were forbidden to buy shares in its founder, or other banks and insurance companies.\footnote{Law on investment companies and investment funds, Art. 24, para. 11. This rule was supposed to govern orders placed after 29 May 1992, but the bidding had started already on 18 May.} Those who had already done so were supposed to have changed their portfolios by end-1993, although enforcement of and compliance with this was less than complete. With designated regulation introduced only in the 11th hour, there was considerable and continuing confusion about the legal status of the investment funds and companies, a fact that has been abused by the funds. For example, it turned out that initially in many IPFs government officials were involved on the boards of funds, sometimes with important roles in the whole process of voucher privatisation.\footnote{Mejstrik (1994), p. 2. This was banned in amendments to the Decree on the issue and use of investment coupons.} Further, as this study illustrates, regulation of funds and investment companies continued to pose a major problem, and the above mentioned changes were not the last to be made. Rather, supervision and regulation of the actors on the capital market by the Slovak Ministry of Finance turned into a highly controversial and politicised issue.

### 2.2.2. A clampdown on the funds

Following the election victory of Meciar in late-1994, the next round of major changes in the regulatory framework were to be introduced as the new government sided with the industrial and managerial lobby in their resistance against the growing influence of investment funds and companies in the management of firms. In the spring of 1995, a whole range of proposals relating to the capital market in general, and the influence of investment funds in particular, were put on the table. A general tenet in the new changes was that they would serve to curtail the influence of investment companies. One such highly controversial provision, for example,
implied that funds were obliged to reduce their holdings in any one firm to a maximum of ten per cent by end-1996. Furthermore, they would in the future be banned from having representatives on the most important board in firms, the Board of Directors (see Table 20). In this way, the amendments tried to put a stop to any ambition by fund-managers to behave as strategic investors. A third change, clearly aimed at reducing/circumscribing the economic viability of funds, was to reduce the maximum fee charged to one per cent of NAV. In an international perspective this is a rather low level – and, it should be remembered that making money on the stock market was made difficult by the depressed state of the market.

The consequences of these changes would be far-reaching, and will be discussed further below. Already here, however, it must be pointed out that these changes ought to be looked at in a wider context of policy changes relating to ownership reform. In fact, the analysis below will show that they can be considered a parallel development to the changes which were made to privatisation policy in 1995, when the Meciar-government gradually diminished the property offer for the planned second wave of voucher privatisation, only to disband the scheme completely in the summer of 1995. Further, the two processes were interacting. To begin with, the cancellation of voucher privatisation inflicted sizeable economic losses on the investment funds, which in many cases had invested heavily into attracting DIKs also for the second wave (cf. Section 2.5.2). In addition, it precluded funds from increasing their holdings in Slovak industry. Moreover, the above described changes would curtail the impact and influence derived from the holdings gained during the first wave of voucher privatisation. The changes that were introduced also most definitely had a political aura. On the one hand the authorities argued that funds were too powerful, on the other hand they at the same time argued against the continuation of voucher privatisation on grounds that it had created an overly dispersed ownership structure – a stance which is slightly complicated to hold. The underlying reasons seem rather to have been political. FNM President, Stefan Gavornik, for example said that a real problem about voucher privatisation was that the firms from the first wave by now (early 1995) were ‘primarily owned by the opposition’.118

2.2.3. Dismal minority protection

Even if the government has proven active in intervening in some aspects, it should be noted that the focus of the legislation has been on the relations between funds and investment companies and the producing firms in which they hold shares. Just like with the capital market regulation in general, very little attention was paid to the protection of minority shareholders, other than in rhetoric. The Law on investment companies and investment funds, which officially set out to regulate also the ‘protection of investors’,119 included only one out of a total of 140 paragraphs under the heading of ‘Protection of shareholders’.120 However, Article 17, paragraph 3,

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119 Law on investment companies and investment funds, Art. 1.
120 Article 23 in the Law on investment companies and investment funds read (in extensio): ‘[i]n promoting the sale of shares or stock certificates, an investment company or an investment fund must not use false or misleading information or conceal facts important for existing or future shareholders in
read: ‘[a]n investment company or investment fund may buy the security at most
and sell it at least at the price of the security for which it was traded on the stock
exchange or similar stock market on the day of purchase.’ Such a provision could
indeed provide a safeguard against opportunistic behaviour by fund managers who
otherwise could reduce the NAV by selling off shares cheaply to other companies
(perhaps controlled by themselves) and buying from the same at a excessively high
price.

The problem in this case is not the written letter of the law – rather norms and
enforcement – both of which have proved lax. First of all, there has been no inde-
pendent corporate watchdog with the task of supervising investment funds. Just like
for the capital market in general it has been the capital market section at the Minis-
try of Finance that was charged with that task. The fact that it was a government-
controlled body did, in the Slovak setting, open the way for erratic, discretionary
and often outright political regulation. As for norms and incentives it may seem
strange that a fund manager would have an interest in lowering NAV. However, a
lack of competition and the fact that the initial investments were made in the ab-
sence of real liquidity go a long way in explaining the peculiar situation where in-
vestment companies indeed have stood to gain from low prices on fund shares.
Reputation-building and other disciplinary mechanisms do not have much effect
either if the whole affair is viewed as a “one-off-happening”. It will suffice to point
at the example of the Czech part of the Harvard group, which in 1996 was fined the
maximum fine by the capital market section of the Czech Ministry of Finance for
having conducted a complicated system of forward deals with the aim of lowering
the NAV of funds in order to be able to buy the shares of the fund at even larger
discounts than normal.121 Furthermore, and perhaps most importantly, even if there
was a will to protect the minority shareholders it would be very complicated given
that there was no proper trading monopoly – making it close to impossible to find
out what actual prices were used in the various transactions. Given all this, it is little
wonder that DIKs would prove to be easy prey for fund managers wishing to take
advantage of their superior knowledge in unscrupulous transactions.

2.3. Portfolio-strategies of the investment funds

This section aims to provide a comparative analysis of the respective investment
companies’ policy with regard to initial investments and subsequent portfolio man-
agement in the period 1992-1996. As regards portfolio composition, the focus will
be on three different, although interrelated, issues. First, the initial strategies and the
degree of concentration is outlined (Section 2.3.1). The attention paid to the degree
of concentration of holdings is derived from the notion that it may provide some in-
sight, both into the tactics and objectives of the respective investment company, as
well as to their potential for influence in the various firms – although this ultimately

making their decisions, particularly it must not offer advantages whose reliability it cannot prove or
which are not in accord with this law, or give incorrect data about personal, technical, and organizational
conditions of the investment company or investment fund. This does not affect the provisions of the
commercial code on unfair competition.’

would depend on the size of the fund in question. The sectoral composition of portfolios and its change over time will be studied in Section 2.3.2. Finally, in Section 2.3.3, the degree of foreign holdings in the portfolios will be briefly touched upon.

2.3.1. Initial strategy and concentration

Although the majority of funds applied similar strategies when it came to attracting potential investors in the “zero round”, these similarities did not apply to the use of these points. While there were many funds set up more with a focus on reaping as large a part of the bidding capital as possible than on what to do with these holdings, there were of course examples of the opposite. The Harvard group provides one such example. In fact, HIS was certainly part of the most focused investment group, investing only in core industries like banking, insurance, brewing, energy and construction. This strategy and focus was reflected already in their bidding behaviour, bidding with the full 100 per cent of investment points at their disposal already in the first out of the five rounds. The aim was to become the largest owner in a minor number of “blue-chip” companies, rather than try to wait for lower prices, or to get a more extensive portfolio. This made HIS the least diversified on the market with only 20 firms in its portfolio (see Table 21). The other investment companies in the study were by these standards much more diversified, acquiring interests in up to 300 (CIC) different firms during the five rounds of bidding. However, not even this was an extreme number comparing to the one fund that acquired shares in 1,420 firms, i.e. only 71 less than was put on offer in the country. Still, CIC was definitely more dispersed than the average investment company – which in Czechoslovakia acquired stakes in 104.3 different firms during the first wave of voucher privatisation.


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<tbody>
<tr>
<td>Harvard Investment Company</td>
<td>20</td>
<td>20</td>
<td>19</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>VUB Invest</td>
<td>238</td>
<td>240</td>
<td>229</td>
<td>139</td>
<td>111</td>
</tr>
<tr>
<td>CassoviaInvest</td>
<td>app. 300</td>
<td></td>
<td></td>
<td>app. 600</td>
<td></td>
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<tr>
<td>PSIS1</td>
<td>155</td>
<td>.</td>
<td>148</td>
<td>.</td>
<td>250</td>
</tr>
</tbody>
</table>

Sources: Annual Reports; interviews; data communicated directly from the investment companies; Investment funds in Slovakia (1995); own computations.

Notes: 1 Figure refers to September 1995. 2 Figures refer to its largest fund, PPIF. 3 Figure refers to October/November 1996.

122 Wendelova and Bukac (1993), p. 15. Petra Wendelova was at the time Managing Director of the Harvard Stock Exchange Company Inc. (Harvardská burzova spolocnost, a.s., HBS), a sister company to HC&C.
123 The group pooled the investment points from all of their eight funds in the Czech and Slovak republics in a concerted effort, see Wendelova and Bukac (1993), p. 16. The group as a whole thus ended up as the largest owner in 51 companies after the first wave. The bidding strategy of the Harvard group also meant that the portfolios of its two Slovak funds were close to identical.
124 See Kotrba et al. (1999), Table 1.15, p. 33.
As can be seen in Table 21 also VUB Invest acquired an initially extensive portfolio (238 issues). This is in congruence with other research that point to banks funds being more diversified. For example, Ceska Sporitelna in the Czech Republic ended up with a portfolio of some 500 different companies.\footnote{126} Such diversification is not defendable with reference to risk spreading; such an objective could be achieved with a much less diversified portfolio. Instead it may point to differing objectives of different types of investment companies. Research points to that many investment funds established by banks could have been striving to secure future banking business rather than to acquire the larger stakes (e.g. 20\%) which could be expected to be necessary for initiating deeper restructuring.\footnote{127} However, one must also take into account the size of the various funds. Bank funds were, in general, the largest, and in the case of VUB Kupón, which had 500.7 million points to invest, a large portfolio was hardly surprising. A more reasonable measure of initial diversification and/or bidding tactics, given the varying sizes of funds, could thus be the number of issues invested into per million investment points (see Table 22). Here the spectrum in our sample ranges from a low 0.48 in VUB Kupón to a high 4.2 in the smallest of PSIS’s funds.

In Table 22 is also calculated NAV (end-1993) per invested voucher booklet of the respective fund. This shows that the large funds did not always do the best with regard to their initial investments. The largest Slovak fund (VUB Kupón) at end-1993, when shares had begun trading, had the lowest NAV per invested voucher booklet. One possible explanation for this is that there simply were not enough attractive firms in the former Czechoslovakia to make up genuinely good portfolios of these large funds. This, however, is something that was inherent in this type of

Table 22. Characteristics of investment fund portfolios, 1993 (concentration, price, NAV/voucher booklet)

<table>
<thead>
<tr>
<th>Investment fund</th>
<th>Issues acquired per mn pts (04/93)</th>
<th>Price/share (04/93)</th>
<th>NAV (end-1993) per 1000 pts</th>
</tr>
</thead>
<tbody>
<tr>
<td>VUB Kupón, a.s.</td>
<td>0.48</td>
<td>41.77</td>
<td>24,377</td>
</tr>
<tr>
<td>Harvard Growth Investment Fund, a.s.</td>
<td>0.61</td>
<td>34.07\footnote{1}</td>
<td>36,213</td>
</tr>
<tr>
<td>Harvard Dividend Investment Fund, a.s.</td>
<td>0.49</td>
<td>33.25\footnote{1}</td>
<td>36,292</td>
</tr>
<tr>
<td>Ferrofond I, a.s.</td>
<td>.</td>
<td>20.17</td>
<td>48,671</td>
</tr>
<tr>
<td>IPF I, Sportelna-VSZ, a.s.</td>
<td>.</td>
<td>28.64</td>
<td>34,117</td>
</tr>
<tr>
<td>IPF II, Sportelna-VSZ, a.s.</td>
<td>.</td>
<td>18.80</td>
<td>52,063</td>
</tr>
<tr>
<td>IPF III. Sportelna-VSZ, a.s.</td>
<td>.</td>
<td>29.86</td>
<td>32,749</td>
</tr>
<tr>
<td>Prvý Privatizacny Investment Fund, a.s.</td>
<td>1.33</td>
<td>39.08</td>
<td>20,090</td>
</tr>
<tr>
<td>Garantovany Investment Fund, a.s.</td>
<td>3.71</td>
<td>30.65</td>
<td>33,790</td>
</tr>
<tr>
<td>Zlatý Investment Fund</td>
<td>4.20</td>
<td>40.04</td>
<td>27,970</td>
</tr>
</tbody>
</table>

Sources: Annual Reports; interviews; data communicated directly from the investment companies; Investment funds in Slovakia (1995); data communicated directly from ASIF/Ministry of Finance; own computations.

\footnote{1} Figure is based on portfolio at end-1993.

\footnote{125} The figure is derived through recalculation of Kotrba et al. (1999), Table 1.15, p. 33; the same methodology give that the average investment company established 1.3 investment funds (which, in turn, on average acquired shares in 81.7 firms).

\footnote{126} Ceska Sporitelna was the largest fund in the country, see Table 18, page 164.
privatisation scheme, and also a rationale for deploying it, i.e. to “find” owners for all firms irrespective of their merits. Another is that the market was too immature to provide a good evaluation of firms; as can be seen in column two (pts./share) VUB Kupón, on average, had acquired the most “expensive” shares, and ended up with the lowest NAV per invested point. An example of the opposite is Ferrofond and IPF II. Sportelna-VSZ which acquired shares cheaply in “steel and mining” (i.e. in VSZ; cf. Table 24, p. 176) which did well on the stock market and thus realised the highest NAV per invested booklet. Thirdly, the average prices per share was affected also by the ratio of Czech shares in the portfolio since share prices in the Czech Republic on average were much higher than in the Slovak Republic (cf. Appendix D, TABLE 12, p. 327). The high ratio of Czech shares in the portfolio of VUB Kupón (84% at end-1993, see Table 25) could thus be a contributing factor to them paying the highest price per share of the case study investment funds.

This third column in Table 22 does, however, not only provide insight into the performance of the funds during bidding – it also gives an idea about the kind of values foregone by DIKs. That is, whether it was “good business” to entrust their points to an investment fund rather than investing them directly, can be estimated by comparing the cash-offers by funds and/or the market value of the shares of the investment fund received in return for the voucher booklet. As will be shown in Section 2.6.1, in many cases it was not.

Over the course of their existence, there would of course be changes in these initial policies of investment companies. Some of the changes occurred in response to the general developments on the capital market, some more directly in response to changing regulations and government policies. A quite general trend, however, was the gradual consolidation of holdings; i.e. funds were turning more into strategic owners than portfolio-investors. In 1995 VUB Invest, for example, set out on a drastic restructuring of its portfolio aiming to concentrate on a smaller number of firms. Given the generally poor liquidity of the Slovak market, they favoured large publicly traded companies with a higher level of liquidity, allowing the fund to either exit or increase their holding. Thus, at end-1995 the portfolio consisted of 139 firms, down from 229 at the beginning of the year, a reduction by 39 per cent. In HIS, the initial strategy of keeping to a low number of liquid blue-chips was still being followed. Cassoviainvest on the other hand went against this trend. With some 600 firms in its portfolio in September 1995, their holdings were indeed dis-

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</thead>
<tbody>
<tr>
<td>VUB Invest</td>
<td>42.8</td>
<td>31.0</td>
<td>36.9</td>
<td>31.2</td>
</tr>
<tr>
<td>HIS</td>
<td>87.2</td>
<td>55.4</td>
<td>41.9</td>
<td>22.2</td>
</tr>
<tr>
<td>CIC</td>
<td>.</td>
<td>.</td>
<td>27.3</td>
<td>.</td>
</tr>
<tr>
<td>PSIS¹</td>
<td>.</td>
<td>37.6</td>
<td>.</td>
<td>.</td>
</tr>
</tbody>
</table>

Source: Annual Reports; interviews; data communicated directly from the investment companies; Investment funds in Slovakia (1995); own computations.
¹ Figure refers to its largest fund, PFIF

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More importantly though, is that the share of the five largest holdings of total NAV drastically sank during the course of 1995, from 58 to 19 per cent. Representatives explain this diversification as a move to reduce risk. That is perhaps also the way to interpret Table 23, i.e. at the same time as one limits the portfolio in terms of the number of issues held, to better be able to monitor the shares, the state of the market made it necessary to reduce the risk-exposure. As can be seen in the table the per cent of NAV made up by the five largest holdings decreased in all cases for which data have been available.

2.3.2. Sectoral distribution
In examining the sectoral composition of the portfolios, it becomes clear that it is even more difficult than with the degree of concentration to identify any common pattern among fund managers. The funds to a large extent invested into the core industries, with a certain initial predominance for shares in banks and the financial sector. In addition to that, one can see that the priorities of the founder had some influence. For example, CIC emerged with a 37.1 per cent stake in steel and mining (see Table 24). A prime aim with setting up CIC was, as mentioned above, to acquire shares in VSZ, something which it achieved; its eleven per cent share in VSZ made CIC the most important private owner of VSZ, and VSZ for long represented the single largest investment of the group. Similarly, VUB Kupón’s holdings of its founder, VUB, was significant, reaching 8.28 per cent of NAV at end-1996 equaling 9.51 per cent of the banks outstanding stock. Thus, VUB represented not only the single largest holding of VUB Kupón, but VUB Kupón was also the single largest private shareholder in VUB.

The most striking aspect of the sectoral distribution is, however, how large the changes have been. The most stable investor in our sample was VUB Invest. Its declared aim was to target highly liquid, easy-to-sell shares, rather than any specific sector. With such aims it is not very surprising that the portfolio-composition has been fairly stable, given that the number of liquid issues on the market has been relatively limited. Still, in general the changes have been substantial. CIC is a good case in point. Steel and mining, initially the largest investment of CIC (37.1%) had by end-1995 been slashed to a mere 12.2 per cent. Likewise, HIS, which initially invested the largest number of points into the banking and financial sector (53.3% of NAV at end-1993) had three years later all but terminated their interests in the sector.

Yet somewhat of a trend was the increasing importance of “bonds and other cash equivalents” (see Table 24). Hand in hand with the concentration of their portfolio VUB Invest, for example, re-invested much of the money received from sales into bonds or fixed income yield bonds, whose share of total NAV increased from 1 to

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128 It should be noted that the figure includes holdings as small as e.g. 10 shares.
129 In addition large shares have been held in wood industry, like furniture companies; agriculture, e.g. a bakery company, but also in construction and building industry.
130 Included in the first wave was significant offerings in some of the state-owned banks, for example in VUB and its Czech counterpart Komercni Banka, see Chapter VI:4.1 (p. 251 ff.).
131 The corresponding figures for end-1995 was 6.43 per cent of NAV, then equaling 12.49 per cent of VUB’s outstanding stock. On control-structures in the “VUB-group”, see Section 2.6.3, page 200 ff. and Figure 20 (p. 202).
PSIS is another example where about one quarter of assets in its largest fund (PFIF) had been invested in bonds and works of art by early 1995.132

2.3.3. Foreign securities

A final aspect of the portfolio composition studied was the degree to which the investment companies invested in foreign securities, since this could provide a guide both to their confidence in the Slovak capital market, as well as to what extent the fund should be seen as a portfolio or a strategic investor. The latter line of reasoning is based upon the assumption that the greater the distance to the firms, the larger

132 Adding to this that all of their funds held a high portion of shares in the financial sector (PFIF > 35%; GIF = 50%; ZIF = 60%) PSIS stands out as the least industrially oriented of the investment companies included in the study, even though initially its largest fund (PFIF) acquired interests also in energy, paper, trade, chemicals and in machinery and consumer goods production. Sources: Investment funds in Slovakia (1995), pp. 8-10; Rajčak (1995) [interview].
the problems for an owner to get involved in direct control of its activities, i.e. the problems with direct involvement and governance are thought to increase with the distance from the firm. An exception to this is the holdings of the Harvard group where governance issues were co-ordinated so that HIS represented the whole group in Slovakia, while the Czech branch represented HIS in the Czech Republic.

A trend, pointed out already in Chapter IV, was that Slovak funds acquired substantial shares in Czech firms. On average shares in Czech firms initially came to account for 23.1 per cent of the Slovak investment funds’ portfolio.\textsuperscript{133} This relatively strong position of Czech securities has remained. However, as is shown in Table 25 the case study funds were not representative in this respect with, on average, more than 60 per cent of NAV at end-1993 in foreign (Czech) securities. The investment company with the highest portion of foreign assets is VUB Invest. This is however not surprising, but rather to be seen as a consequence of their size compared to the Slovak market. There simply was not enough attractive Slovak issues to buy into if one at the same time should abide by the rules that put ceilings on the holdings of investment funds. Also in the Harvard group the majority of assets have been in Czech firms. The General Manager of HIS, Ms. Matysová, explained the traditionally high portion of foreign assets by suggesting that Czech firms were in a better position at the time of privatisation, and that the first year after privatisation there was no Slovak company which paid dividends. Such considerations are of course extra relevant given the poor performance of the stock market (lessening capital gains) and given the fact that many funds were cash-starved to begin with. In such a situation dividends turned an important source of income. Cassoviainvest, finally, stands out as the most “domestic” of the four investment companies, with initially only one fifth of assets in foreign securities. Still, during 1995 they doubled this share to in excess of 36 per cent of NAV, thereby going against the trend in the other investment companies which showed gradually declining holdings of foreign securities.

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<tbody>
<tr>
<td>VUB Invest</td>
<td>84.0</td>
<td>71.0</td>
<td>67.0</td>
<td>63.3</td>
</tr>
<tr>
<td>HIS 1</td>
<td>82.1</td>
<td>62.1</td>
<td>49.4</td>
<td>8.6</td>
</tr>
<tr>
<td>CIC 1</td>
<td>21.2</td>
<td>18.3</td>
<td>36.9</td>
<td>–</td>
</tr>
<tr>
<td>Weighted avg. (above three)</td>
<td>62.6</td>
<td>58.0</td>
<td>56.3</td>
<td>53.6</td>
</tr>
<tr>
<td>PSIS/PPIF 2</td>
<td>60.4</td>
<td>55.0</td>
<td>66.4</td>
<td>73.7</td>
</tr>
</tbody>
</table>

Sources: Annual Reports; interviews; data communicated directly from the investment companies; own computations.
Notes: \textsuperscript{1} Weighted average of the holdings of funds administered by the investment company. \textsuperscript{2} Figure refers to PSIS’s largest fund (PPIF) only – and is not included in the above average.

\textsuperscript{133} PlanEcon (1992), p. 2

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2.4. Strategies and common problems in governance

During voucher privatisation funds acquired property with a nominal book value of Sk 58 billion ($1.75 bn), equalling 60.4 per cent of the total on offer in Slovakia.\textsuperscript{134} It was, in short, clear that the funds were destined to become the dominant actors in the market for property rights in the country. In a “normal” firm, investment funds controlled somewhere in the vicinity of 40 per cent of outstanding equity.\textsuperscript{135} It follows that the behaviour and strategies of investment companies would have a significant impact on the ensuing governance-structures. It has also been established that all the investment companies in our study had portfolios large enough to enable them to take an active part in the governance of firms. The vehicle for turning portfolio-holdings into actual influence in the decision-making process of a firm is usually through representation on the governing bodies of the particular firm. However, the extent to which they are actually represented will also depend, among other things, on the general strategy of the fund and the institutional set-up. Given the 1995 changes in regulation mentioned, whereby investment funds were banned from representation on the Board of Directors and forced to reduce their holdings in any one particular firm to a maximum of 10 per cent, it is clear that the institutional set-up was made less than conducive for fostering the active involvement of investment funds and investment companies in the governance of firms.

These moves to curtail the influence of investment funds points to one of the great contradictions of the voucher privatisation scheme. Before the programme was started, fears were voiced that the voucher scheme would lead to a too dispersed ownership structure to enable effective control.\textsuperscript{136} The potential problems were recognised by the authorities, which nevertheless held the view that the problems of an overly dispersed ownership structure would be overcome through secondary trading, where shares would ‘accumulate very quickly in the hands of investors who are capable of providing sufficiently strict oversight over the financial discipline of their company’\textsuperscript{137} Also, investment funds were explicitly acknowledged as having an important role to play, not only as portfolio investors, but also as strategic investors.\textsuperscript{138} Given all this, one would be led to believe that the concentration of ownership should have been welcomed. However, the earlier discussion has illustrated that they were not. It is therefore interesting to consider the possible causes for this resistance against the investment funds, something that is done by beginning to look at the behaviour of investment funds as owners.

\textsuperscript{134} See Appendix D, TABLE 12 (p. 327).
\textsuperscript{135} On initial ownership structure and the concentration of ownership, see Chapter VI: 2.1 (Table 32, p. 219) and Chapter VI: 2.4, page 231 ff.
\textsuperscript{136} These fears were natural since privatisation per se would not necessarily lead to an improvement of performance, unless the process made it possible for effective corporate control. Also, there are good grounds for saying that corporate control is more effective where there are larger blocks of shares (cf. Shleifer and Vishny (1986); Caves (1990); Leech and Leahy (1991); Kornai (1990)). A possible outcome of the voucher scheme could, were it not for the investment funds, instead have been a scenario with thousands of small and disinterested shareholders, great logistical problems connected with general shareholders meetings and so on. Such a situation would de facto have left incumbent management in charge of all important aspects of decision-making.
\textsuperscript{137} Kupónová privatizácia. Informancti príručka (1991), Section II: 16.
\textsuperscript{138} Kupónová privatizácia. Informancti príručka (1991), Section I: 6.2-6.3.
How funds and investment companies have used their powers is thus the main theme of the remainder of this section. We begin by reviewing the structure and function of the governing bodies (Section 2.4.1). In connection with this, the actual behaviour of the investment companies included in our study with regard to board representation is presented. A discussion of the relations between the new owners in the form of investment fund representatives and the incumbent managers is then introduced. The attitudes of fund managers will be reviewed as will their perception of the problems and their response to these problems. In the next section (Section 2.4.2), the changes in regulation and their effects on funds and on the governance structure in general are looked at. In Slovakia, as will be shown, the gradually more and more restrictive government policies with regard to fund involvement did indeed play a crucial role in shaping and changing the behaviour of funds and investment companies, and eventually in the demise of the funds.


The Slovak governance system bears resemblance to the German two-tier board system. In practice, the normal set-up used to be to have three different “boards”. Firstly there would be a Board of Directors, which ‘directs the activities of a company and acts in its name’.\(^{139}\) The board would typically meet bi-weekly or on a monthly basis. Secondly there would be the Supervisory Board, which ‘oversees the action of the board of directors and monitors the realization of the business activities of the company’,\(^{140}\) meeting every two to three months. Normally both boards would consist of some five or six members.\(^{141}\) In addition to the two statutory boards there would be a “Board of Managers”, consisting of the General Director and other top executives, and which would meet and run the firm on a daily basis.\(^{142}\)

Even though the basic rules with regard to the statutory bodies were set out in the *Commercial Code*, the code left a good deal of discretion for owners to decide on the internal division of powers.\(^{143}\) The Supervisory Board, for example, is guaranteed only minimal rights, i.e. control rights over finance, even though the statutes of a firm can allocate more powers to it. Consequently, the relative influence of the Supervisory Board varies from firm to firm, depending on its statutes. Thus, the dominant owners have a potentially great influence in setting up the controlling bodies and their jurisdiction. In 1995 it was estimated that the more “American model” with a strong Board of Directors was predominant, accounting for some two-thirds of all companies;\(^{144}\) this was also the model which for different reasons

\(^{139}\) *Commercial Code*, Section 191, para. 1.

\(^{140}\) *Commercial Code*, Section 197, para 1.

\(^{141}\) On board size and composition in three selections of Slovak firms, see also Chapter VI:3.2.1. Both boards must have a minimum of three members. Regarding the Supervisory Board a minimum of one-third of the members must be elected by the employees in firms with more than 50 employees; likewise, a maximum of two-thirds (and a minimum of one-half) of the members are elected by the General Shareholders Meeting. The basic rule is that also the Board of Directors is elected by the General Shareholders Meeting, although this power can in the by-laws be ascribed to the Supervisory Board. See *Commercial Code*, Section 194, para. 1 & 3; Section 200, para 1.

\(^{142}\) See Oravkin (1995) [interview].

\(^{143}\) See *Commercial Code*, Sections 191-201.

\(^{144}\) See Mizla (1995) [interview].
(see below) was favoured by investment companies. Or, as the Vice-President of HIS, Mr. Holly, put it:

‘in those companies where the FNM has had a great share there is a strong Supervisory Board, whereas when the majority of owners are represented by investment fund managers there is a strong Board of Directors.’

The question then is, who is it that manages and controls the firms? Beginning with executive management, we can say that there were no drastic changes. Before privatisation, there was much speculation that new owners would quickly move to replace incumbent management, often thought to have been corrupted by the communist system and thus inapt to lead firms in a new capitalist market environment. In reality, however, the outcomes have proved a lot more complex than this stereotypical picture. For one, the evolution of a different economic co-ordinating mechanism did not in any significant way change the basic features of the human capital of Slovakia, even though behaviour, of course, will be affected by the changing incentive structures. Also, although recruitment in the communist era was made according to wholly different criteria than would have been the case in a competitive market environment, the people who were put in charge belonged to the highly educated, even if they were more often graduates from technical universities than from the non-existing business schools, or, in other words, these people were to some extent "the best they had".

This is a fact that seems to have been acknowledged by fund managers. HIS again proves a good case in point. Despite their initially strong position in the boardrooms, replacements were the exception rather than the rule, and the General Manager of HIS said that: ‘the most important role of both of our funds is to stabilise the management and the development of the companies.’ The idea was that if incumbents did well during the period of transformation and achieved intended results they should also be able to co-operate in the future. This, however, does not in any way imply that the relationship between new owners and incumbent management has been without problems. Quite to the contrary, it seems that the de facto property rights exercised by managers during the communist era and discussed in Chapter II:5 were indeed present and left a strong heritage. All fund managers agree that the major problem in their relationship with managers are in some way connected to this heritage of managers behaving as owners during communism. This of course brought a potential for conflict when “young men from Bratislava” came and tried to tell managers what to do. This resistance on behalf of managers to accept the consequences of having new outside owners is also pointed to as the major reason for replacing top management.

A consequence of this situation was that most funds initially perceived it as necessary to get as strong representation on the governing boards as possible. Fund managers all viewed representation as the only way to prevent managers from spinning off or diluting the value of assets in one way or the other. The General Man-

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145 Holly (1995) [interview].
146 Matysová (1995) [interview].
147 Sevcik (1995) [interview]; Mizla (1995) [interview].
ager of HIS, for example, mentioned that typical reasons for removing managers was that management took decisions about the property of the company for which they had no formal competence, for example by selling off one branch or establishing daughter companies.148 Also, in order to get the insight and influence necessary to stop managers from pursuing their private interests it was necessary to take an active part on the Board of Directors rather than only on the Supervisory Board.149 Even PSIS, which in sharp contrast to other fund managers wanted to act more like a portfolio than a strategic investor, often put representatives on both boards if their voting power allowed it in order to avoid managerial mishandling.150

Of course, the potential for actual representation varied among fund managers, depending on the size and structure of their portfolios. Cassoviainvest, for example, in 1995 had holdings sizeable enough to render them representation on the governing bodies of about one-quarter of the approximately 600 firms in their portfolio. VUB Invest, somewhat less diversified and above all with much more sizeable holdings, had representation in more than half of the firms in its portfolio.151 In most cases, they were even represented on both the Board of Directors and the Supervisory Board. The Harvard group, finally, was one which because of the extremely low number of companies in the portfolio could put their own people on both boards in all firms in the portfolio. In October 1995, there were for example a mere seven Slovak firms in the portfolio of HIS’s funds.152

Thus, the sheer number of people needed to maintain representation on firms where funds, given their holdings, could demand such representation posed a serious constraint for many of the larger and/or more diversified funds. In-house competence for these kinds of operations and monitoring was hard to find, investment companies were often forced to sub-contract for these tasks, and not always able to find the kind of people they would have wished. A consequence was that complaints from managers about the funds being represented by too young and inexperienced people were commonplace.153

Given problems like this, it is not difficult to understand that, despite the fact that the investment companies have been extensively involved in the Board of Directors, none seemed too happy about the situation. Representatives of Cassoviainvest, VUB Invest and PSIS alike, would rather have seen a development where such close monitoring would not have been necessary and where it would suffice that they concentrated their scarce resources on representation on the Supervisory Board. A Vice-Director of VUB Invest, Mr. Sevcik, pointed to a problem with the prevailing situation in that fund representatives on the Board of Directors to some

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148 Matysová (1995) [interview].
150 Rajcak (1995) [interview].
151 Thus, before they began to restructure and sell off some of their holdings in 1995 VUB Invest had representatives in some 140 companies.
152 For the thirteen Czech firms there is an agreement with HC&C that it takes care of board representation, likewise HIS represents the Czech funds’ ownership in Slovak firms.
153 While a representative of CIC agreed that such complaints were not always groundless he maintained that the presence of the investment funds was still a great advantage for the firms, saying that managers often tried to find new scape-goats for problems which were really a heritage of the communist system, see Mizla (1995) [interview].
extent were made “hostage” of the nitty-gritty details, thus increasing the potential for making mistakes as well as reducing the potential for strategic decision making. Thus, as it was, nobody was really content with the situation.

2.4.2. **Politicised governance: Slovakia in 1995-1996**

The core of the problem seemed to rest with the fact that managers and owners had completely different ideas and values, not only about what kind of influence the owners should have but also with regard to the long-term needs and strategies of the firms. While fund managers have tended to emphasise the problems of low quality in production, inexperience in sales and difficulties in establishing themselves on new markets, managers have often emphasised the need for new capital. In addition, fund managers held that a manager ‘is paid for the job he does and for the results that he realises’; and indeed also tried to initiate bonus-systems of various sorts. However, managers in many cases wanted something else, they wanted to become the actual owners of the firms, or as Mr. Mizla of CIC said, ‘a lot of managers openly talk about the fact that they would like to have some shares in the company as a private person in order to be motivated.’ Still, this notion was rejected by CIC as well as other fund managers.

The conflict was further compounded by the changes in privatisation policy during 1995. As pointed out by representatives of VUB Invest, a direct result of the new privatisation policy with direct sales was that managers who acquired a large chunk of shares on soft terms from the FNM all of a sudden lost all respect for other minority owners. In fact, during the course of 1995 and 1996, many funds could only sit by and watch how control of companies slipped through their fingers as managers or other domestic industrial groups took over. One example is HIS which saw four of their major investments fall into the hands of management. Firstly, a controlling stake in Slovnaft was sold to its management (see Appendix C). In JCP Sturovo the dominance of HIS/HC&C was also challenged following the sale of a 30 per cent stake by FNM. The story repeated itself in Nafta Gbely (see Appendix C) Finally, in VSZ management and trade unions gradually gained control (see Chapter VI:2.2). By the summer of 1995, when Hutnik got representatives on the Supervisory Board, the company was effectively insider-controlled and HIS was the only outsider represented in the governing bodies. However, in the end the HIS-representative found that the meetings were not worth the travel since there was no information forthcoming. Also, following the dismissal of its representative on the Supervisory Board, Mr. Siroky, at end-November the Harvard group took the full consequences and sold their 12.1 per cent stake in VSZ in early 1996. VUB Kupón also held a significant amount of shares in VSZ (7%) and had to watch their

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154 Mr. Sevcik, who was also assistant to the General Manager, exemplified by saying that sometimes all invoices (!) had to be signed in a large bunch by the fund representatives, see Sevcik (1995) [interview].
155 Cf. Ondíková (1995) [interview]; also see Chapter VI:3.2.2 where firm executives give their view.
156 Mizla (1995) [interview].
157 Mizla (1995) [interview].
158 Mizla (1995) [interview].
board-representative fired. With only one outsider left on the board of the largest firm in the country, the fund quickly began to lower their holdings, arguing that the company was far too non-transparent. The Director of Funds Management at VUB Invest, for example, after having reduced their holdings in VSZ by 50 per cent (app. 400,000 shares) said that VUB Invest would be happy having no shares at all in the company. \[160\]

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\textbf{Oravkin (1995) [interview].} & 183 \\
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It was, however, not only the changes in privatisation policy that affected the position of investment funds and companies in different firms. Also the question of board representation \textit{per se} turned into a major issue in Slovak politics. The government of Mr. Meciar made clear that they found it unsuitable to have “outside” investors (investment funds) being represented on both boards. Their unwillingness for this type of arrangement was then manifest in the amendment to the \textit{Law on investment companies and investment funds} adopted in 1995 (see Section 2.2.2). The amendment expressly forbade investment funds to be represented on the Board of Directors and gave until end-1996 for these changes to be fulfilled.

These changes, and the responses that they provoked from investment companies, would prove to have far-reaching effects on many levels. A first and immediate consequence was that in most cases extraordinary General Shareholders Meetings had to be called to elect new bodies and to decide about what competencies should be given to the Supervisory Board. This implied, of course, that fund managers would revert on their old policy of having a strong Board of Directors and instead try to vest as much powers as possible with the Supervisory Board. Still, whatever they achieved in this respect could later easily be changed by any new majority owner. Yet an implication is that many of the smaller funds would be without any chance of board representation, as all fund-representatives would fight over the few seats on the Supervisory Board.

As for the real effects of the other part of the amendment, i.e. the requirement for a maximum of 10 per cent in any one firm, they were less clear. Many funds were of course forced to sell their shares, either directly on the market or in different swap deals with other funds. Still, regarding the major investment companies it seemed already in 1995 that they were not prepared to easily give up their positions. Representatives of VUB Invest, for example, said that one solution would be to transfer holdings to other companies for the days around the general shareholders meeting. As a preparation for that, VUB Invest transformed into a holding structure. That way share-holdings could for example be transferred to some other company, \textit{de facto} controlled by the investment company, for the days around the General Shareholders Meeting, and then sold back to the fund. The price for this will be a dramatic deterioration with regard to transparency, in addition to some increases in administration costs. It is in the light of this that the concentration of the fund market and the controversial transformation of investment funds into normal stock companies should be seen. One interpretation is thus that the increasingly restrictive
policies towards funds, in combination with inefficient mechanisms for rule-enforcement, is what provoked the demise of Slovak investment funds.

2.5. Investment funds and capital market development

Being the dominant shareholders following voucher privatisation, one could have expected investment funds and investment companies to play an important and positive role in the development the Slovak stock market. These expectations, however, largely failed to materialise. As discussed above, the major problems plaguing the stock exchange had been, among other things, the strain on liquidity; the generally low level of trading activity; the excessive amount of off-market and, later, direct trades; the low level of transparency and so on. Investment funds and investment companies have done little to change any of this – in fact, quite to the opposite in many respects.

A serious obstacle for developing the stock exchange towards a transparent one has been the tendency for investment funds to conduct the majority of their trades off-market. For HIS, for example, off-market direct trades reportedly accounted for some 60-70 per cent of the trading volume; the situation was similar for other funds and investment companies. In this respect it did not matter much that all major investment companies set up their own brokerage companies since they were nevertheless primarily dealing off-market. Following the regulatory changes in September 1995, where off-market transactions were officially banned, those transactions indeed moved to one of the two official markets. Whether this actually served to increase transparency is, as was discussed in Section 1.4.2, doubtful as the funds continued with predominantly direct trades of larger blocks of shares. The question is why?

Part of the explanation as to why this type of block-trading has dominated the Slovak capital market lies with the substantial premiums paid for larger blocks of shares; reportedly up to 100 per cent of market price. These premiums, in turn, originated in the battle for control over particular firms that was fought by managers and domestic industrial groups in what was commonly called the “third wave” of privatisation. It is also this process which resulted in the significantly increasing ownership concentration which is discussed in the following chapter. Fund managers, of course, were not late to realise this – especially since it proved somewhat difficult to make money on “normal” portfolio management. The Harvard group, for example, early realised this and was making good money from slowly and secretly buying in to firms and ending up with a controlling block of shares, later sold to some strategic investor. This strategy had the dual advantage of yielding maximum influence while in the portfolio as well as the large premiums when selling. Also, HIS was far from alone in this. The Director of Funds Management of

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161 In the Harvard group, for example, all trades are conducted by the sister company within the group, Harvard Stock Exchange Company (Harvardská burzova spolocnost, a.s., HBS), which also offers its services to external clients.


163 On increasing ownership concentration, see Chapter VI:2.4 (esp. Table 33, p. 232) and Appendix D, TABLE 25-TABLE 30.

VUB Invest, Mr. Oravkin, in August 1996 stated that: ‘[t]he best way of capital empowerment in Slovakia is nowadays investing into majority blocks.’

A consequence is that funds had no genuine interest in increasing transparency on the market, something which would endanger the value of their insider information and making much less possible the kind of lucrative block deals from which they were thriving. On the contrary, there are strong incentives in reporting wrong prices, thereby affecting the market. The situation thus posed a dilemma. While in general it must be considered as desirable to lessen the extent of direct trading and insider deals – a view which at least in theory, was shared by some of the fund managers. At the same time, however, it was clearly difficult for investment companies to become more of the portfolio-type of investor on a market as illiquid as the Slovak one. In fact, there was something like a “Catch 22”; the government on its side wanted to confine investment companies to portfolio-handling, however, at the same time government regulation and policy lessened the attractiveness of engaging in the capital market, thus lessening liquidity and making it even more difficult to do without the revenue ensuing from the power-games played. Thus, in conclusion, the general strategy of the fund managers in our case study has not been one conducive for enhancing transparency of the official markets, nor for bringing liquidity to these markets.

2.5.1. Mutual funds: a project doomed to fail?

One of the major reasons why the funds have played such a relatively insignificant role for the development of the capital market, in addition to the above discussed habit of trading little and off-market (alternatively in direct trades), is that they have failed to bring fresh liquidity to the market. First, their initial holdings never had any backing in real money and the vast majority of the population also looked upon their share holdings as a one-off gift from above. To be able to behave efficiently, the investment companies thus had to raise fresh capital by means of establishing institutions and organisational arrangements which were all new to the Slovak population. For this to work one had to either raise the savings level or/and divert savings from the only institutional arrangement known for the population thus far, namely traditional savings accounts. One way to do this was to establish mutual funds.

All investment companies in our study attempted this, but with highly varying degrees of success. CIC established and administered two mutual funds, one being

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165 Quote in TREND Tyždenník o hospodárstve a podnikaní, No. 34, 1996. Nobody wanting to stay on the market could ignore this fact. Even PSIS who wanted to behave like a portfolio investor often held stakes in the 5-15 per cent range given the large premiums paid for larger packages, see Rajcak (1995) [interview].

166 Mr. Rajcak of PSIS was the only one interviewed fully in favour of the changes in capital market regulation which required all trades to go through brokers and the official exchanges, as well as the stricter (although still lax) requirements for firms to publish their results. The General Director of HIS, Ms. Matysová, agreed however that in the long run it would be sensible to concentrate trading and making it more transparent. However, Mr. Holly from HIS was somewhat more critical, stating that the reason for the legislative changes was that the government wanted to have control over something that they did not understand. Mr. Mizla of Cassoviainvest, finally, said that the increasing costs for transactions would pose a problem, at the same time as he was sceptical towards whether the rules will achieve the increased transparency which the government officially was aiming for.
a closed-ended cash fund (Fond Ludoveho Investovania/People’s Investment Fund) and the other a open-ended one (Fond Ludoveho Sporenia/People’s Savings Fund). The former, at end-1994, had a NAV of Sk 32.99 million ($1.05 mn) while the latter at the same time held net assets valued at Sk 121.9 million ($3.9 mn). Slightly more successful were the operations of VUB Invest with its two funds. Net assets in its Financial Fund (open-ended) and Real Fund (closed-ended) amounted to Sk 167.9 ($5.37 mn) and 38.5 million ($1.23 mn) respectively at end-1994. Together these four funds, however, held a mere 10 per cent of total net assets in mutual funds at end-1994, which then in total amounted to Sk 3.4 billion ($108.7 mn), see Figure 19.

The real innovator and entrepreneur on this market was instead PSIS which with its three unit funds did for the mutual funds market what HC&C in 1992 had done for voucher privatisation, i.e. they made it straightforward, comprehensible and, above all, profitable for the average citizen to allocate their savings into funds rather than into the traditional savings account. In early 1995, their funds were raising some Sk 150-200 million ($5-7 mn) a month (!) from the public, thus constituting the only vehicle raising a substantial amount of cash and consequently placing PSIS in a position as a “market-maker” on the Slovak capital market. The largest fund was Sporofond, an open-ended fund with one billion units in the par value of Sk 1/unit. By early 1995 the fund had attracted some 43,000 clients since its establishment in 1993 and had a market value of about Sk 1.5 billion ($50 mn).

Figure 19. The rise and fall of Slovak mutual funds, 1991-1996

Source: Data communicated directly from ASIF/Ministry of Finance; own computations.

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168 Also HIS established two minor mutual funds which severely failed to attract the interest hoped for.
169 In addition to Sporofond PSIS was operating one other open-ended fund (General Investment Fund [Vseobecný investičný fond, VIF]) with a market value of about Sk 500 million ($17 mn) and a closed-
Investing and taking money out from Sporofond was made easy, and Mr. Rajcak of PSIS explained that the attractiveness of the fund was that it operated like a bank. Clients could withdraw their money in a maximum period of one month, though usually it only took two weeks. Liquidity of the fund was good and the strategy was to invest into the 10-20 best companies in the Czech and Slovak Republics. Shares were usually bought either from brokers or from DIKs in direct deals, in order not to push the prices up.\footnote{The basic strategy was that prices of the shares would rise and begin to approach a realistic value once the market stabilised. However, the Act on safeguarding the state interests in the privatisation of strategically important state-owned companies and joint-stock companies (Act no. 175/1995) adopted in the summer of 1995 was a blow in that it caused prices of many shares to drop since the state had made clear that they would retain their influence in a number of companies, e.g. VUB, Plastika etc.} In short, what one saw at the time was the beginning of a success story. It was to be a story which, however, would come to an abrupt end as is shown in the section below.

2.5.2. De-licensing PSIS

In April 1995 the problems for the group began, and what was about to happen is a story which is hard to believe. On 31 March 1995, the Ministry of Finance decided to strip PSIS of its license; stop trading in the shares of the funds; and, to put their funds under forced custody, most of them with HIS.\footnote{Agroninvest was put in charge of the two minor first-wave funds and Velky Fond (one of the funds established for the second wave of voucher privatisation, see below), and HIS in charge of all other funds.} The decision was made public on 6 April, but the Ministry of Finance gave no specific reasons for the actions taken. The decision was allegedly made in accordance with the Law on investment companies and investment funds\footnote{Law on investment companies and investment funds, para. 37.} stating that ‘if competent state authority in state inspection finds out that an investment company or investment fund does not maintain an appropriate level of liquid assets in relation with promises to shareholders, the license of the investment company will be revoked.’\footnote{TREND Tyzdenník o hospodárstve a podnikaní, No. 26, 1995.} However, PSIS never had any problems in buying back fund units.\footnote{CTK-Business News, 3 July 1995.}

In June 1995 the state secretary of the Ministry of Finance further explained the reasons for the sanctions, saying that PSIS had used Sk 700 million against the law by illegally handling the assets of its mutual funds (e.g. Sporofond) when financing the second wave of coupon privatisation.\footnote{Rajcak (1995) [interview].} The same story told by a representative of PSIS, Mr. Rajcak, is (of course) a different one, although the one which the Constitutional Court would judge as the correct one in its November 1995 decision which would revoke the decision by the Ministry of Finance. Mr. Rajcak explained that the success of the mutual funds meant that PSIS was facing a problem of finding good enough investment objects for its funds. The problem was accentuated by the fact that the FNM did not float any shares on the market, they only privatised through direct sales. This made PSIS decide to take part also in the second wave of voucher privatisation, for which it established two funds, Big Fund [Velky Fond, ended fund, the Slovak Property Fund [Slovensky majetkovy fond, SMF]; both small in comparison with Sporofond.
VF] and the Pensioners’ Fund [Fond pre dochodcov, FPD]. In short, the idea was to have the mutual funds invest into the second wave of voucher privatisation by buying future-shares of the two voucher-funds. In return for these shares, which would be finally acquired at the prices prevailing three months after trading in the second-wave shares had begun, Sporofond extended pre-payments in the amount of Sk 260 million to FPD and some Sk 450 million to VF. The cash was used to finance the campaign set up to attract voucher-holders to the two funds.\footnote{Rajcak (1995) [interview].}

The campaign was indeed successful with the Pensioners’ Fund attracting some 300,000 clients already by September 1994, i.e. before the elections that in effect would lead to the cancellation of voucher-method. PSIS had sent letters to pensioners that included a voucher booklet and a letter saying that if they wanted to join the fund they would register the booklet and send it back to the fund. The campaign was a success in that 95 per cent of the targeted pensioners did join. Thus, a problem was that it was impossible to stop the campaign even if PSIS would have anticipated what was about to happen. VF, in turn, attracted about 250,000 citizens. Thus, in total PSIS had attracted more than half a million citizens for the second wave. For this the fund extended money with which DIKs could pay the registration fee of Sk 1000 or 700. The money would later be deducted from dividends, i.e. a pre-payments scheme.\footnote{Rajcak (1995) [interview].}

The whole manoeuvre was professedly done in accordance with the Law on investment companies and investment funds (§17:6) which, in the interpretation of Mr. Rajcak and PSIS, opened up for investment fund and unit funds to buy also shares which were not on the financial market, but which it was possible to assume that would be publicly traded.\footnote{Rajcak (1995) [interview].} The paragraph stated that ‘[t]he assets in the stock fund and the assets of the investment fund may also be invested in securities still non-negotiable on the financial market…which can be assumed to be accepted for trading on this market in the future.’\footnote{Law on investment companies and investment funds, Article 17, para. 6.} The line of reasoning is indeed a tenable one if one, like Mr. Rajcak and most citizens, viewed the voucher booklet as a state security issued by the Ministry of Finance, entitling the bearer to buy shares in the firms included in the list of companies slated for voucher privatisation.\footnote{Law on investment companies and investment funds indeed states that the ‘investment coupon …shall be deemed to security […] giving the right to purchase shares specified for sale against coupons’ (Article 22, para. 1); on the amount of property approved for the second wave, see Chapter IV:3.3, page 122 ff.} Further, according to the Law on investment companies and investment funds the Ministry of Finance could after publication only change the list marginally, i.e. to correspond better to the number of interested citizens or to incorporate new information about the value of the companies included etc.\footnote{Law on investment companies and investment funds, para. 24c; the paragraph, however, was later omitted with the introduction of Act no. 190/1995.} Thus, by investing his points with an investment fund (VF or FPD) the citizen had (in theory) ensured the fund to become the owner of shares that would be publicly tradable, in exchange for a pre-agreed number of shares in the investment fund itself. This made it certain that the fund in
the future would receive shares in companies listed by the Ministry of Privatisation, shares that the mutual funds made a pre-payment for.

However, the Ministry of Finance obviously did not share the viewpoint of PSIS and Mr. Rajcak that this was a transaction without risk and thus cancelled the license of PSIS on 31 March 1995. Whether this assessment of risk was contingent on the Ministry of Finance already knowing that the whole scheme of voucher privatisation would be cancelled by the government, or on some other considerations, is not possible to find out. There were, for example, repeated allegations that the decision was politically motivated and that a contributing factor for de-licensing PSIS would be the financial support for the opposition daily Sme which PSIS, through its ownership in Sumus s.r.o. (publisher of Sme), extended.182

PSIS’s reaction to all of this was initially to complain to the Ministry of Finance, without results. In July they turned to the Constitutional Court, complaining that the Ministry of Finance had not acted in accordance with the law.183 On 30 November 1995 they were given right in a verdict from the court which supposedly was final. The ruling stated that the Ministry of Finance had not acted in keeping with the law, adding that for the most part the sanctions imposed upon PSIS were not supported by the findings of the court.184 According to the ruling, PSIS should be able to renew its activities and regain control over the various funds. The Ministry of Finance, however, signalled that they had far from given up, and following the ruling by the Constitutional Court State Secretary Jozef Magula stated that the court had manifested deep ignorance of the law and had been acting contrary to the constitution, although adding that the Ministry would respect the ruling. However, the story of PSIS and the Ministry of Finance was far from finished. Already in January 1996 it was clear that the brokerage company PSBS (a sister company to PSIS) would not be granted a renewed license.185 Further, in mid-February, when PSIS had reached an agreement with HIS about regaining control of their funds, the Ministry ordered yet a renewed audit of PSIS before they could be returned their funds.186 Then, in June 1996 the Ministry of Finance once again revoked the license of PSIS (!), this time arguing that PSIS had not transformed itself into an investment company before end-November 1992, which it according to the Law on investment companies and investment funds should have done.187 Interesting is that documents which acknowledge the correctness of this transformation was signed by the State

182 Cf. Hospodarske Noviny, 12 April 1995; BBC Monitoring Service: Central Europe & Balkans, 13 May 1996; CTK-Business News, 19 February 1996. The allegations also held that the behaviour of the Ministry of Finance was discretionary and highly contingent on the various informal alliances between political groupings and the different investment companies. Clearly there are some differences between the behaviour of PSIS, more or less openly supporting the political opposition and, say, Cassoviainvest which traditionally held close ties to the Meciar-government through its founder VSZ. An example could be that CIC in the fall of 1995 bought the oppositional local (Kosice) newspaper Slovensky vyehod (Slovak East) only to install a HZDS-loyal editor-in-chief (Jan Pall Bily), cf. BBC Monitoring Service: Central Europe & Balkans, 19 October 1995. The paper was later (1 March 1996) merged with the pro-government Luc (The Beam).

183 Asked about the possible outcome Mr. Rajcak stated that it is very difficult to say. He does however acknowledge that there is chance that the Ministry was right if judging by the exact reading of the law.


Secretary at the Ministry of Finance, Jozef Magula, himself in 1992 and 1993.\textsuperscript{188}
The decision would, once again, be appealed to the Constitutional Court.

* * *

It is difficult to assess the long-term consequences of these happenings. One thing seems clear, however, and that is that it did not aid in the development of the Slovak capital market. Not only did it affect PSIS as an investment company; it also greatly raised the general level of uncertainty surrounding the market for collective investment. Trust and confidence in the impartial regulation of capital market activities was severely afflicted, thus creating the kind of uncertainty that is far from beneficial from an institutionalist viewpoint. In addition, it dealt a lethal blow to the market for mutual funds in general. Sporofond was put in liquidation by HIS since more than one-third of its unit-holders had requested to cash in.\textsuperscript{189} With close to 50,000 persons having lost faith in this type of collective investment, the market for mutual funds was more or less dead. Figure 19 illustrates the demise of the funds, both in terms of the number and the amount of assets held. By mid-1995 it was estimated that total assets in mutual funds had decreased by close to 20 per cent compared to end-1994, that is to Sk 2.8 billion ($95 mn), a figure which could be compared to the Sk 100 billion ($3.4 bn) or more deposited in savings accounts.\textsuperscript{190} Thus, 1995 was a watershed for mutual funds and collective investment in general.

2.6. Investment funds: agents for corporate governance or agents of individual accumulation?

In this section the question of “who controls the controllers?” is approached. In short, what agents was it that ultimately controlled the sizeable holdings of the investment funds? Whose interests did the funds represent? For example, for what purpose and through what mechanisms could the close to one million DIKs enforce their interests in the funds? It is interesting to see to what extent these could influence the use, management and income derived from these assets of which they were the nominal, albeit indirect owners. Furthermore, given the potential influence of these funds in voucher privatised firms, it is indeed an interesting issue as to who actually controlled these holdings, not least since it may provide some insight into what kind of incentive structure fund managers met.

Let us begin by observing that the direct influence of small investors with regard to collective investment is limited in any economy, regardless of the specific institutional set-up. Rather, it is in the nature of collective investment that the property rights held by individual investors can be exercised only indirectly at best. Most commonly this is exercised through \textit{exit}, as the concerted effort needed to make \textit{voice} feasible is often deemed too costly. However, recognising this fact is not the

\textsuperscript{188} Narodna Obroda, 16 February 1996, p. 1.

\textsuperscript{189} From mid-April 1995 the unit-funds had stopped buying back units from its shareholders. This caused panic among investors, and according to the law a fund must be closed if more than one-third of its shareholders requested the resale of their units in a period of six months. By end-June 1995 this figure had reached 35.7 per cent in Sporofond, and HIS announced the closure of the fund, see Reuters News Service, 27 June 1995.

\textsuperscript{190} CTK-Business News, 3 July 1995.
same as saying that the degree and type of influence of investors does not matter. Quite to the contrary, it can be argued that such factors will have a profound influence on the incentives of fund-managers, and thus on their responsiveness to the priorities of the actual investors – which most commonly ought to be for profit maximisation.

In many countries the combination of market competition among fund managers, the mobility of investors capital associated with exit, and legal protection of shareholders/investors rights is sufficient to guarantee relatively good performance, although often collective investment is more or less connected to discounts relative to NAV. In addition to market competition and exit, there is also always the potential threat of a hostile take-over in case those discounts get too large, thereby making it profitable to take on the costs connected to collective action on the scale needed to change and improve management of the funds assets. Let us now turn to the potential efficacy with which these mechanisms could work in the Slovak setting. In Section 2.6.1 the potential disciplining force of exit and market competition is analysed. In Section 2.6.2 the focus is moved to the potential for voice. Finally, in Section 2.6.3, we leave the funds and instead look at where control over the actual investment companies was vested.

2.6.1. Control of the funds: exit and market competition

We begin by looking at to what extent the mechanisms of exit and market competition could serve to put pressure on fund managers to strive for profit maximisation in the interest of their shareholders. Prerequisites for these mechanisms to work include genuine competition, a liquid secondary market and institutions safeguarding the interests of individuals choosing to pool their savings in funds. In Slovakia, however, neither of these factors were strongly evident during the period of study. Firstly, regarding competition among funds, competition was indeed fierce during the “zero round” when DIKs were to be signed up.\footnote{The exception is the massive efforts which were made to attract DIKs for the second wave of voucher privatisation. PSIS’s efforts, which made it the largest investment company for the second wave with about 550,000 DIKs signed up, have already been mentioned in Section 2.5.2. However, also the other investment companies in the case study established their funds for the second wave. The Harvard group, for example, established four voucher funds which attracted the interest from some 200,000 individual investors, making HIS the second largest investment company in the second wave. To attract investors extended loans to citizens to buy their voucher booklet (see cover) and the registration stamp, something which about half of the investors used; however, unlike the first wave they extended no buy-back guarantee, see Matysová (1995) [interview] and Holly (1995) [interview]. Also CIC hoped to make money on the second wave and established some 10 funds, out of which two were national and the remainder minor regional funds, see Mizla (1995) [interview]. VUB Invest, finally, just like for the first wave established only one fund, VUB Kupón Plus. Their campaign was staged from September to December in 1994 and meant that VUB Invest gave and advance of Sk 1,000 to those who handed over the registered booklet, later to be reduced from dividends. In addition to this loan investors were promised a minimum return, once the shares were distributed, of initially Sk 2,000 – a figure which the fierce competition forced them to raise to Sk 4,000 towards the end of the campaign. Altogether somewhat less than 200,000 DIKs chose to entrust their voucher points to VUB Invest, of which about 40 per cent (app. 80,000) used the offer of a cash advance. However, when the fund began to reach 200,000 investors they stopped accepting new investors. As it would turn out this was a good move and in this sense VUB Invest was a better judge of the political landscape after the elections than for example PSIS who reached almost three times as many investors. The Director of Funds Management, Mr. Oravkin, also pointed out that PSIS ‘misread the political message’, see Oravkin (1995) [interview]. Even though VUB Invest made a good judgement it was too late for them, as for any other investment company/investment fund,}
ment companies have had no strong incentives to attract new investors since the whole affair was very much viewed as a one-off happening. In addition, the collapse of the market for mutual funds following the closure of Sporofond (see Section 2.5.2) did not serve to strengthen competition on the market for collective investment.

A prerequisite for exit to be a real option is the existence of a liquid secondary market. However, looking at the formative period of 1993 and, not least, 1994 (when the stock market was on its way up) there was precious little trading going on in the shares of investment funds. Trade in these shares at the RM-S was practically non-existing in 1993 and minuscule even in 1994 (see Table 26). Further,

Table 26. Trade in investment fund shares, 1993-1996 (total annual turnover at the RM-S, % of issue)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>“All Funds”</td>
<td>Mean &lt;0.01</td>
<td>1.72</td>
<td>30.70</td>
<td>61.70</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
<td>0.01</td>
<td>3.00</td>
<td>174.45</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>107</td>
<td>112</td>
<td>122</td>
</tr>
<tr>
<td></td>
<td>of which direct trade (%)</td>
<td>.</td>
<td>42.38</td>
<td>60.62</td>
</tr>
<tr>
<td>25 Major Funds (N=25)</td>
<td>Mean &lt;0.01</td>
<td>2.69</td>
<td>20.87</td>
<td>77.65</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
<td>0.02</td>
<td>3.21</td>
<td>26.94</td>
</tr>
<tr>
<td></td>
<td>of which direct trade (%)</td>
<td>.</td>
<td>33.74</td>
<td>62.11</td>
</tr>
<tr>
<td>Case study funds (N=10)</td>
<td>Mean 0.01</td>
<td>3.39</td>
<td>22.76</td>
<td>66.20</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
<td>0.02</td>
<td>2.08</td>
<td>27.37</td>
</tr>
<tr>
<td></td>
<td>of which direct trade (%)</td>
<td>.</td>
<td>30.79</td>
<td>53.22</td>
</tr>
<tr>
<td>VUB Kupón</td>
<td>Mean &lt;0.01</td>
<td>3.63</td>
<td>0.92</td>
<td>40.14</td>
</tr>
<tr>
<td>Harvard Dividend IF</td>
<td>Mean &lt;0.01</td>
<td>0.79</td>
<td>17.15</td>
<td>6.06</td>
</tr>
<tr>
<td>Harvard Growth IF</td>
<td>Mean &lt;0.01</td>
<td>1.07</td>
<td>15.11</td>
<td>7.63</td>
</tr>
<tr>
<td>Ferrofond</td>
<td>Mean 0.06</td>
<td>1.05</td>
<td>24.88</td>
<td>9.07</td>
</tr>
<tr>
<td>IPF I. Sporitelna-VSZ</td>
<td>Mean &lt;0.01</td>
<td>4.08</td>
<td>20.91</td>
<td>58.47</td>
</tr>
<tr>
<td>IPF II. Sporitelna-VSZ</td>
<td>Mean &lt;0.01</td>
<td>2.70</td>
<td>96.57</td>
<td>260.56</td>
</tr>
<tr>
<td>IPF III. Sporitelna-VSZ</td>
<td>Mean &lt;0.01</td>
<td>2.77</td>
<td>6.66</td>
<td>17.41</td>
</tr>
<tr>
<td>PPIP</td>
<td>Mean &lt;0.01</td>
<td>6.14</td>
<td>28.91</td>
<td>138.25</td>
</tr>
<tr>
<td>GIF</td>
<td>Mean 0.02</td>
<td>6.35</td>
<td>9.25</td>
<td>75.67</td>
</tr>
<tr>
<td>Zlaty IF</td>
<td>Mean 0.04</td>
<td>5.30</td>
<td>7.25</td>
<td>48.73</td>
</tr>
</tbody>
</table>

Source: RM-S Database; own computations.

Comment: On the composition of the different samples, see footnote 91, page 163.

to inhibit the losses which the cancellation of the second wave left them with. VUB Invest, for example, ended up with and outstanding debt in the range of Sk 80 million towards the bank (VUB) from which the company borrowed the money for cash-advances. The final loss incurred by the investment company was difficult to assess since it included things like advertising, administrative costs etc. – not to mention the damages made to their reputation. Likewise the General Manager of HIS found it hard to estimate the losses, but laughed at the compensation of Sk 0.5 offered by the government to all funds which asked to have their registration cancelled, see Matysová (1995) [interview]. The amount can be compared to estimates which held that funds spent Sk 2.5-3 billion only on pre-payments, not to mention advertising and administration, see Rajcak (1995) [interview]. Thus, by February 1996 only 90 of the 166 funds registered for the second wave had asked the Ministry of Finance to cancel their registration (see TREND Tydenník o hospodářství a podnikání, No. 7, 1996), the others were, like for example VUB Invest and HIS, biding their time and hoping that there would be an opening for using the funds in the bond-scheme – even though rumours (which would prove true, cf. Section 1.2.1) already in October 1995 had it that the Ministry of Finance would tightly regulate trading.
when liquidity started to grow substantially in 1995 and 1996, a large part of the trades were direct trades of larger blocks of shares – thus not directly affecting the minor shareholders. This block-trading, in turn, was a reflection of the moves by market actors to gain control over the investment funds (more below). Thus, in short, the potential disciplining power on fund-managers derived from exit and/or market competition for investors must be considered weak.

**Great discounts**

Closely interrelated with this, being both a cause and a consequence of the initially very illiquid market, are the very low prices on fund shares. Given the turbulent institutional environment, the nature of collective investment, inexperience on behalf of fund managers as well as investors etc. it is not in and by itself surprising that fund shares have been trading at discounts. In fact, quite often pooled investments carry some discount compared to NAV; on the well developed Swedish market, for example, a discount of some 25 per cent is not unusual.\(^\text{192}\) Still, Slovak discounts on collective investments have been playing in a wholly different league, with few funds trading at less than a 50 per cent discount. In addition, discounts were significantly higher than in the neighbouring Czech Republic, where investment funds were started on the same premises and at the same time.\(^\text{193}\) In 1993-1994 discounts averaged about 80 per cent in Slovakia, see Table 27. The table also illustrates that mistrust against collective investment was not significantly reduced over time, despite the fact that it would be reasonable to expect this, i.e. that learning on behalf of the actors, combined with a gradually more mature market, would have raised confidence in collective investment. The slight reduction in 1995 (and 1996) could be interpreted as exactly this, i.e. increasing confidence, however before any further judgement on the point is made it is necessary to probe deeper into the question of who were buying the shares and for what reason.

The funds included in the case study sample constitute no exception to this general trend of dismal economic performance, although there are some minor differences among individual funds. VUB Kupón, for example, with the backing of the largest commercial bank, is the one which showed the best (least bad) performance during its existence; implying end-year discounts in the 49.5 to 61.4 per cent range between 1993 and 1996.\(^\text{194}\) Both a cause and a consequence of this fact has been that shares of VUB Kupón have been among the most liquid, being traded both at the BCPB and the RM-S.\(^\text{195}\) At the other side of the spectrum one finds the funds

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\(^\text{192}\) At end-1996 shares in Industrivärden, a major Swedish industrial holding, carried a discount of 31 per cent (down from 38% at the beginning of the year), see Industrivärden: årsredovisning 1996 [Industrivärden: annual report 1996].

\(^\text{193}\) In early 1995, for example, a survey of 39 Slovak and Czech investment funds showed discounts in the 30-80 per cent range, although none of the Slovak funds had been trading at a discount lower than 55 per cent. The figures refers to the situation prevailing in early 1995 (Jan.-Feb.). Source: *Investment funds in Slovakia* (1995).

\(^\text{194}\) Even if comparing with the larger sample of the 25 Major Funds there was only one other fund that showed smaller discounts, see Appendix D, TABLE 17 (p. 331).

\(^\text{195}\) The value of VUB Kupón shares traded in the period 1993-1996 at the RM-S equalled 21.9 per cent of the volume traded in all fund shares traded at the RM-S. Comparable figures for 1993-1994 was 42.3 per cent, then in 1995 as a consequence of the trade-stop (see footnote 201, p. 197) it was 3.7 per cent, only to rise to 23.1 per cent in 1996. Source: RM-S Database; own computations.
administered by CIC, with discounts ranging between a high 65.2 per cent and an extraordinary 93.5 per cent. Occupying a position in-between these two were the two Harvard funds, whose performance hardly differed at all. Shares in both of their funds were traded at the BCPB (from June 1994) and the RM-Systém, although they were far less liquid than those of VUB Kupón. The three funds established by PSIS, finally, for which comparable data have been unavailable, were before being put in forced custody trading with discounts between 73 and 81 per cent (January 1995).

Beginning by looking at the consequences of the extremely high discounts, it will suffice to point to three areas on which they had their effect. Firstly, of course the low prices of fund shares meant that those individual investors who sold their holdings received precious little capital, which in the majority of cases was used for consumption rather than re-investment; something which, in turn, helped to keep liquidity low. However, as will be returned to shortly, even if the low level of liquidity is part of the explanation for the discounts, it cannot in and by itself explain...
the total extent of them. Secondly, the high discounts point to the fact that the investment funds have not been very beneficial for their shareholders. Investors would have done better to purchase shares in firms directly.

In Table 28 is calculated the total losses, or rather foregone profits, for individual shareholders who invested their voucher booklet with the respective fund. Using the case of VUB Kupón, each investor received 20 shares in the fund in return for a full voucher booklet (1,000 points); these shares drew dividends to the total amount of Sk 1,880 in 1993-1995 and had a market value of Sk 9,440 at end-1995, i.e. the investor who sold his shares at the time would in total have received Sk 11,320. This figure is then compared to the NAV at end-1993 of the shares which the fund could buy with 1,000 investment points, i.e. Sk 24,377 in the case of VUB Kupón, leaving theoretical foregone profits of Sk 13,057. However, if the investment funds had done their job with regard to portfolio-handling, one would expect the value of the funds to at least keep pace with the general index (SAX), which in 1994-1995 was up 40.4 per cent. This line of thinking, which is not unreasonable given the insider-knowledge of funds as compared to the rest of the market, would lead to foregone profits of Sk 22,898 for the person who entrusted his investment points with VUB Kupón. Furthermore, as can be seen in the table investing with VUB Kupón was indeed to prefer to many of the other investment funds. The person who did this with any of the three funds managed by CIC and established in co-operation between VSZ and Slovenska Sporitelna (IPF I-III) in the end only received a market value (incl. dividends) of about Sk 3,000 (app. $100) and had foregone profits of between Sk 40,000 and 70,000. The question then is, if the shareholders of the funds were deprived of this money, where did they go?

Table 28. Performance of investment funds with regard to individual investors 1993-1995 (all figures refer to values per voucher booklet invested with the fund)

<table>
<thead>
<tr>
<th>Fund</th>
<th>Shares (no.)</th>
<th>Dividend (Sk.)</th>
<th>NAV 12/93 (Sk.)</th>
<th>Mkt. value 12/95 (Sk.)</th>
<th>Loss, comp. to 12/93 (Sk.)</th>
<th>Loss, comp. to SAX-idx. (Sk.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VUB Kupón</td>
<td>20</td>
<td>1,880</td>
<td>24,377</td>
<td>9,440</td>
<td>13,057</td>
<td>22,898</td>
</tr>
<tr>
<td>Harvard Growth IF</td>
<td>20</td>
<td>400</td>
<td>36,213</td>
<td>11,780</td>
<td>24,033</td>
<td>38,652</td>
</tr>
<tr>
<td>Harvard Dividend IF</td>
<td>20</td>
<td>1,400</td>
<td>36,292</td>
<td>11,600</td>
<td>23,292</td>
<td>37,943</td>
</tr>
<tr>
<td>Ferrofond I</td>
<td>30</td>
<td>1,200</td>
<td>48,671</td>
<td>4,200</td>
<td>43,271</td>
<td>62,919</td>
</tr>
<tr>
<td>IPF I, Sporitelna-VSZ</td>
<td>10</td>
<td>34,117</td>
<td>11,780</td>
<td>24,033</td>
<td>30,867</td>
<td>44,640</td>
</tr>
<tr>
<td>IPF II, Sporitelna-VSZ</td>
<td>10</td>
<td>994</td>
<td>52,063</td>
<td>3,390</td>
<td>47,679</td>
<td>68,696</td>
</tr>
<tr>
<td>IPF III, Sporitelna-VSZ</td>
<td>10</td>
<td>1,150</td>
<td>32,749</td>
<td>2,820</td>
<td>28,779</td>
<td>41,999</td>
</tr>
<tr>
<td>PPF</td>
<td>10</td>
<td>1,000</td>
<td>20,090</td>
<td>3,190</td>
<td>15,900</td>
<td>24,010</td>
</tr>
<tr>
<td>GIF</td>
<td>10</td>
<td>2,000</td>
<td>33,790</td>
<td>4,210</td>
<td>27,580</td>
<td>41,221</td>
</tr>
<tr>
<td>ZIF</td>
<td>10</td>
<td>0</td>
<td>27,970</td>
<td>3,620</td>
<td>24,350</td>
<td>35,641</td>
</tr>
</tbody>
</table>

Sources: RM-S Database; data communicated directly from the investment companies; own computations.

Comment: The market value of the PSIS-funds was indeed somewhat reduced from April 1995 when they were put in forced custody, the values for PPF, GIF and ZIF was then 3,360, 5,770 and 4,800, respectively. This does not, however, as can be seen in the table change the general picture.

Notes: 1 This “loss”-figure is calculated as the difference between the NAV per voucher booklet at end-1993 and the total payouts-received by the DIK if selling his shares at end-1995 (including accrued dividends). 2 This alternative “loss”-figure is calculated as described above, with the exception that it was assumed that NAV of the fund would have developed as the SAX-index during 1994 and 1995.
Decreasing NAV: large-scale asset-stripping

The probably most important factor in explaining the high discounts, the mistrust in investment funds and the “losses” for individual shareholders was a process which was reflected in a steady decrease of the net asset values of investment funds. As was first illustrated in Figure 18 (p. 162) the declining NAV of funds was a general phenomenon. Asset values in funds declined from Sk 51.4 billion ($1.55 bn) at end-1993 to a mere Sk 9.8 billion ($307 mn) at end-1996; a figure which to 91 per cent was made up of the assets in one single fund, VUB Kupón. This process was in part connected to the transformation of funds into joint-stock companies discussed in Section 2.7. However, it is also a process that began long before these transformations started. As can be seen in Table 29, total NAV of funds declined already during the course of 1994 by Sk 7.3 billion ($228 mn). Even though the case study funds in that year did better than the others one must begin to wonder what was wrong if they managed to underperform a “theoretical index-fund” by an enormous Sk 24.7 billion ($770 mn). The same picture emerges even if looking at what happened in 1995, when the market did poorly in general – during this period the total NAV of Slovak investment funds was reduced by high 55 per cent while the SAX-index in the same period lost “only” 28.2 per cent.199 Looking at a two-year period, that is end-1993 compared to end-1995, the corresponding figures are -52 per cent and +40.4 per cent, i.e. a “theoretical” index-fund would have outperformed all

Table 29. NAV of investment funds in Slovakia, 1993-1996 (bn Sk and per cent)

<table>
<thead>
<tr>
<th>Group/indicator</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
<th>1996¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>All investment funds</td>
<td>51.4</td>
<td>44.1</td>
<td>24.3</td>
<td>9.8</td>
</tr>
<tr>
<td>N</td>
<td>162</td>
<td>311</td>
<td>118</td>
<td>36</td>
</tr>
<tr>
<td>“annual loss compared to SAX”</td>
<td>-56.4</td>
<td>-7.3</td>
<td>-18.4</td>
<td></td>
</tr>
<tr>
<td>“cumulative loss compared to SAX”</td>
<td>-56.4</td>
<td>-63.7</td>
<td>-82.1</td>
<td></td>
</tr>
<tr>
<td>25 Major Funds</td>
<td>29.8</td>
<td>25.7</td>
<td>17.0</td>
<td>15.9¹</td>
</tr>
<tr>
<td>N</td>
<td>23</td>
<td>25</td>
<td>24</td>
<td>17¹</td>
</tr>
<tr>
<td>as per cent of all funds</td>
<td>58.0</td>
<td>58.2</td>
<td>69.7</td>
<td></td>
</tr>
<tr>
<td>“annual loss compared to SAX”</td>
<td>-32.6</td>
<td>-1.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“cumulative loss compared to SAX”</td>
<td>-32.6</td>
<td>-34.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Case study funds²</td>
<td>22.4</td>
<td>19.2</td>
<td>11.0</td>
<td>10.3¹</td>
</tr>
<tr>
<td>N</td>
<td>7</td>
<td>7</td>
<td>7</td>
<td>3¹</td>
</tr>
<tr>
<td>as per cent of all funds</td>
<td>43.6</td>
<td>43.4</td>
<td>45.3</td>
<td></td>
</tr>
<tr>
<td>“annual loss compared to SAX”</td>
<td>-24.7</td>
<td>-2.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“cumulative loss compared to SAX”</td>
<td>-24.7</td>
<td>-27.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Memorandum item</td>
<td>1.096</td>
<td>1.955</td>
<td>0.718</td>
<td>1.158</td>
</tr>
</tbody>
</table>

Source: Data communicated directly from ASIF/Ministry of Finance; own computations.
Notes: ¹ Note that the figures for the Case study funds and the 25 Major Funds refers to mid-year 1996, and are thus not comparable to the figures for all investment funds. ² Excluding the funds established by PSIS.

199 A partial explanation to this is that the Prague Stock Exchange showed a worse performance than either the BCPB or the RM-S during 1995 and that many Slovak funds held such a large proportion of Czech securities.
Slovak funds by a massive Sk 47.8 billion ($1.6 bn). In this 24-month period the case study funds reduced their nominal NAV by 50 per cent, and experienced a cumulative theoretical loss of Sk 27.4 billion. One example is CIC, which during the course of 1994 on average managed to lose half of the net assets in three of the funds in its custody (IPF I-III), while SAX-index rose a very high 95.5 per cent (!); a result which naturally lead to suspicions of illegal manipulation with stocks.200 Other examples of behaviour that have caused suspicions of fraud amount. The fact, however, that most of them remained unverified suspicions, leads us to the main problem of investment funds – the lack of transparency. With little or no insight into their doings, it is little wonder that there was no confidence in their shares, and thus extremely high discounts on an illiquid market.

2.6.2. Control of the funds: voice and take-overs?

An interesting question, given the high discounts of fund-shares, is why there were no take-overs of these funds? In most well developed markets discounts around 70 to 80 per cent would very quickly lead to a take-over bid on the fund – but not so in Slovakia. With the exception of when Nomura International bought in to VUB Kupón and forced the fund to split – taking one-third of the shares with them – no major take-overs took place during the period of study.201 To answer this it is nec-

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200 See CTK-Business News, 10 July 1995. The three mentioned funds (IPF I-III) were later withdrawn from trading on the BCPB, on the initiative of CIC, in the beginning of July 1995.

201 The Nomura-deal was not one which would be classified as a hostile take-over. In fact the split of VUB Kupón started out as a consequence of the buy-back guarantee extended during the first wave. As a result the bank (VUB) ended up holding more than 31 per cent of the shares in the fund. By law, however, a bank could not hold more than 10 per cent of a investment fund – and the bank was urged to sell off their holdings by amongst others the NBS. Finding a buyer for such a large package was however not without complications. In 1994 the investment house Nomura International p.l.c. in London nevertheless bought a 29.4 per cent package. Nomura bought additional shares on the market during the course of 1994, reaching 31.4 per cent of equity in VUB Kupón. Nomura, however, later decided it wanted to pull out of the fund in order to establish their own Slovak-Czech investment fund, cf. TREND Tyždeník o hospodárstve a podnikaní, No. 3, 1995. At an extraordinary General Assembly on 23 January 1995, Nomura pushed through a resolution according to which VUB Kupón would either lower its share capital by giving to Nomura a proportionate share of the shares in the fund (31.4%) or pay Nomura the NAV of its share (app. Sk 4 bn; $130 mn), see TREND Tyždeník o hospodárstve a podnikaní, No. 5, 1995. Since the latter was unrealistic the resolution would mean that the fund had to split. Other shareholder could not stop it since the law stated that to lower the share-capital of an investment fund, a minimum of 30 per cent of shareholders had to be present at a General Assembly, out of which at least two-thirds had to vote with the suggestion. At the time of the General Assembly VUB only held some five per cent of equity, despite the buying-frenzy which preceded the Assembly, during which the bank bought several hundred thousand shares according to the Director of Funds Management of VUB Invest, see Oravkin (1995) [interview]. Upon the General Assembly followed a period of confusion – nobody had ever done anything like it. The immediate reaction of the Ministry of Finance was to stop all trade in VUB Kupón shares on 23 January and to begin an investigation into what happened, including audits etc. Mr. Oravkin said that at the beginning the Ministry did not understand what was happening. One month later, on 22 February, even the portfolio and the accounts of the fund were frozen. Later, after a 24 April decision by the Ministry of Finance, VUB Invest was allowed to reopen trade in the portfolio. However, the Ministry of Finance refused to approve the deal. These powers were derived from the fact that VUB Kupón was licensed by the Ministry which had to approve any change in the statutes of the fund. A decrease of capital required such a change of statutes. Even though the resolution on a decrease was re-approved on the General Assembly in June 1995 the Ministry of Finance would not approve the deal. The Director of Funds Management saw only one major reason for the hesitancy of the Ministry, namely that they are afraid that the deal would set a precedent for other funds, i.e. that anyone with a strong enough stake in a fund could decrease the capital and get paid in shares. This brought about yet a change in regulations, implying an amendment according to which 50 per cent of all shareholders (votes) in an investment fund
ecessary to look closer at the control structures that were established around the funds.

A common trait in Slovakia was that fund managers went through great pain to minimise any possible influence of the nominal owners, be they individual DIKs or holders of larger blocks. The Harvard group provides a good example of how the structure and internal statutes effectively precluded minor shareholders from exercising any property rights, except from the right of selling which, given the high discounts, was not a very attractive alternative. The management contracts within the group stipulated that a fund wishing to terminate their indefinite contracts with the investment company had to pay liquidation damages equalling three times the amount of fees otherwise payable to the investment company. In addition, termination due to a material breach required the approval of two-thirds of shareholders, in addition to a three-year notice period. An additional safe-guard, unique to the Harvard funds, was that shareholders or groups of shareholders acting collectively with in excess of five per cent of shares had to forfeit their voting rights (sic!), i.e. a clear breach with the notion of exclusive and transferable property rights. Also, according to the statutes HC&C collected the votes of all DIKs not present during the General Assemblies. Consequently, no outsiders had positions on either the Supervisory Board or the Board of Directors, and control of the funds effectively rested with HIS. Although formal regulation differed between funds and investment companies, it seems that the end-result was rather similar. A financial analyst with CIC, Mr. Mizla, for example explained that in their funds, as with all investment funds, the influence of DIKs was in practice non-existent.

A conclusion is that the incentives from and/or possibilities for a mechanism like hostile take-overs to put pressure on fund managers in the Slovak setting was severely circumscribed by the behaviour of investment companies and the lack of legal protection for minority shareholders. The high barriers put up by fund managers rendered it close to impossible for investors to change management for one with lower charges or better performance, if they had so wished. Furthermore, in 1995 and 1996 many of the investment companies moved to further strengthen their hold of investment funds through direct and indirect ownership.

As can be seen in Table 30 there was a general increase in ownership concentration during the period. This had started already in 1995, and was reflected in the drastically increasing turnover in investment fund shares (see Table 26, p. 192). It is probably not too daring a proposition to say that the experience of VUB Kupón and Nomura helped to trigger this process. Looking a little closer at who the buyers had to approve a decrease in capital. The Nomura-deal, however, was started under the old law and in the end had to be treated according to it – and Nomura received their share (31.4%) of all holdings in the individual companies.

203 Ownership of its Slovak funds was like in most cases very dispersed, although some investors had shares of up to 10 per cent (e.g. Slovenska Sporitelna).
205 The one case which to some extent goes against this conclusion is the development in VUB Kupón where a foreign investor, the Japanese investment house Nomura, after acquiring a large share in the investment fund forced the fund to split and withdrew with a portfolio equal to their relative holding; this unusual event is however more telling about government regulation than it is representative of the influence of DIKs.
were it stands clear that it was the investment companies themselves, firms related
to the founder and other financial institutions which were closely related to the in-
vestment companies that evolved as the major owners (see Appendix D, TABLE
18, p. 332). In VUB Kupón, for example, the newly established VUB Invest Hold-
ing moved to control 19.3 per cent and the bank (VUB) increased their share to 9.01
per cent during the course of 1996. The Harvard funds, in turn, were basically in the
hands of the Harvard group with a sister company to HC&C, the Harvard Stock
Exchange Company (HBS),\textsuperscript{206} moving in as the largest owner.

Also, given the high discounts on investment fund shares the investment compa-
nies, or their affiliates, did not have to pay too much to secure control. This control

\begin{table}[h]
\centering
\caption{Concentrated ownership of investment funds, 1995-1996 (per cent of all shares)}
\begin{tabular}{|c|c|c|c|c|c|}
\hline
Year & Group & Indicator & Largest & Two largest & Three largest & Five largest \\
\hline
\hline
1995 & “All Funds” & Mean & 25.14 & 29.19 & 30.86 & 31.18 \\
& (N=122) & Std dev & 28.53 & 29.14 & 30.57 & 30.88 \\
& 25 Major Funds & Mean & 17.03 & 22.54 & 24.08 & 24.76 \\
& (N=25) & Std dev & 16.91 & 18.23 & 18.79 & 19.44 \\
& Case study funds & Mean & 13.16 & 18.20 & 20.10 & 20.61 \\
& (N=10) & Std dev & 7.86 & 9.66 & 10.99 & 11.41 \\
& VUB Kupón & & 32.32 & 37.98 & 37.98 & 37.98 \\
& Ferrofond & & 19.21 & 24.52 & 24.52 & 24.52 \\
& Harvard Dividend IF & & 15.13 & 27.68 & 34.76 & 34.76 \\
& IPF I. Sporitelna-VSZ & & 11.82 & 11.82 & 11.82 & 11.82 \\
& Harvard Growth IF & & 10.29 & 19.18 & 25.64 & 31.00 \\
& GIF & & 8.74 & 8.74 & 8.74 & 8.74 \\
& IPF III. Sporitelna-VSZ & & 7.56 & 14.18 & 14.18 & 14.18 \\
& Zlatý IF & & 7.35 & 7.35 & 7.35 & 7.35 \\
& PPIF & & 5.84 & 10.95 & 10.95 & 10.95 \\
\hline
1996 & “All Funds” & Mean & 30.99 & 39.03 & 42.20 & 43.19 \\
& (N=110) & Std dev & 26.47 & 25.85 & 26.87 & 27.30 \\
& 25 Major Funds & Mean & 22.10 & 31.88 & 35.30 & 37.40 \\
& (N=25) & Std dev & 13.60 & 15.46 & 17.49 & 19.20 \\
& Case study funds & Mean & 14.00 & 21.32 & 23.12 & 24.21 \\
& (N=10) & Std dev & 4.01 & 5.51 & 7.23 & 9.29 \\
& VUB Kupón & & 19.30 & 28.31 & 33.65 & 33.65 \\
& Ferrofond & & 19.21 & 24.50 & 24.50 & 24.50 \\
& Harvard Dividend IF & & 17.25 & 29.80 & 29.80 & 29.80 \\
& IPF II. Sporitelna-VSZ & & 15.33 & 25.20 & 32.23 & 43.15 \\
& GIF & & 14.21 & 20.54 & 26.10 & 26.10 \\
& Zlatý IF & & 11.67 & 17.56 & 17.56 & 17.56 \\
& IPF III. Sporitelna-VSZ & & 6.96 & 13.33 & 13.33 & 13.33 \\
\hline
\end{tabular}
\end{table}

Source: RM-S Database; own computations.

Comment: On the composition of the different samples, see footnote 91, page 163.

\textsuperscript{206}In Slovak and in Appendix D (TABLE 18) as Harvardská burzova spolocnost, a.s. (HBS).
should, as we will see in Section 2.7, be interpreted a prelude to the final transformation of funds. In conclusion it is thus possible to state that the incentives and priorities which guided fund managers must be sought among the interests which established and controlled these investment companies who have almost total discretion over shares and their use.

2.6.3. Control of the investment companies

The majority of funds in the former Czechoslovakia were established either by banks or in close co-operation with banks and other financial institutions; the Slovak Republic constituted no exception. However, even though most funds would have some kind of direct or indirect connection to a financial institution, not least in order to finance their campaigns in late 1991 and early 1992, one may divide the majority of funds into being established and controlled by one of three groups: (i) “genuine” private interests (e.g. PSIS and HIS); (ii) financial institutions, for example banks or insurance companies (e.g. VUB); (iii) “interest groups”, for example by industry or trade unions (e.g. CIC). However, while it is somewhat easy to point to what “type” of interests that are behind the various investment companies, it is definitely more difficult to pin-point the actual ownership structures and the personal linkages with different political groupings that seem to have had a great influence on the fortunes of different funds.

In many cases the ownership structure of the investment companies is surrounded by secrecy and complicated webs of cross-holdings and is, at best, blurred. Again, the Harvard group may serve as a good case in point. As regards HIS, its representatives make clear that they have no obligation to make public who the owners are, although reveals that there were two major owners of the investment company.207 Further, ownership in the group as a whole has been at least as intricate, although in practice Mr. Kozeny still controls operations through direct and/or indirect control of the parent-company (HC&C).208 The other companies in the group have steadily been buying out DIKs from funds, making Kozeny and his family the largest shareholder of the funds.209 In fact, in most cases the fund certificates sold on the market have been purchased by the founding investment companies themselves, or by agents closely related to the founder of the investment company. It is thus not surprising that Mr. Kozeny in 1995 explained that ‘I’m the guy who still makes the decisions.’210

PSIS is also an example of an opaque ownership structure. The investment company was in 1995 a fully owned subsidiary of the First Slovak Investment Group

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207 Matysová (1995) [interview]
208 HC&C was in 1995 majority-owned by Netherlands-based Emerging Market Investment. HC&CS in turn was majority-owned by the president of the company, Mr. Siroky, who held 20 per cent of HIS where he was also the president. The other 80 per cent was owned by HC&CS. Despite the complicated ownership structure Mr. Kozeny still actually controlled the operations of HC&C, see Jaros (1995), p. 6.
210 As quoted in Finance East Europe, Vol. 5, No. 5, 1995, pp. 1-2 [emphasis added]. The remark was made after Mr. Kozeny left Prague for Zurich, and later the Bahamas, where he ran operations by phone.
(Prva Slovenska Investicna Skupina, a.s.).\textsuperscript{211} The Group was also the main owner of the three funds with stakes ranging from 5.8 to 7.3 per cent at end-1995 and stakes between 9.6 to 14.2 per cent at end-1996. In addition, by end-1996, the brokerage company controlled by the group had moved in as the second largest owner in the two minor funds (see Appendix D, TABLE 18, p. 332). The group, in turn, was privately owned with individual although, once again, unidentified investors having a controlling stake. Control of Cassoviainvest was relatively more straightforward in that it was always more or less in the hands of VSZ and its directors.\textsuperscript{212}

The ownership and control structures within the VUB group, finally, deserve some extra mentioning since it in a good way highlights the complicated relations where debt and equity control merge, and also where the state, albeit indirectly, remains a potentially strong actor. In addition it sheds some light on the effects of the harsher policies of the Meciar-government, since the organisational restructuring which took place within the group was in direct response to the changing government policies. In April 1995 VUB Holding (see Figure 20) was established as a normal joint-stock company. Between then and October 1995 some three-quarters of all activities and staff were moved from VUB Invest to the new company. Thus, by end-October 1995, VUB Invest was itself as much a legal fiction as the investment funds ever were – having only five fund managers and six persons working back-office. All other departments, including investment management, which was the most important department, were put in the VUB Holding Company.\textsuperscript{213} The re-structuring of the group was done in order to meet two strategic aims. Firstly, since VUB Holding had the legal status of a normal joint-stock company, the Ministry of Finance and its capital markets section, did not have the same rights and insight into the company as it had in VUB Invest which was established in accordance with the Law on investment companies and investment funds. The reaction was however understandable bearing in mind the haphazardous way in which supervision had been carried out.\textsuperscript{214} A second reason given by the Director of Funds Management, Mr. Oravkin, was that there was a wish to diversify activities of the company. Mr. Oravkin painted a scenario where VUB Holding within not too long had five or six subsidiaries, for example asset management, broker, general consultancy etc. There were also plans to establish a venture capital company in order to be able to take stakes much larger than the investment funds in individual companies. The ownership structure within this group was still such that all operations were fully controlled by the bank. VUB at the time (October 1995) owned a full 100 per cent of

\begin{footnotesize}
\textsuperscript{211} The First Slovak Investment Group [Prva Slovenska Investicna Skupina, a.s.] functioned like a holding company, bringing together a number of firms, among them PSIS and the First Slovak Brokerage Company, Ltd. [Prva Slovenska Brokerska Spolocnost, s.r.o., (PSBS)].

\textsuperscript{212} VSZ in September 1995 strengthened their position further by increasing the basic capital of Cassoviainvest, bringing their share up to a safe majority of 51 per cent. Prior to this the ownership structure had for a long time been such that VSZ held one-third (34\%), 41 company managers one-third (33\%), and one-third (33\%) was owned by investment funds, which in turn were controlled by VSZ and Slovenska Sporitelna, see Hospodarske Noviny, 5 May 1995.

\textsuperscript{213} It was the investment management department that was active in the firms in the funds portfolio, sometimes holding seats on the boards. Accounting, marketing, analysis etc. were also activities that were lifted out of VUB Invest.

\textsuperscript{214} The case of PSIS was of course the most prominent, see Section 2.5.2, page 187 ff.; but, also the way that the Ministry of Finance handled the buy-out by Nomura (see footnote 201, p. 197) can to some extent explain the wish to be outside of the jurisdiction of the Ministry of Finance.
\end{footnotesize}
VUB Holding and some 68 per cent of VUB Invest – a holding that the bank was about to sell to VUB Holding. VUB Kupón in turn was at end of 1996 controlled by VUB Invest (19.3%) and VUB (9.9%). VUB, finally, had VUB Kupón as its largest private owner (9.5%) with the FNM holding 50.79 per cent.

The resulting control structures within and outside the group are illustrated in Figure 20. Using the actual bank as a starting point, we see that the largest owner of the bank was indeed the state, through the FNM. Its largest private owner, however, was VUB Kupón, which was owned by VUB itself and by VUB Invest (which, in turn, was owned by VUB). Looking instead at the individual firm this meant that there was dual control ensuing from the bank, both through debt (directly) and equity (indirectly via VUB Kupón and VUB Invest). In addition the firm could very well have the state as an owner – especially if it had been classified as being of strategic interest – as well as other individual investors.

In October 1995 Nomura still held 20 per cent of VUB Invest while some 12 per cent was held by about 300 persons, mostly senior management at the bank and people who initially worked at VUB Invest, see Oravkin (1995) [interview].
2.7. Transforming the funds: the end to an era

The transformation of investment funds into “normal” joint-stock companies was, as mentioned, a process that began in earnest already in late 1995. Even though the above described establishment of VUB Holding was a step in the same direction, i.e. to avoid supervision by the Ministry of Finance and the restrictions put on the holdings and activities of traditional investment funds, the actual transformation of investment funds represented a qualitatively different step – with far-reaching implications both for the minority shareholders and the corporate governance structure in general. The transformations were made by means of a loophole in the law which, at least technically, opened for the cancellation of a fund – without liquidation – by merging with some other joint-stock company which was not operating under the jurisdiction of the Law on investment companies and investment funds. The argument of some fund representatives was that since such mergers were not explicitly forbidden in the law they should be considered legal, or, as a representative of Eurotrade a.s., Stefan Planeta, said: ‘[t]he fact that the law deals only with cancellation of funds by liquidation does not mean that this law prohibits the cancellation without liquidation.’

The Ministry of Finance disagreed. Their basic, and quite logical, stance was that funds should have been liquidated and assets divided among shareholders. The mergers without liquidation, in their view, violated the Law on investment companies and investment funds on three counts: (i) the law allowed only for funds to merge or join with another investment fund, subject to the approval of the Ministry of Finance; (ii) changes of statutes were valid only after the approval of the Ministry (Art. 16, para. 3); and, (iii) an investment fund could be cancelled only by liquidation (Art. 34). Furthermore, a reading of the law gives support to the Ministry of Finance’s stance also elsewhere. It is, for example, stipulated that accumulation of ‘financial means from legal entities and physical persons for the purpose of using them to participate in enterprises’ is only allowed for investment companies and funds which are regulated by the Law on investment companies and investment funds. Moreover, as far as could be judged, the new “funds/companies” had no ambitions to get rid of the portfolios that remained – quite the opposite.

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216 Eurotrade a.s. in Kosice was a company closely affiliated with VSZ which in June 1996 merged with Ferrofond – where the largest owner was VSZ, see TREND Tyzdenník o hospodárstve a podnikaní, No. 9, 1997. However, the Vice-President of HIS, Eduard Sebo, admitted that the practice was indeed exploiting a loophole in the law, see East European Banker, No. 7, 1997.

217 TREND Tyzdenník o hospodárstve a podnikaní, No. 9, 1997.

218 The Law on investment companies and investment funds indeed stated that ‘[o]nly investment funds under this law can be created by splitting or merging investment funds.’ (Article 8, para. 1). The crux of the question may be in the interpretation of what “only” refers to, i.e. whether only the funds governed by the law are applicable for the regulation (a rather empty formulation in that case) or whether it refers to what one would expect, namely that the regulation pertains to all investment funds. The wording is, nevertheless, admittedly unclear.

219 Law on investment companies and investment funds, Article 3, para. 1 and Article 2, para 1.

220 This was indeed a principal objection of the Ministry of Finance, whose representative (Mr. Kohut) said that ‘[f]unds can not in their activity use the property assembled with the aim of collective investment into a free business without respecting and fulfilling the obligations to limit and displace the risks’
Nevertheless, the loophole was increasingly being put to use during 1996. It was also indirectly accepted by the trades register which accepted the registrations of the newly merged companies. Something of a mass movement started, where non-transformed funds felt that they were put to a disadvantage as compared to the funds/companies not under the jurisdiction of the Ministry of Finance. Of the 102 investment funds which were actively operating at end-1995 some two-fifths had either merged or transformed into joint-stock companies by August 1996; of the 20 largest funds there were then only six which remained unchanged.221 By early 1997, only two funds were working in accordance with the Law on investment companies and investment funds (VUB Kupón and Tatra kupon fond in Bratislava).222 The investment funds in the case study thus constituted no exception. The two Harvard funds in late 1996, at an extraordinary General Shareholders Meeting, decided to merge with the companies Prva Strategicka (First Strategic) and Druha Strategicka (Second Strategic). Shareholders would receive shares in the new companies at a one-to-one ratio. Interesting is that the shares were transferred from the accounts of the two investment funds already before the shareholders meeting.223 The funds established by PSIS were transformed as were the ones in the custody of Cassoviainvest; Ferrofond I Finally, when VUB Kupón – which at end-1996 alone accounted for 91 per cent of the total NAV of non-transformed investment funds in Slovakia – in the summer of 1997 followed suit, the whole process may be said to be concluded. The fund was first renamed Strategia Invest IF in July 1997 and merged with the Interfin Group a.s. in Bratislava; following this it was on 3 October 1997 decided that the fund would split as would the assets and debts of the fund.224

Turning to the reasons of why these transformations took place one has to look back once again at the policies and regulations that were formulated in 1995. There can be no doubt that the main reason for funds to change was to avoid the supervision from the Ministry of Finance and its capital markets section. The official stance of the investment funds was indeed also that they were only defending themselves against the hostile attitude and actions of the government and the Ministry of Finance.225 Furthermore, changes in 1995 had indeed made it difficult for investment funds to function in a profitable way. Beginning with the cancellation of the second wave of voucher privatisation, which incurred losses on the investment companies of an estimated Sk 8 billion, the incentives for remaining normal investment funds were gradually eroded. The concurrent change in privatisation policy which meant that more and more industrial firms got majority-owned by other

in accordance with the Law on investment companies and investment funds, see TREND Tydenník o hospodářství a podnikání, No. 10, 1997.
221 TREND Tydenník o hospodářství a podnikání, No. 34, 1996.
222 TREND Tydenník o hospodářství a podnikání, No. 13, 1997.
223 TREND Tydenník o hospodářství a podnikání, No. 2, 1997. Interesting is also that as late as June 1996 representatives of HIS emphatically declared that they were not considering any kind of transformation, see TREND Tydenník o hospodářství a podnikání, No. 27, 1996.
224 The majority of assets (55%) would go to Intermark a.s. and the remainder to Istrofin a.s. Bratislava. The former company was controlled by AKS a.s., Penta Brokers o.c.p., a.s., Slovenska Poistovna a.s., VUB Invest Holding a.s. (all Bratislava) and Greenacre Investment Fund Ltd, Cyprus; the latter was a venture controlled by AKS and Penta Brokers, with 22 and 18 per cent respectively. See TREND Tydenník o hospodářství a podnikání, No. 47, 1997.
225 Cf. TREND Tydenník o hospodářství a podnikání, No. 10, 1997.
industrial groups and/or incumbent management also put pressure on the funds since the value of their assets fell. The legal changes of the summer 1995 was a third blow to the investment funds. Fourthly, the supervision by the capital markets section at the Ministry of Finance could have functioned better. Irrespective if there was any truth in the allegations about wrongdoings and that their rulings were influenced by the wishes of the Meciar-government, it was sufficient for market actors to lose confidence in them as an independent body – especially given the generally very politicised nature of Slovak society at the time. Finally, once the process had begun it was indeed also the case, as pointed out by the General director of VUB Invest Holding (Karol Melocik), that the transformed fund posed a serious threat to funds remaining under the jurisdiction of the Law on investment companies and investment funds.226

Turning then to the effects of the changes, they are multi-dimensional. We begin, however, with their effects on the minority owners. Just like there could be no doubt as to the main reason for the transformations there can be no doubt that minority owners suffered serious mistreatment during this process. Disregarding the dilution of assets that had taken place before the transformations – the actual transformation meant that they lost much of what was left. As was pointed out by the General Director of Creditanstalt Securities (a brokerage) such transformations would in countries with a developed capital market have been unimaginable without funds giving the shareholder the right to sell their shares for a reasonable price (or, NAV/share).227 In Slovakia, however, this did not happen. Furthermore, not only were they deprived of their “share” of the assets/values of the fund – in many cases the shares in the new “funds/companies” were not publicly traded which made it impossible to capitalise their assets even at the highly discounted rate offered by the market. In some cases this was a consequence of the choices of the new companies, but in others it was a consequence of the refusal of the Ministry of Finance to issue new identification codes (ISIN) to the securities issued after the merger – and without them they could not be publicly traded. A by-effect, however, of the Ministry using this last weapon in fighting the transformations was nevertheless that small shareholders were locked in.228 It can thus be concluded that what happened in 1996 was only the final step in the abuse of the minor shareholders – if there ever were any serious thoughts about protecting the minor shareholders they were by now a little late. The process that had taken place was aptly summarised by the director of the Association of Stock Brokers, Michal Horvath, who characterised the process as a wild one without protection of minority shareholders. Horvath said that ‘[i]t is naive to think that the damaging of small shareholders is happening only when transforming the fund. In many cases what was transformed was only the rest of original property of investment fund.’229 This was also illustrated in the preceding Section 2.6.1.

226 TREND Tyždenník o hospodárstve a podnikaní, No. 9, 1997.
227 Martin Cabaj in TREND Tyždenník o hospodárstve a podnikaní, No. 9, 1997.
228 Still in 1997 the Ministry of Finance maintained the transformations to be illegal, refusing to issue ISIN-codes, see TREND Tyždenník o hospodárstve a podnikaní, No. 10, 1997. In the summer of 1997 the Ministry of Finance were prosecuting some 25 funds, trying to annul their transformations.
229 TREND Tyždenník o hospodárstve a podnikaní, No. 9, 1997 [emphasis added, my translation].

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The potential effects of these transformations regarding corporate governance fall outside of the time-scope of this study proper. It may nevertheless be speculated that the new funds/companies will use the possibility of buying higher stakes than the previously allowed 10 per cent – in fact, had there been legislation in place which allowed for strategic industrial funds to develop, perhaps the transformations of funds may never have happened. The higher stakes, in turn, will of course strengthen incentives for monitoring management. In this sense the transformations did not mean the end to institutional ownership of industry in Slovakia – rather it posed a possible beginning of a new era. In part, these new funds/companies represent what was envisioned by the Federal Ministry of Finance when launching the voucher privatisation programme. The Ministry in 1991 wrote that '[a]nother reason not to fear the dissipation of stock ownership is the existence of a secondary market. On this market, stock acquired for investment coupons will be bought and sold. The experience of other countries show that stock will accumulate very quickly in the hands of investors who are capable of providing sufficiently strict oversight over the financial discipline of their company.'

3. Summary

In this chapter, an attempt was made to move from the more narrow definition of privatisation, which was the focus of Chapter IV, towards the more wide definition of ownership reform. The latter is a concept that entails much more of the institution-building necessary for developing a modern market co-ordinated economy. One insight from the analytical framework was, for example, that changing ownership in itself would not be sufficient. Rather, if privatisation was to achieve the goals with regard to increasing the economic efficiency and thus the wealth of the country, much would depend on the behaviour and incentives that faced the new owners. Their behaviour, in turn, would be influenced by what in Chapter II:5 was termed “institution-building”, for example the development of markets and the regulation thereof. Just as the micro-economic liberalisation discussed in Chapter III:2.2 implied creating the pre-conditions for product and service markets, this institution-building is/was necessary if the market for property rights shall be functional and able to cater for the changing needs of a dynamic and growing economy. The questions which were indirectly approached concerned two of the four economic goals which privatisation was said to be able to serve, namely as a basis for the further reallocation of property rights and as a pre-condition for the establishment of new mechanisms for corporate governance. This was done by an analysis of the meso-level of institutions and actors, namely the nascent capital market and the “phenomenon” of investment funds.

The development of the capital market and the rise and fall of investment funds were closely interrelated in Slovakia. Both the stock market and the investment funds came into being as a direct consequence of the path initially chosen for large-scale privatisation, i.e. voucher privatisation. In addition, in both cases the estab-

\[\text{Kupónová privatizace. Informační příručka (1991), Section II:16.}\]
lishment of the formal structures necessary was swift and relatively unproblematic. However, as has been shown above, neither of these two “institutions” were able to actually perform in the way which they were initially believed/hoped to do. The question is why? In both cases, the cause of the problems at least indirectly relates to issues of institution-building and regulation. Firstly, the rules established were far from stable, the examples of BOB and PSIS suffice. This made it difficult for market actors to adjust as well as lessened the incentives to even try to adapt since the credibility of the rules was undermined by the changes. Secondly, much of the policy changes in 1995 were clearly political and to some extent discretionary, further reducing credibility and integrity of regulators and enforcing agencies.

In the case of the capital market, it remained illiquid and non-transparent throughout the period of study. Furthermore, turnover volumes fell back in 1997 and 1998 once the ownership structure of industrial firms and investment funds had begun to settle. Taking together the problems identified with the capital market, it was possible to identify it as characterised by very high transaction costs. The non-transparency of the market served to drastically increase the value (and necessity) of insider-information. The market in many respects developed into a “playground for privileged insiders”. This, in turn, kept many investors away and thus reduced liquidity. Not least did it frighten off foreign portfolio investors. For firms, this further lessened the incentives to provide information to the market (and thus increase transparency) in an effort to perhaps raise capital and/or supporting the prices of its shares. Furthermore, as long as the market can give no proper evaluation of firm performance, incumbent management can with a good conscience shrug off falling prices of their shares and explain it with the “general state of the market” rather than with firm performance. This is one way that potential corporate governance mechanisms have been undermined. In the final analysis, these developments points to what was discussed in Chapter II:2, namely that many formal institutions may be established by the stroke of a pen, while the establishment and development of other complementary institutions is much more of a long-term process where the self-interest of the various actors is an important explanatory factor.

Regarding the investment funds and investment companies, and their role in corporate governance and capital market development, we initially discussed their emergence and concluded that also this was a direct consequence of the method chosen for privatisation. Their large portfolios were analysed and the very real potential for influence pointed to. Furthermore, their behaviour and somewhat problematic relations with incumbent managers in terms of different goals and different perspectives was discussed. However, given how things evolved during the period of study a great deal of attention came to focus on the forces which led to their demise. These were traced to: (i) the different interests of the involved actors, i.e. DIKs, investment funds, their founders, the state/government and incumbent management; (ii) the lack of protection of minority shareholders; (iii) the restrictive regulations on funds, i.e. the ceiling on a maximum ten per cent holdings, the denial of presence on the Board of Directors and the cancellation of the second wave of voucher privatisation; and (iv) the non-neutral state and the lack of independent supervision.
It was also showed that the “institution” of investment funds faced similar problems as the capital market in general with regard to transparency, and did by their behaviour partly serve to worsen the non-transparency of the capital market. Regarding the restrictive policies against investment funds and investment companies they seem to have been based on a combination of suspicion and fear for the power of funds. Then State Secretary at the Ministry of Finance, Jozef Magula, pointed out that funds had become too powerful and that they were ignoring the interests of small investors; he said: “The facts are that the funds are controlled by management and not by shareholders”.\(^\text{231}\) What the authorities claimed they wanted to see was the funds turning into portfolio investors rather than strategic owners. Although Magula, in our eyes, was right that fund managers did not pursue only the interests of their DIKs, it was apparently not the only driving force. Would it have been so, they would have put more energy into legislation that protected minority shareholders. This, however, is not to say that the State Secretary was not sincere in his pursuit of minority shareholder protection – this is testified to not least by his resignation in response to the introduction of bearer-bonds (see Section 1.4.3). However, his views were not shared by all members of government, nor other influential interests (e.g. the industrial lobby and investment funds). In fact, there was no influential party which stood to gain from an improved minority protection, neither industry (which itself was attempting to gain control over firms) nor investment funds (as has been illustrated). Instead, the battle seems to have been between industry and the newly established financial sector in the institutional form of investment funds. It is also on the power-relations between these two groups upon and between which regulation came to focus, i.e. regulation has been about competition between two different types of capitalists – not about the protection of small shareholder. A fund manager at DanInvest, probably got to the core of the problem when he commented that “[s]ome of the funds are beginning to be real owners and are firing bad managers, and some of those bad managers are friends of the government.”\(^\text{232}\) In conclusion, is it then the unstable institutions that have led to the dismal state of transparency of the markets. The answer is most likely yes – at least it has been a strongly contributing factor since actors and organisation have seen this non-transparency as a means to protect their own interests in a situation when one have not trusted the formal institutional set-up.

* * *

In Chapter IV the study treated privatisation and economic transformation in Slovakia mostly from a macro-perspective. This chapter brought in the meso-perspective, both in the analysis of the process of establishing markets and in the adoption of the perspective of the major owners (investment funds). It has been concluded that neither the establishment of markets, nor the activities and development of investment funds, has been without problems. The establishment and development of a market-conform regulatory framework has been made problematic – often characterised by political interference and sudden changes. This has been detrimental for the long-run stability needed to support economic development and restructuring.


The study has thus raised a number of questions relating to the restructuring of ownership and markets; questions which can only be answered through micro-level studies of individual enterprises. What impact has the restructuring of ownership (privatisation) had for individual firms? How have the strategies of management been able to influence the course of privatisation? How have the relations between executive management, the statutory boards and owners developed? These questions are closely related to the application and adaptation of the regulatory framework and other institutions on a micro-level. To approach this level of analysis the following chapter will use a number of case studies. These cases are, of course, not representative for all privatised companies. They can, however, serve as good in-depth examples of the restructuring and development of corporate governance in Slovakia during the period of study.
CHAPTER VI

Privatisation and governance in practice: the firms

‘No corporate governance – one is boss.’
Ján Porvazník, Executive Director, FNM SR

In the preceding two chapters the main issues of the study have been approached on a macro- and meso-level of analysis, respectively. In Chapter IV the formulation and changes in privatisation policy was analysed and in Chapter V the market and the group of actors (investment funds) that evolved as a consequence of these policies were approached. In this chapter, it is time to look into how these changes came about on a micro-level in more detail. In relation to Chapter IV this means analysing the actual application and enactment of the policies pursued in ownership reform. In relation to Chapter V, it is a matter of looking at the firm-level responses and attitudes towards the newly established market for corporate control and the major owners, respectively. Furthermore, by turning to this micro-level it will be possible to get some idea of as to what responses ownership reform and economic transformation have resulted in at the firm-level in terms of restructuring. The key to sustainable growth is restructuring and modernisation of much of the existing industrial capacity, and only if firms and managers face the proper incentives and working environment can they be expected to undertake such activities. To begin with, this makes it necessary to look more closely at the responses and actions of firms and managers.

One of the main analytical propositions of the study has been that it is the combination of formal and informal institutions which shape incentive structures, and thus the effectiveness of the ensuing system for corporate governance. This requires that in this chapter a fair amount of attention is paid to the behaviour and attitudes of managers in this chapter. Clearly managers have a key position, and their behaviour will to a large extent influence the actual outcome of economic transformation. Not only are they the effectuators of change on the firm-level, responding to a given incentive structure – their responses and attitudes will also affect the incentive structure, i.e. they are to some extent “rule-setters” at the same time as they are “rule-followers”. This position is becoming increasingly accepted as case studies

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1 Porvazník (1995) [interview].
have gained ground as a methodology for studying enterprise transformation. Clark and Soulsby for example concluded that ‘[t]he values, motives and actions of the key enterprise managers are shown to be essential factors in explaining both the process of transformation in state enterprises, and the role of institutional factors in that process.’

The basis for the chapter is thus a number (nine) of case studies on Slovak industrial firms, conducted in 1995-1996. The studies are based on interviews with senior management in combination with other data provided by firms. The case studies were then completed on a case-by-case basis. It is the analysis of these cases that form the basis for much of this chapter; illustrations from the cases are given throughout. In addition to the case study data, and as a frame of reference for comparisons, statistical analysis of a database with two other samples of companies have been conducted; one is a random one with 56 industrial firms (Sample-of-56, S56) and the other is a retrospective sample with the top 60 firms according to average return on capital in the period 1993-1996 (Top-60, T60). The restructuring and economic performance of the case study firms is described and analysed in Appendix A. This appendix looks at factors such as output and sales development, employment and industrial labour productivity, exports and trade reorientation as well as indicators of their general economic performance. The appendix also provides an overview of the general developments in Slovakia with regard to the same factors.

* * *

The chapter commences with a brief presentation of the firms included in the study (Section 1). The following section looks in greater detail at the ways in which these firms were transferred into private hands and the resulting ownership structure (Section 2). After that, attention turns towards the governance structures that have evolved in firms (Section 3), and their relation to the capital market (Section 4). Section 5 concludes with a brief summary of the main findings.

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2 A number of case studies have been sponsored by the World Bank and other international organisations. A selection of these can be found in CIS – Middle Europe Centre (1993) which presents ten cases on firms in Czechoslovakia, out of which two are Slovak firms. The main results are found in Estrin et al. (1993) which summarises the results of 43 detailed case studies, 15 each in Poland and Hungary, 10 in the Czech Republic and three in the Slovak Republic. Yet a good overview of case studies on firms in Eastern Europe is found in Carlin et al. (1994) which analyses case studies that had been written by February 1994 on more than 450 firms in; a problem is however that the data refers mostly to the pre-privatisation period. Among the more recent ones can be mentioned Djankov and Pohl (1997) where 19 case studies on Slovak firms are presented.

3 Clark and Soulsby (1995), p. 215. The article puts forth the results of a deep study of three former SOEs in the Czech Republic.

4 For details on the case study sample, see Chapter I:3.1.2, p. 10 ff. Also, for a discussion about the reliability of the information gathered and its potential for generalisation, see page 11 ff.

5 The kind of data provided ranges from the statutory annual reports to internal working documents to information materials. In some cases where figures were not available in print it has been necessary to rely on the information given orally during interviews. Interviews are below denoted by the names of the interviewed persons only in cases where direct quotes are used, otherwise not. Regarding annual reports they are only denoted as “Annual Reports” in the tables below. The same conventions apply in Appendix A.

6 For more details on these two samples, see Chapter I:3.1.3 (p. 12 ff.).
1. Introducing the firms

The section begins with a short presentation of each of the participating firms. Of the total of nine firms, two were drawn from consumer goods production, five from general manufacturing, and two from heavy industry. Basic information on the firms, their sector of production, size and relative size is summarised in Table 31.

The manufacturing of textiles and textile products has had a prominent role in the Slovak economy and OZETA odevné závody, a.s. in Trencin (below Ozeta) is one of the oldest textile firms in the country. The firm was established in February 1939 by Czech businessman Ján Nehera, with production commencing in small scale one year later with a mere 33 employees. In 1945 the firm was nationalised, and during communism when the textile industry experienced a rapid expansion, the firm was under the control of Slovakotex, a state-monopoly in textiles with some 74,000 employees. Ozeta was privatised according to the primary project, prepared by incumbent management, which stood without competition, and was sold under the voucher-scheme. Five years later Ozeta was the largest producer of men’s clothes in Slovakia, employing close to 6,000 persons and accounting for almost 20 per cent of Slovak exports of textile and textile products. Production is divided among six divisions, located in Nove Mesto nad Vahom, Hlohovec, Topocany, Skalica and Tornala, although the major production site is the one in Trencín where also the main office is located. The firm is an example of a relatively successful adaptation to the new conditions of a market economy, and was never in the red from the beginning of transformation and throughout the period of study. Although showing declining profitability and a production fall in real terms, the firm fared way better than the sector average (see Appendix A) and its shares for long belonged to the more liquid issues on the BCPB.

The second company, drawn from general manufacturing, is Cosmos a.s. The firm is a medium-sized producer of various types of brushes, and used to have a monopoly on the production of toothbrushes. Since its establishment in 1832, making it the oldest firm in the sample, it has been located in the same building, situated in the centre of the growing Bratislava. It was nationalised with the Benes-decrees of 1946, but carried the name of Bürstenfabrik Carl Grünebog until 1949. From the fifties until 1990, it was part of a large furniture concern (ZNZ) with ten different firms in its holdings. In December 1990 it was broken out of ZNZ and became a separate firm. Cosmos was, like Ozeta, privatised in the first wave of voucher privatisation, although the likeness ends there. Cosmos was hard struck by

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7 The below information relating to OZETA odevné závody a.s. is, unless otherwise noted, based on Briestensky (1995) [interview] and materials provided in conjunction with the interview. Also, the study would not have been possible without the written information subsequently provided by courtesy of OZETA odevné závody a.s.

8 The below information relating to COSMOS, a.s. is, unless otherwise noted, based on Moserová (1995) [interview] and materials provided in conjunction with the interview. Also, the study would not have been possible without the written information subsequently provided by courtesy of COSMOS, a.s.
economic transformation and showed an increasingly negative return on capital since 1993. Total revenue dropped from current Sk 59 million ($2.0 mn) in 1991 to 50 ($1.5 mn) in 1994, equalling an above average real decline of 31 per cent (see Appendix A).

No less than five of the nine firms in the sample are drawn from general manufacturing. Of these only one (Hydronika) existed prior to World War II, the others are all more or less the result of the communist-era industrialisation. Beginning in the eastern part of Slovakia, ZTS Sabinov a.s. is located in the small town of Sabinov. ZTS Sabinov is a medium-sized heavy engineering firm, established in 1957, whose main field of activity is the production of gearboxes destined for the machinery and milling industry where they are used in various types of transportation bands. The firm is typical in that it was designed and erected according to the needs and priorities of the communist economy. The vast majority of its revenue originated from the deliveries of special gearboxes for the domestic armaments industry as well as the CMEA market in general – both of which collapsed post-1989. The developments in the 1990s are also typical of a firm whose technological profile made adaptation difficult. For instance, between 1990 and 1993 turnover plummeted by 85 per cent in real terms and the firm posted losses in 1993-1995. However, in 1996 the firm again recorded positive profits (see Appendix A).

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Table 31. **Overview of industrial firms included in the case study**

<table>
<thead>
<tr>
<th>Name</th>
<th>Sector and NACE-code</th>
<th>Employees¹</th>
<th>Prod. value²</th>
<th>Privat. method³</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB Stotz</td>
<td>Electrical &amp; optical equipment (DL)</td>
<td>–</td>
<td>–</td>
<td>X</td>
</tr>
<tr>
<td>Cosmos</td>
<td>Manufacturing N.E.C. (DN)</td>
<td>182 (41)</td>
<td>59 (13)</td>
<td>X</td>
</tr>
<tr>
<td>Hydronika</td>
<td>Machinery &amp; equipment NEC (DK)</td>
<td>1,099 (64)</td>
<td>769 (118)</td>
<td>X</td>
</tr>
<tr>
<td>Ozeta</td>
<td>Textiles &amp; textile products (DB)</td>
<td>6,045 (408)</td>
<td>1,476 (343)</td>
<td>X</td>
</tr>
<tr>
<td>Slovenské</td>
<td>Transport equipment (DM)</td>
<td>3,704 (115)</td>
<td>1,222 (80)</td>
<td>X</td>
</tr>
<tr>
<td>Ldomice</td>
<td>Basic &amp; fabricated metal products (DJ)</td>
<td>24,601 (852)</td>
<td>46,254 (1297)</td>
<td>X X</td>
</tr>
<tr>
<td>ZPA Krizik</td>
<td>Electrical &amp; optical equipment (DL)</td>
<td>–</td>
<td>–</td>
<td>X</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>Machinery &amp; equipment NEC (DK)</td>
<td>787 (46)</td>
<td>263 (40)</td>
<td>X</td>
</tr>
<tr>
<td>ZVL Bearings</td>
<td>Basic &amp; fabricated metal products (DJ)</td>
<td>1,422 (82)</td>
<td>487 (75)</td>
<td>X X</td>
</tr>
</tbody>
</table>

Sources: Interviews and related materials; Kniha Faktov 1993; Volumes I & II; PlanEcon (1992), Nos. 50-52.

Notes: ¹Total reported number of employees in 1991. Figures within brackets refers to number of employees as a per cent of the sector average in CSFR as a whole. ²Production value refers ’value of own production’ in 1991. Figures within brackets refers to production value as a per cent of the sector average in CSFR as a whole. ³This column gives information on the dominant method for privatisation where VP stands for Voucher Privatisation, LMBO for Leveraged Management Buy-Out, and FDI for Foreign Direct Investment. ⁴In parenthesis is given the international two-digit NACE-classification, which below will be the basis for comparison with sector averages; for a listing of the groups belonging to manufacturing, see Appendix D, TABLE 9 (p. 325).
Not far from Sabinov is the town of Presov and yet another communist-era medium-sized engineering firm, ZVL Bearings a.s.\textsuperscript{11} The firm was established in the late 1970s and specialises in the production of tapered roller bearings, holding approximately one per cent of the world bearings market. During the 1970s and 1980s it was part of one large industrial group (ZKL) together with nine other bearings producers in the former Czechoslovakia, seven of which were located in the Slovak Republic. At the time of the case study (1995), the assortment consisted of some 130 different types of bearings, and the firm had an annual capacity of about five million pieces. The story of its privatisation and restructuring is of interest as it illustrates how the rights and interests of minority shareholders can be infringed upon when managers, creditors and the major shareholders align their powers. At the same time it is a story of how progressive management, when given the proper incentives, can make a difference for the better.

Also located in Presov is ZPA Krizík a.s., an industrial group producing technology for the handling and measurement of energy, liquids and gases, i.e. electricity meters, valves and pneumatic cylinders for industry automation, transformers and water meters.\textsuperscript{12} The firm was established in 1947 as a daughter-company to Prague-based Krizík, which dated back to the 19th century. Like most companies during communism, it was grouped into a VHJ consisting of close to 15 different enterprises that focused on industry automation, production of industrial robots and computer technology. As regards privatisation, the firm was first slated for voucher privatisation but after many debacles it was eventually privatised by way of a management buy-out.

A few hours north-west of Presov lies Krompachy, a small town with some 10,000 inhabitants. On top of one of the buildings in the industrial area behind the railway, one can easily recognise the logotype of ABB, signalling the existence of one of the relatively few joint-ventures in Slovakia, ABB Stotz s.r.o.\textsuperscript{13} The joint-venture was established in 1992 by German Stotz, part of the ABB concern, and Slovenské Elektrotechnické Závody (SEZ, a.s.) in Krompachy. The latter produces a wide range of electrical products and systems, and is with its approximately 1,000 employees the second largest employer in Krompachy. ABB Stotz produces low voltage dischargers and current pads, but also markets other products from partner-companies within the ABB concern. In our sample of firms it has few traits in common with the other companies. For example, it is a newly established firm and is thus not a direct result of either central planning or the centrally administered privatisation process. Also, it had from the very beginning clearly defined and strong owners with a genuine interest in the company, and with the implicit financial backing of ABB it holds a fundamentally different position in relation to its
creditors in comparison with debt-ridden domestic firms etc. It nevertheless merits its presence in our sample because it provides an insight into how governance structures could have evolved were it not for the pressing and real need to privatise such a large portion of the economy, under the constraints that were discussed in Chapter IV. It also provides an idea of the kind impetus for change that a successful joint-venture can bring with it.

On the outskirts of Bratislava is *Hydronika a.s.*, originally founded in 1897. The firm produces linear hydraulic cylinders/motors, which find their final use in various road construction- and earth moving machines, for example bulldozers, cranes, mobile lifting ramps, as well as in the agricultural sector. Hydronika is rather typical in that its whole existence was based on deliveries to markets and industries that no longer exist, i.e. the CMEA market and the domestic armaments industry. Although still the leading producer of hydraulic cylinders in the former Czechoslovakia, its domestic market experienced a serious decline in 1991, followed by the total collapse of the Soviet market in 1992. Unrecovered claims towards former Soviet customers amounted to 310 million ($10.5 mn), in excess of 37 per cent of the total 1991 turnover. Hydronika became insolvent, and the state stepped in with a bailout. On the premises was thus a cash-starved company with a good deal of technological expertise, good quality, a relatively modern production site, but little resources to put them into use.

Finally, turning to the sector of heavy industry, case studies have been made on two firms, the Eastern Slovakian Ironworks and the shipbuilder Slovenské lodenice. The latter is a land-locked shipbuilder located in the centre of Europe, halfway between Vienna and Budapest in southwest Slovakia. Slovenské lodenice a.s. is a good example of successful restructuring. The company was established late in the 19th century, and in 1921 it was declared to be in the ownership of the Czechoslovak Republic. The first, short, period of state-ownership ended in 1923 when the shipyard was leased to Škoda in Pilsen. However, it was not until after 1945 that production gained momentum, now once again in state-hands, and from 1965 the company was made part of the ZTS Martin trust of companies. In 1990 Slovenské lodenice achieved the status of an independent state-owned enterprise, and on 1 May 1992 it was established as a joint-stock company which was to be privatised in the first wave of large-scale privatisation. In the mid-1990s it was among the largest inland-shipbuilders in the world, holding about 10 per cent of the European ship-

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14 In August 1996 ABB Stotz was, together with ABB Slovenergia and ABB EZ, grouped into a holding group, ABB Slovakia. Source: *The Slovak Spectator*, 22 May 1997.
15 The below information relating to *Hydronika a.s.* is, unless otherwise noted, based on Pekár (1995) [interview] and Chlebík (1995) [interview] and materials provided in conjunction with the interview. Also, the study would not have been possible without the written information subsequently provided by courtesy of *Hydronika a.s.*
16 With piston diameters of up to 260 mm and a stroke of up to 6000 mm it is not the ordinary home-appliances which are produced.
17 The below information relating to *Slovenské lodenice a.s.* is, unless otherwise noted, based on Kóña (1995) [interview] and materials provided in conjunction with the interview. Also, the study would not have been possible without the written information subsequently provided by courtesy of *Slovenské lodenice a.s.*
ping market. In Slovakia (1995), it had become the 33rd largest company according to revenue and the 12th largest exporter. 18

The ninth and final firm included is the joint-stock company Východoslovenské Zeleziarne a.s. (Eastern Slovak Ironworks, j.s.c.) in Kosice, below referred to as VSZ a.s. 19 The company is the largest and most modern producer of steel-plate and sheet products in the former CSFR and the largest corporation in Slovakia with a turnover equal to 9.7 per cent of Slovak GDP (1995) and accounting for 12 per cent of the country’s total export revenue (1996). It is difficult to term such a corporation as representative in any sense, nevertheless it is an interesting firm, not least because it well illustrates the political nature of privatisation in Slovakia. The steel-mill was founded in 1959 as a grand project by the communist government, six years later actual steel production began. Today VSZ is the backbone not of a city or a region, but a large portion of a country in the centre of Europe. With this in mind, it is easy to understand the obsession among politicians about VSZ.

* * *

In conclusion, the small strategic sample represents significant variance with regard to factors such as size (from the largest firm in the country to a small toothbrush-manufacturer); sector (heavy industry to light consumer goods); 20 stage of production (from semi-finished products [VSZ], to industrial inputs [Hydronika] to finished products [Ozeta]); location, from west- to east- to south; ownership structure and method of privatisation. This variance should be seen as positive for the study, given the above-discussed use of the case studies. A selection of firms within one or two sectors only would not have been better since the problems about generalisations is more one inherent in the case study methodology which given its time-consuming nature makes it very difficult to reach the high number of cases needed for any far-reaching generalisations.

2. Privatisation in practice

It is now time to return to the issue of how privatisation took place in Slovakia, although now on a much more tangible level, namely the firm level. Recalling the discussion in Chapter IV:2.1 and IV:2.3 where the institutional framework for large-scale privatisation was presented the methods for privatisation were classified as being either standard or non-standard. The former included public auction, public tender and direct sales to predetermined buyers while the latter referred basically to voucher privatisation but also included, for example, the free transfer of assets to local councils (see Figure 10, p. 107). The choice of method, or combinations

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18 TREND Tyždenník o hospodárstve a podnikaní, No. 25, 1996.
19 The below information relating to VSZ a.s. is, unless otherwise noted, based on Link (1995) [interview] and materials provided in conjunction with the interview. Also, the study would not have been possible without the written information subsequently provided by courtesy of VSZ a.s.
20 What is lacking in the sample, however, is any firm directly being part of the military-production; unfortunately it was not possible to get any firm from that sector to participate in the study. This problem is however not unique to this study, when summarising the results of 43 case studies Estrin et al. (1993) for example concluded that ‘it proved virtually impossible to obtain participation from any firms in the defence sector.’
thereof, was then nominally left for incumbents to suggest in their primary privatisation projects (PPPs).

Most firms in the case study sample were initially slated for the first wave of large-scale privatisation, along with 751 firms in the Slovak Republic as a whole. The only exception is ABB Stotz, which is a *de novo* firm established as a joint-venture (see Section 2.3). Even though voucher privatisation was the rule rather than the exception during this first wave, the relatively decentralised nature of the process left at least some room for manoeuvring on behalf of management, not least due to their privileged position with regard to information as insiders. This, in turn, meant that the ultimate method and timing for privatising a firm, as will be illustrated below, was influenced by the ambitions, tactics and connections of their respective management. To find explanations as to why firms were privatised in a certain manner it is thus necessary to look at the incentive structure and constraints facing management. In addition, as will be seen in Section 2.4, privatisation in many cases was indeed only the first step in transforming the ownership structure of the firms.

The remainder of this section is divided into four parts. Section 2.1 focuses on firms which underwent voucher privatisation and the rationale for accepting/pursuing such a strategy of privatisation. After that the section turns to the question of direct sales and managerial buy-outs, i.e. the method that turned dominant during the second wave of large-scale privatisation (Section 2.2). A brief look at the developments in Slovakia with regard to joint-ventures and foreign direct investment follows (Section 2.3); the example of ABB Stotz is drawn upon there. Finally, Section 2.4 looks more closely at the issue of how the ownership structures that resulted from privatisation have changed over time, both with regard to the case study sample and the two control samples (T60 and S56).

2.1. Voucher privatisation

In the case study sample, there were five firms where voucher privatisation turned out to be the dominant method for privatisation; these were Cosmos, Hydronika, Ozeta, Slovenské lodenice, and ZTS Sabinov. All of these are in a sense “classical” examples of voucher privatisation in that they were privatised in accordance with the primary privatisation project which allocated the maximum allowed 97 per cent of the shares for voucher holders to bid on. In addition, the mandatory three per cent of shares were set aside for restitution through the Restitution Investment Fund (RIF). The process by which these were privatised was rather straightforward, and to a large extent followed the scheme outlined in Chapter IV:3.1. They were all broken out of their former VHJs and corporatised as fully state-owned enterprises.

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21 In the case of Ozeta the precise figure was 95.6 per cent. In two of the cases, VSZ and ZVL Bearings, privatisation was achieved by a combination of voucher privatisation and direct sale (see Table 31). In the former (VSZ) only 72 per cent of the shares were put on offer, of which 62.4 per cent were sold, leaving the state with a controlling block of 37.6 per cent. ZVL Bearings is a special case which indeed also offered 97 per cent of its shares in voucher privatisation, of which 96.8 per cent were sold, but which through various transformations nevertheless soon turned out to be an insider dominated venture and thus is discussed as an example of the rapidly changing ownership structure, see Section 3.1 (p. 235).
in 1990. Preparation of the PPPs took place during the course of 1991, and in 1992 – just before bidding commenced on 14 May – most of them achieved the status of joint stock companies where the FNM stood as formal owner of all shares. Shares were then, to a greater or lesser extent dependent upon investor interest, distributed among private owners in the five rounds of bidding. Finally, in April 1993, shares were transferred from the account of the FNM to the new owners.

As can be seen in Table 32 investment funds became the predominant group of owners, not only in our case study sample but also in Slovakia and CSFR as a whole. On average, investment funds got 43.5 per cent in our sample, individual investors (DIKs) 34.9 per cent and the state, through FNM and RIF, continued to control 21.6 per cent. Not only did funds become the largest owners but the ownership structure also became highly concentrated with the one largest fund holding 15.6 per cent on average. The corresponding figure when looking at the two largest funds was 26.4 per cent – thus outweighing the state’s interest in the majority of

<table>
<thead>
<tr>
<th>Firm</th>
<th>Investment funds</th>
<th>DIKs (Indiv. inv.)</th>
<th>“State”</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Largest 1</td>
<td>Two largest 2</td>
</tr>
<tr>
<td>Cosmos a.s.</td>
<td>16.9</td>
<td>9.4</td>
<td>16.9</td>
</tr>
<tr>
<td>Hydronika a.s.</td>
<td>66.8</td>
<td>20.3</td>
<td>39.0</td>
</tr>
<tr>
<td>Ozeta a.s.</td>
<td>58.7</td>
<td>17.1</td>
<td>28.6</td>
</tr>
<tr>
<td>Slovenské lodenice a.s.</td>
<td>56.9</td>
<td>19.9</td>
<td>35.5</td>
</tr>
<tr>
<td>VSZ a.s.</td>
<td>32.7</td>
<td>11.0</td>
<td>21.0</td>
</tr>
<tr>
<td>ZTS Sabinov a.s.</td>
<td>34.3</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>ZVL Bearings a.s.</td>
<td>38.3</td>
<td>11.8</td>
<td>23.6</td>
</tr>
<tr>
<td>Avg. Case-sample 4</td>
<td>43.5 (17.8)</td>
<td>15.6 (4.7)</td>
<td>26.4 (8.3)</td>
</tr>
<tr>
<td>N 7</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Avg. Sample-of-56 5</td>
<td>46.1 (20.9)</td>
<td>14.5 (9.0)</td>
<td>24.4 (13.6)</td>
</tr>
<tr>
<td>Avg. Top-60 4</td>
<td>34.0 (23.3)</td>
<td>10.5 (11.1)</td>
<td>16.8 (16.6)</td>
</tr>
<tr>
<td>N 3</td>
<td>26</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td>Avg. CSFR 2</td>
<td>39.4 (22.2)</td>
<td>13.4 (6.3)</td>
<td>22.2 (10.9)</td>
</tr>
</tbody>
</table>


Notes: 1 Including the three per cent allocated to the Restitution Investment Fund (RIF). 2 The figures for CSFR as a whole do not add up to 100 per cent as it also contains shares sold to domestic investors (3.25%) and foreign investors (1.34%), neither of which were the case for Slovak firms. 3 Number of valid observations; the relatively low number for the Top-60 reflects the fact that relatively less of these firms were privatised during voucher privatisation. Also, the variance in the number of observations within one group is due to the fact that for the variables “DIKs”, “State” and “Investment funds Total” only those firms reporting all three measures have been included. 4 Standard deviation given within parenthesis. 5 Only holdings in excess of 5 per cent are reported.

Comment: The figures reported for the case-sample, S56 and T60 reflects the ownership structure at end-1993; this is, however, viewed as a very good approximation of the initial ownership structure given that, as noted in the preceding chapter, turnover on markets were minuscule during 1993. Turnover figures for the groups at the RM-S were 0.2, 0.2 and 0.1 per cent of the total issue, respectively.

22 The continued holdings of the state was the combined result of (i) unsold shares; (ii) the mandatory three per cent allocation to the Restitution Investment Fund (RIF) controlled by the FNM; and (iii) changing valuation of property (see below).
cases even though it should be noted that there were large differences among firms (see figures for standard deviation). The general pattern described holds up also when comparing to the Sample-of-56 and the nation-wide (CSFR) average. The one group which does stand out from this general pattern of investment fund dominance is our retrospective sample of top performers (Top-60) which showed statistically significant lower figures with regard to fund ownership and correspondingly higher figures for state ownership than the random Sample-of-56. Thus, the conclusion has to be that the ownership structure, quite contrary to initial expectations/fears, from the outset became quite concentrated, especially given that the variation is the lowest for the holdings of the largest fund.

* * *

With the benefit of hindsight the question is then what factors can help to explain the strange situation as to why incumbents with so little resistance – or, even co-operation, were prepared to put their de facto control/property rights at risk by handing formal ownership over to new private outside owners. In short, what motivation and/or rationale did they have to co-operate with the authorities during this process?

A first, rather obvious factor, is that given that they were slated for the first wave and given that they could find no outside investors with an interest in the firm (and thus in a direct sale) – they had little formal choice. The economic director and the director of development at Hydronika both refer to this lack of outside interests as a compelling reason for choosing voucher privatisation. A second, and important factor, was that there was a strong top-down pressure for using vouchers. The Chief Financial Officer (CFO) of Ozeta, Mr. Briestensky, for example, explains that there was no chance for a choice in the process. This top-down pressure could be derived not only from a wish to press ahead with privatisation per se but also from the fact that Slovakia, as compared to the Czech Republic, had allocated a smaller amount of property for the first wave relative to the federal target for the Slovak contribution to voucher privatisation, implying that a high percentage of first-wave firms had to adopt voucher privatisation if the republic was to reach its target. The difference is illustrated by the fact that in the Czech Republic a mere 39.7 per cent of projects relied solely on voucher privatisation whereas in Slovakia the corresponding figure was 90.1 per cent. This difference between the republics can also serve as a partial explanation as to why there were no competing projects accepted in Slovakia since such projects seldom/never suggested voucher privatisation.

Thirdly, and related to the above, it was not seen as realistic when the first wave primary projects were prepared that policy would change as drastically as it did during the second and third Meciar-led governments. In other words, there was a strong political credibility and commitment connected to economic transformation

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23 The share held by the two largest investment funds outweighed the share held by the FNM in 55.6, 66.0 and 39.4 per cent of the cases for the Case-sample, Sample-of-56 and the Top-60, respectively. However, corresponding figures when comparing only the largest fund with the share held by the FNM in the three different samples were 55.6, 46.8 and 27.3 per cent, respectively.

24 The results of the statistical analysis with regard to initial ownership structure are reported in Appendix D, TABLE 23-TABLE 25 and TABLE 31 (pp. 335-338).

25 Kotrba et al. (1999).

with liberal Minister of Privatisation Miklos backing the policy of voucher privatisation and a “no concessions” attitude towards management. This stance, it can be assumed, deterred some incumbents from trying to get “a piece of the pie”, especially since the possible terms of payment at the time were nowhere near as soft as they would become in 1995 and 1996.27

The above point, however, does not imply that voucher privatisation went uncontested by incumbents. There were many firms, slated for the first wave, which despite the above restrictions, managed to work out concessions for themselves through various sorts of lobbying, obstruction and in general slowing the process – examples are given in Section 2.2.

However, this type of obstruction was not characteristic for the above firms which all, to a greater or lesser extent, endorsed the idea of voucher privatisation and co-operated in its execution. A partial explanation, valid for some of the firms, could be that management with their deep knowledge about the firms held a view that there was no real value to their firms. This could hold for maybe Cosmos, ZTS Sabinov and Hydronika; firms that were and continued to be serious loss-makers as is shown in Appendix A.28 However, such an explanation does not hold for Ozeta and Slovenské lodenice which both turned out to be good examples of successful restructuring, with an above average return on capital (see TABLE D 7, p. 312). Still, the view that expected future profitability was (closely) related to the behaviour of management, is to some extent supported by the fact that the management in Ozeta tried to enforce a management-employee buy-out. The CFO explains that voucher privatisation was a backlash, at least in comparison with the original plans for a widespread employee-management ownership which were turned down in early 1992.29

Interestingly enough, the one common denominator for firms which allocated the maximum 97 per cent to voucher privatisation is that management refer to becoming “free from the state” as the major motivation for choosing/accepting voucher privatisation. The Economic Director of Slovenské lodenice (Mr. Koňa), for example, said outright that full voucher privatisation was a way to minimise any future state influence through the FNM. However, given that the primary projects were prepared in 1991, at a time when investment funds were still in their cradle,30 and the main concern regarding the voucher scheme focused on it resulting in a too dispersed ownership structure – these comments from managers could also be inter-

27 Cf. discussion below and discussion in Chapter IV:3.4.2, also see Figure 27 (p. 287).
28 Although over-all data for Slovak firms have not been accessible, evidence from the Czech Republic show that firms entering privatisation with 97 per cent of shares allocated for vouchers were weak ones (under-capitalised and with low profits), see Marcincin and van Wijnbergen (1997).
29 In this original plan for a management-employee buy-out all managers and some 5,000 employees had signed up and paid a first instalment of Sk 1,000 ($34) to get subsidised shares. The shares would, according to the plan, have been bought at a 50 per cent discount from the FNM. Each participant should have received shares with a nominal value of Sk 30,000 ($1018) to be paid in instalments over 10 years. When this plan was aborted management advised employees to use the Sk 1,000 to join the voucher programme instead. A second, more successful, attempt at giving management and workers a stake was concluded in May 1995 when a minor new emission was targeted at employees. The emission increased the share capital from Sk 696 million ($23.4 mn) to Sk 731 million ($24.6 mn).
30 The Harvard group started their advertising campaign only in November 1991 and the primary projects were originally due on 31 October 1991, although the deadline was later extended to 20 January 1992.
interpreted as an *ex post* rationale for a stance that in fact built on a belief that that “freedom from the state” also implied freedom from any external pressure. At the time, there was also a widespread belief that investment funds would become “weak” owners. Still, as time would show, the attractiveness of investment funds implied that most firms acquired potentially strong outside owners.\(^{31}\) The point is, however, that managers acted in belief that voucher privatisation would serve to enhance their independence.

It deserves mentioning that not only did investment funds come to interfere with any possible plans of avoiding strong outside stakeholders, the state also remained relatively strong in some firms. In 1992 the book values of land and real estate were revalued according to new regulations.\(^{32}\) For Cosmos, with its central location in the centre of Bratislava, this meant an increase in the basic capital from Sk 21.6 million ($0.73 mn) (1991) to Sk 50.8 million ($1.80 mn) (1992). The problem was that this equity was kept by the FNM, which ended up controlling 65 per cent of Cosmos after voucher privatisation.\(^{33}\) The General Director was very upset that the value was ‘not distributed among the shareholders as the voucher privatisation was in process already’.\(^{34}\) Further, in many firms there were quite substantial blocks of shares unsold due to a lack of attractiveness and/or problems with setting the prices “right” during the five rounds of auctions.\(^{35}\)

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In conclusion, it is not possible to point to any single factor that made it possible to pull off voucher privatisation in such a relatively smooth and swift manner. Rather a range of factors such as outer pressure, inner motivation and perhaps the fact that one saw no alternative; factors which were mutually reinforcing, made it rational for incumbents to co-operate with the authorities to a greater or lesser extent. In short, managers did behave rationally although in accordance with their subjective models of their feasible alternatives. Voucher privatisation thus, at least *ex ante*, carried a promise for everyone; be it that one saw it as a good way to be released from the direct responsibility for a loss-making firm, as a way to spread ownership and thus retain *de facto* control etc. However, as will be illustrated below, not everybody acted in the same manner, i.e. not everybody perceived reality in the same way.

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\(^{31}\) Whether and/or how funds utilised this influence is a wholly different matter.


\(^{33}\) A similar thing happened to Hydromika, also located in Bratislava, where following voucher privatisation only 11.85 per cent of the shares remained unsold but where the FNM/RIF share was nearly doubled to 22.5 per cent following the revaluation of property.

\(^{34}\) Moserová (1995) [interview].

\(^{35}\) In CSFR as a whole 7.2 per cent of the shares offered for voucher privatisation remained unsold, see Appendix D, TABLE 12 (p. 327). It should also be noted that the standard deviation (in per cent) for the average share held by the state in our three samples were ranging from 20.8 (Sample-of-56) to 27.8 (Top-60) with the seven case study firms in the middle with 23.4 (see Table 32, p. 219), implying that the state retained sizeable stakes in a number of firms.

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2.2. Management buy-outs

As was pointed out in Chapter IV, privatisation policy was very much influenced by the numerous changes in government in Slovakia. A company well illustrating this is VSZ. Privatisation of the largest company in the country would turn out to be a protracted, turbulent and controversial process, carrying on from 1991 until July 1995. During voucher privatisation (1991/1992) 11.8 million shares (72% of the total) were offered, of which 87 per cent were sold (62.4% of the total). A major buyer was, as discussed in the preceding chapter, investment funds directly and indirectly controlled by VSZ, for example through CIC which gained a stake in excess of 10 per cent. However, after voucher privatisation the state, through FNM and RIF, still retained a controlling minority stake of 37.6 per cent; a block which would be surrounded by much controversy.

The next step in the privatisation of VSZ was when the government of Meciar II on 11 March 1994 surprisingly decided to sell a 9.52 per cent stake the very same day that it received a vote of no-confidence in parliament (!). Not only the timing but also the pricing of the stake raised concerns; shares with a face-value of Sk 1.5 billion ($46.8 mn) were sold for a mere Sk 300 million ($9.4 mn), equalling only one-third of the going market price. The buyer, suitably named Manager, was a firm established by five politically well-connected (HZDS) senior members of the VSZ Board of Directors, led by then Minister of Finance Julius Toth. In addition, Alexander Rezes, who in December 1994 became Minister of Transport, Communications and Public Works, was among the founders of Manager.

The deal was later examined by the State Prosecutor and legal proceedings were initiated against the founders of Manager in May 1994; still, no major changes were made (more below). Thus, the FNM still held 9.097 million shares in VSZ, representing 24.9 per cent of the total, and the battle for control could continue. The next skirmish began when the new government in July 1994 announced a tender for a direct sale of FNM-shares in VSZ. The tender attracted nine different bids, including for example Creditanstalt, although the government failed to make a final decision. The hesitancy on behalf of the government was partly attributable to internal dis-

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36 Only the Harvard funds with some 11 per cent gained a larger stake, see CTK-Business News, 25 January 1993. A total of 67 Czech and Slovak investment funds and 169,798 DIKs had acquired 32.7 and 29.7 per cent of the shares, respectively.
37 The deal was thus part of the so-called Midnight-privatisations, see Box 3 (p. 122).
38 At the time of the sale the market price for VSZ-shares was about Sk 600 ($19). Of the total Sk 300 million ($9.4 mn) 10 per cent was to be paid within 30 days and the remainder in five annual instalments, see CTK-Business News, 25 March 1994.
39 Julius Toth, who days after being recalled as Minister was installed as chairman of the Supervisory Board of VSZ, is reportedly the person who secured the deal. A pertinent detail is that Toth also became deputy chairman at the Board of Directors of Priemyselna Banka [Industrial Bank] in Kosice which granted the loan to Manager. Priemyselna Banka, in turn, is controlled by VSZ; partly through its own holdings, partly through the holdings of its investment company, Cassovianinvest. Source: CTK-Business News, 25 March 1994. Even the Supervisory Board was actively involved in that it extended an interest-free 4-year loan to the five top-managers. Each of the five members in the Board of Directors got a credit of Sk 2 million ($62,000) in order to purchase shares in the company, i.e. a total of Sk 10 million ($310,000). This loan was to be paid back in four instalments, starting in 1995. Source: VSZ Annual Report 1994.
40 Link (1995) [interview]. According to Mr. Link Alexander Rezes was one of the founders, since ‘at the time of founding Manager he was one of the members of the Board of Directors in our company.'
agreements over who the buyer should be, partly to fears of drawing the same criticism as the previous government, i.e. for rushed sell-offs towards the end of its term. Thus, at the time of the early elections (31 September-1 October 1994) the FNM remained the single largest owner of VSZ with about one-quarter of outstanding equity.

Following the election victory of third-time PM Meciar, the officially stated aim of the government was to promote employee ownership; not least as a concession to HZDS’s far-left junior coalition party, ZRS. For this purpose, trade unions at VSZ had already in 1994 established a limited liability company named Hutnik [Metal-lurgist] with the suitable official aim of boosting the influence of workers by selling shares to present and former employees. Then on 16 February 1995, a 10 per cent stake was actually sold to Hutnik at bargain prices, although VSZ employees were never to receive any VSZ-shares. The result was thus that a further one-tenth of equity was controlled by insiders.

When in June 1995 VSZ was put on the list of strategic enterprises, where a controlling stake would be kept by the state, it seemed that the remaining shares would stay in the FNM-portfolio. However, the strategic interest in VSZ turned out to be short-lived. Privatisation of VSZ was instead completed when, on 20 July 1995, the FNM surprisingly decided to sell its remaining 15.2 per cent stake to Ferrimex, s.r.o., a company jointly owned by Hutnik (25%) and ARDS a.s. (75%). ARDS, in turn, was reportedly owned by Minister Rezes, the then vice President of VSZ (Mr. Drakik), and the chairman of the Supervisory Board (Mr. Rusnak). The price paid was, predictably, well below market price. Thus, after four years of controversy the largest and most important company in Slovakia had been transformed into a completely insider controlled venture. The price paid for the control-

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41 Hutnik had been one of the bidders in the above mentioned tender, and trade unions had in August 1994 threatened to take action unless the whole block of shares held by the FNM were sold to Hutnik. Hutnik, however, was closely associated with the top management of the company – to the extent that the main owner of VSZ, Alexander Rezes, in early 1997, upon being asked how many shares of VSZ that were under his influence, without modesty replied: ‘[c]ount: Manager (ten per cent), Ferrimex (15 per cent), Hutnik (ten per cent), Vseobecna (12 per cent).’ Source: Slovak News Agency-TASR, 21 March 1997.

42 For the 1,644,816 shares Hutnik had offered Sk 200/share ($6.5), less than half the going market-price.

43 Instead of receiving VSZ shares employees became part-owners of Hutnik, which at end-1995 was owned by some 22,000 VSZ-employees. Source: CTK-Business News, 1 December 1995. However, Hutnik-shares are not publicly traded and transferability is limited to other employees and require the permission from the Board of Directors of Hutnik. The potential for employee-influence is thus indeed limited. Source: CTK-Business News, 20 February 1995.

44 On the Strategic Enterprise Act, see Chapter IV.3.4.1 and Appendix D (p. 315).

45 The deal was concluded between the first and second reading in parliament as President Kovac had vetoed the original law. Thus, at the second reading in September 1995 VSZ had been totally sold but still remained on the list of strategic enterprises. Source: Miklos (1997), p. 111. Asked why the company was no longer “strategic”, FNM spokesman Oto Balog said: ‘I am unable to answer this.’ Source: CTK-Business news, 3 August 1995.

46 Also, the daughter of Rusnak, Martina Tomkova, was on the board of the company. Source: CTK-Business News, 3 August 1995. The inside ownership was partly confirmed by Mr. Link saying that ‘Ferrimex is created...by Hutnik and top managers of the company [VSZ, my remark].’ Link (1995) [interview].

47 Ferrimex bought the shares at Sk 200 ($6.7) each, while market price was some Sk 400. The total sum paid amounted to Sk 502.5 million ($16.9 mn). Ferrimex was later transformed into a joint-stock company, with a basic capital of Sk 1 million ($33,600).
ling stakes was far below market value, and the case amply illustrates the importance of political connections.

The close alliance between VSZ and HZDS is testified to not least by the fact that VSZ has been a main contributor to HZDS campaign financing. Also, for the 1998 election campaign the chairman of the VSZ Supervisory Board, the above-mentioned Alexander Rezes, was appointed campaign-general for HZDS. Close contacts are, however, only part of the explanation. Adaptiveness on behalf of management has also been remarkable during this process, and those involved have been able to use/manipulate whatever institutional set-up to work to their advantage; first voucher privatisation by setting up investment funds and an investment company; when voucher privatisation was shelved they managed to work out direct sales of all remaining shares, both to management directly (Manager and Ferrimex) and to trade unions (Hutnik). The Hutnik-deal shows how incumbents in an ingenious way managed to turn the demands for increasing employee-participation into their own advantage; even if one presupposed that there was no coalition between top management and the trade unions, the deal, at the very minimum, prevented the shares from falling into the hands of an outside investor.

Yet another example pointing to the increasingly politicised nature of privatisation, is the privatisation of ZPA Krizík. The firm was initially slated for the first wave of large-scale privatisation and the managing director accordingly prepared a PPP, which included voucher privatisation. When the Commercial Director, Mr. Sandor, in 1995 commented on this project his remark was that ‘it was his duty’ [to prepare the project]. The project was subsequently turned down and the firm was not even transformed into a joint-stock company. Once voucher privatisation had been avoided repeated attempts by various insider groups to seize control over the company through a direct sale followed.

A first such attempt was made already in 1991/1992 by a group of six managers who, with the broad backing of employees (app. 1,200) and middle management, submitted a privatisation project. The quality of the project is difficult to assess, but in the end it was nevertheless rejected. Yet an attempt was then made by another group of managers, including Mr. Sandor. This group created a joint-stock company with only some 100 employees. Their plans to buy the company through a management buy-out were however barred, partly because of lack of consensus within the group, partly because new rules which put a ceiling on assets to be privatised through buy-outs of about Sk 0.5 billion ($16.3 mn), while the assets of the whole firm amounted to some Sk 1 billion ($32.6 mn).

The successful bidder would turn out to be a group of nine top managers who established a limited liability company for the purpose of submitting a privatisation project, ESIC s.r.o. An important difference compared to the aforementioned at-

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48 TREND Tyždenník o hospodárstve a podnikaní, No. 43, 1997.
49 It should be noted that top management were positive to the Hutnik-deal; also, the subsequent cooperation between top management (ARDs) and the trade union leadership (Hutnik) in securing the Ferrimex-deal points in the direction of a de facto coalition between the two parties.
50 Mr. Sandor, who by no means can be seen as an objective source in this matter, comments that they were no experts and thus prepared a poor business plan.
tempts was that all executive power was concentrated in ESIC, and that the group had the good political backing which would prove necessary. The sell-off meant that on 1 April 1994 ZPA Krizík a.s. was created, and under full control (70%) of the nine managers in ESIC.\footnote{Thirty per cent of the shares were owned by employees who purchased shares emitted by the company.} This project was, just like VSZ, part of the midnight-privatisations in February/March 1994.

The deal was a complex one, involving three different groups of assets: (i) the original plant from 1947 with the majority of production, which was incorporated into ZPA Krizík a.s. as of 1 April 1994; (ii) a new plant originally built to house the production of industrial robots which was transformed into a state-owned joint stock company (ZAT) later bought by ZPA Krizík;\footnote{Initially the FNM held 97 per cent of the shares in ZAT while RIF the mandatory 3 per cent. In September 1994 an open-bid competition for the purchase of 51 per cent of ZAT took place. Among 5-6 competitors ZPA Krizík a.s. was chosen as the winner, thus becoming the majority owner also of this group of assets. Since ZPA Krizík was not the full owner it was kept as a separate entity. A problem with this purchase was that one was forced to buy the company with existing stock/inventories; most of it useless in that much of it consisted of computer peripherals for industrial robot production – a market which no longer existed. On the other hand, the purchase turned into an asset when the original plant had to be closed due to environmental problems, especially with galvanisation. All production was then moved to the new plant where it found room on the space allocated for the robots production it was intended for.}\footnote{This credit was at the time of the interview running with a 12.5 per cent annual interest rate, according to Mr. Sandor.} (iii) surrounding facilities, for example apartments, which were transferred to the municipality free-of-charge. This in a way illustrates the complexity of privatisation, a complexity which in and by itself in many cases opened up the possibility for manipulation, since privatisations in the post-communist context entailed many types of assets and transactions that would “normally” not be included in a similar transaction in the context of a developed market economy. Further, management is the one group, which has an absolute advantage when it comes to evaluate these assets – and, they were also in a position where they could move assets between different companies.

Just like in the case of privatising VSZ the sale of the original assets to ZPA Krizík, valued at about Sk 1 billion ($32.6 mn), was a give-away deal. A first instalment (10%) had to be paid in cash and was financed by a bank-loan. The remainder of the purchase price should be paid to the FNM over the coming ten years.\footnote{In addition to these five cases there were many instances where one remarked that the terms of sale had been extremely soft, although not outright illegal. One case, interesting not least because it documents the direct links between FNM-staff and the disputed sale in question, concerned the sale of a majority block of Kovohuty Krompachy (copper) is described in detail by Miklos (1995), pp. 20-22.}\footnote{Plesnik (1994) [interview].} This, and eleven other so-called midnight-privatisations, were later investigated by a parliamentary committee, which found that the government had not followed existing procedures. It concluded that with ZPA Krizík, as in four other cases (including VSZ), undue preferential treatment had been granted to the buyers with regard to price and other conditions.\footnote{Plesnik (1994) [interview].} However, following the return to government by Meciar, reportedly there were no material changes made to any of these direct sales.\footnote{Plesnik (1994) [interview].}

Thus, although few cases have rendered the same public interest as, for example, the sell-offs of VSZ and Slovnaft (see Appendix C, p. 317) they, and ZPA Krizík, are not exceptional and could be taken, with the above reservations about generali-
sations from case studies, as illustrative of the way in which direct sales in Slovakia have been carried out. They are also representative for a general trend where the terms of payments according to which direct sales are carried out have become increasingly softer over time. Prices, as a per cent of book value, have been lowered; instalment plans have been extended to ten years; deductions from the agreed price for investments made have become commonplace, no matter whether they are financed with retained earnings or through outside finance; and, the bond-scheme which replaced voucher privatisation has functioned as yet an additional discount. This development is clearly visible also when looking at the financial situation of FNM which was undermined by these give-away deals to the extent that it in early 1998 looked unlikely that it could meet its obligations towards bond-holders.56

The fiscal effect of privatisation aside, the two cases illustrate a point made by the EBRD when discussing the potential effect of insider dominance and concluding that even if such privatisations are not ideal, and do not produce ideal owners, some comfort may come from the fact that ‘a certain amount of effort by managers is typically required in order to secure ownership. As a result, some selection of managers occurs through the privatisation process.’ 57

However, the question remains whether dealing with the authorities and having for the time correct political connections makes adequate qualification for restructuring an enterprise. One problem with direct sales to insiders is that once about to gain control insiders may do their best to hinder outsiders from gaining stakes in the firm. Indeed, this is also what has been observed in our case studies, i.e. that much effort has been spent on precluding outsiders from gaining a foothold in the firms. Thus, these firms, although with high-powered incentives, may operate without any outside monitoring.58

2.3. Foreign investment

If privatisation by means of direct sales to domestic owners gained in importance over time the opposite is true for privatisation by means of foreign direct investment (FDI). FDI never held a strong position in Slovakia, and over time it even diminished. The total inflow of FDI between 1990 and 1996 amounted to no more than 887 million dollars, equalling 4.7 per cent of 1996 GDP. This is the lowest figure for all of the Visegrad-countries, and equals no more than 12.5 per cent of the neighbouring Czech Republic, which during the corresponding period attracted 7.1 billion dollars, i.e. in excess of 12 per cent of its 1996 GDP.

Given Slovakias proximity to Austria and Germany, and the fact that generally it has been the economically more advanced countries (to which Slovakia ostensibly belongs) that have attracted the bulk of FDI, one would have expected considerably

58 Barberis et al. (1996) in their study of Russian shops for example found that it was not sufficient with strong incentives for management; for shops to really be restructured it was also required new human capital, i.e. new management.
higher volumes of FDI. Slovakia is indeed an exception that poses a puzzle, with a lower cumulative (1989-1996) per capita inflow ($117) than even Kazakhstan ($187), Azerbaijan ($130) and Turkmenistan ($118). The corresponding average inflow for the other three of the four initial Visegrad countries (Poland, Hungary and the Czech Republic) was $710.

In our sample of firms, only ABB Stotz in Krompachy was privatised with foreign participation. ABB Stotz is a rather typical joint-venture (as opposed to the other form of FDI, greenfield investments) which was established on 31 December 1992 as a limited liability company (s.r.o). The German partner, ABB STOTZ-Kontakt GmbH in Heidelberg, is the majority owner (51%) whereas the Slovak partner company SEZ holds 49 per cent. The German partner provided the major capital input whereas SEZ provided the location (on the same site as SEZ itself), facilities and staff. The major advantages with FDI, be it through green-field investments or joint-ventures like ABB Stotz, lies perhaps not in the actual capital injections but rather in the fact that the foreign partner/investor brings with him new technological solutions, marketing skills, access to new markets through established networks, new organisational solutions and improved corporate governance; as

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59 Not surprisingly it is exactly Austria and Germany that have been the largest investors, although their internal rank has varied between different years. These two have been followed by the Czech Republic, the US, UK, Netherlands and France, cf. Hosková and Vágnerová (1998).

60 EBRD (1997), Table 7.5, p. 126. However, it should be noted that the FDI-inflows in the three cited CIS-countries are primarily connected to natural resource development, something which Slovakia does not have. The unweighted average inflow for CIS-countries is $44 per capita in 1989-1996, although it should be remembered that FDI gained pace much earlier in Eastern Europe than in the CIS.

61 SEZ, in turn, is a management-controlled joint stock company where a group of 49 persons (e.g. directors and junior managers) held 51 per cent of outstanding shares (1995). SEZ is with its about 1,000 employees the second largest employer in Krompachy and produces a wide range of electrical products and systems.

62 For an interesting discussion, and a positive evaluation of FDI, in an evolutionary perspective, see Kogut (1996). Also, on the relation between privatisation, restructuring and FDI, see Hunya (1997).
pects which are all visible at ABB Stotz. In addition, by providing role-models for imitation such ventures may have diffusion effects in the economy, towards suppliers as well as customers.63

In the light of these, and other positive effects of foreign participation, the low level of FDI in Slovakia is particularly revealing. When trying to explain why Slovakia has been lagging behind many of its neighbours one has to look beyond the more traditional economic factors since Slovak macroeconomic performance, both with regard to growth and price stability, was second to none during the period of inquiry. Likewise, there have been no real formal institutions that have barred FDI, quite to the contrary those having invested in Slovakia seems quite content. The General Director of Volkswagen in Bratislava (Jozef Uhrik) for example stated that ‘[t]he environment for foreign investors is certainly no worse here than in the Czech Republic, Poland or Hungary.’64 The question thus remains, what is different in Slovakia?

The one overriding difference has been the highly unpredictable political situation in Slovakia, where politics have been dominated by Meciar ever since 1992. Most analysts would indeed agree with former Minister of Privatisation Ivan Miklos when stating that ‘[t]he first and most important factor why foreign investment is not coming is political instability which makes impossible any prediction of future development, both in politics and economics.’65 Not only have the political problems helped to create a bad image of Slovakia abroad, it also meant that Slovakia in 1997 was excluded from “fast-lane entry talks” with the European Union, thus further lessening the future attractiveness of investing in Slovakia. However, being anticipated the decision may well have served to depress the levels of FDI also in the past.

Privatisation policy per se is also a factor that can explain the low level of FDI. Initially the main focus was on quickly getting voucher privatisation on track, leaving little room or time for the often time-consuming process of establishing a joint-venture or planning a purchase of a firm. ABB Stotz is an exception and the General Director, Mr. Fabišík, explains the successful establishment of the firm with the fact that the idea of a joint-venture had been put forth some time earlier, before voucher privatisation had commenced; and also that the idea had been anchored with the government and obtained its approval. In other cases exactly this need for having the blessing of the government could explain the very limited number of joint-ventures established prior and during voucher privatisation.

When privatisation policy changed and direct sales on a case-by-case basis became the dominant method one could have expected things to change. However, as these changes in privatisation policy were so closely connected to the general policies of the Meciar governments the change was for the worse rather than the better.

63 The VW purchase of Czech Skoda is an often cited example where a major investment can bring with it impetus for change within a whole industry.
64 Reuters News Service, 24 April 1996. Volkswagen is with its assembly factory in Bratislava among the major foreign investors in the country. Other major investments include e.g. British Tesco which in March 1996 from American K-Mart bought a number of supermarkets (K-Mart had in 1991 bought the 13 Prior supermarkets in CSFR), Slovalco Aluminium (a joint-venture with Norsk Hydro) and Whirlpool-Tatramat (a whiteware producer, primarily washing machines).
65 Reuters News Service, 7 August 1996
The Meciar-governments post-1992 have expressed a close to open hostility towards foreign capital, thus deterring many investors from even trying to get involved in the generally very opaque process of direct sales. These policies have also drawn criticism from for example the World Bank, which urged the country to “take steps to allay the impression that the government favours domestic companies and investors in privatization and in its industrial policy.”66 One case which by many has been mentioned as especially deterring is the way which the government handled the sell-off of Slovnaft, where EBRD after a failed international offering by Slovnaft had taken a large stake (10.5%) in July 1995, only to see their position undermined by the give-away deal of 39 per cent of equity to management-controlled Slovintegra in August the same year.67 Such behaviour should not be underestimated when it comes to changing the sentiment of the international investment community. Given the limited room for foreigners in both types of privatisation there were also expectations that foreign investors would make their entry through the secondary market once firms had been privatised. However, as discussed in the preceding chapter the non-transparency of the securities market prevented many foreign investors from doing even this.

The above does not imply that there is no recognition at all of the beneficial effects of FDI, only that such considerations have taken second place to an urge for control on behalf of the government and to their preferences for giving preferential treatment to those with close political ties to the government. This urge for control over investments has, however, remained even though the government has recognised the needs for higher inflows. When Deputy Minister of Economy Jozef Brhel in September 1997 (finally) admitted the need for FDI, saying that “[w]e cannot proceed in reforming of the bad structure of the industrial sector without foreign capital”,68 he still added that the possible tax incentives would be restricted to foreign investment targeted for strategic sectors, adding that the government was the one to judge what the strategic sectors would be.69

66 See BBC Monitoring Service: Central Europe & Balkans, 2 January 1997 [referring to a study by the World Bank made public on 1 January 1997].
67 EBRD paid $59 million for their stake, i.e. the full face value (Sk 1,000) per share while Slovintegra, paid a mere Sk 156 per share (the market price at the time was around Sk 800), see CTK-Business News, 10 July 1995, also see Appendix A.
69 Reuters News Service, 16 September 1997. The recognition of the need for FDI should be seen in the light of the acute balance of payments problems which were plaguing the Slovak economy in 1996-1997; potential tax relief would also be tied to improving export performance of targeted firms and sectors (ibid.). The tax incentives discussed concerned the possibility of reducing registered tax by 70-75 per cent during a five year period. Tax relief in order to boost FDI had however been promised already in 1994 by President Kovac, see BBC Monitoring Service: Central Europe & Balkans, 26 May 1994. The need for foreign capital was admitted also by SDL (Brigita Schmögnerova) in May 1996, who also blamed the political situation for the lack of inflow, see CTK-Business News, 24 May 1996. Also the government of Meciar III had made suggestions in the same direction, for example when the Ministry of Finance in June 1997 weathered plans for tax relief, see Reuters News Service, 23 June 1997.
2.4. The resulting ownership structure

As previously argued (Chapters II and IV) privatisation should only be seen as the starting point in transforming the ownership structure, and given the free transferability of property rights, considerable changes in this initial ownership structure could be expected. Below, an attempt is made to trace these changes, their causes and potential effects. Changes in ownership structure are studied using three different panel-data sets. Firstly and primarily we show how ownership has changed in the firms included in the case study. In addition, to give a broader picture of ownership changes over time, the results are compared to the Sample-of-56 and the Top-60 sample. The data shows one dominant trend with regard to the ownership structure, namely a concentration and restructuring of ownership following privatisation. Commonly this restructuring and concentration has been referred to as the “third wave” of privatisation, and has taken place in two dimensions.

Firstly there has been a statistically significant general increase over time in the average size of the holdings held by non-state owners. Between 1993 and 1996 the average share held by the one largest non-state owner increased from 17.8 to 37.3 per cent in our case study firms (see Table 33). The same pattern is evident also with regard to the two other samples, with the share held by the largest non-state owner rising from (end-1993) 15.0 to (end-1996) 34.0 per cent and 10.2 to 40.6 per cent for the Sample-of-56 and the Top-60, respectively. Looking at the figures for the two largest owners the trend towards increasing concentration is even more notable, with two owners on average holding, or being very close to hold, an absolute majority in all three samples at end-1996. Also we can see in Table 33 that the major part of the change took place during 1995 and 1996. There is, however, a difference between the top performing firms and the two other samples in this respect. At the outset (1993) the Top-60 sample exhibited a statistically significant less concentrated non-state ownership structure than the random Sample-of-56 and the case study sample. Over time, however, these differences diminished and in 1995 and 1996 there are no significant differences between the three samples.

One firm within the case study sample which slightly differs from this pattern of increasing concentration is nevertheless ZVL Bearings, where no major changes in ownership structure took place; what happened in that firm instead was that all valuable assets were transferred to a new company, ZVL Auto which was con-

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70 The expression was first used to denote the similar process in the Czech Republic, and thus referred to the “wave” following upon the two waves of voucher privatisation.
71 For the Sample-of-56 and the Top-60 this holds regardless of whether one looks at the share held by the one, two or five largest non-state owners (see Appendix D, TABLE 28-TABLE 30). The one exception to this general trend is that the increase in the share held by the two largest non-state owners for the case study sample does not come out as significant at the 10 per cent level in the statistical analysis, although the means increase from 31.6 to 53.4 per cent between 1993 and 1996. In order to eliminate the effect of the initially rather large state holding it is chosen to use only non-state ownership when trying to assess the degree of ownership concentration.
72 See Appendix D, TABLE 25-TABLE 27.
trolled by management.\textsuperscript{73} This whole process when the original firm was emptied and left only with the debts, was done with the blessing of the main bank, VUB, which through its positions on the Supervisory Board took an active part in the transformation. Another firm that breaks the pattern of gradually increasing concentration of ownership is ZPA Krizik. In this case, as was discussed in Section 2.2, privatisation was achieved through a direct sale of all shares to top management in 1994.

The second, and equally important, aspect of the changes in ownership concerns the composition of owners. When studying this dimension a three level classification of owners was applied, with “private” owners defined as named private persons, limited liability companies and private joint-stock companies; “funds” including shares held by traditional investment funds; and “state” accounting for shares under direct/indirect control of the state through the FNM. When analysing the ownership structure according to this classification two important trends are visible, firstly the state has significantly reduced its holdings, and secondly an increasingly high percentage is held by “private” owners.

As previously discussed, investment funds initially gained a strong position in Slovak industry, on average they held a total of 46.1 per cent of outstanding equity in the part of the Sample-of-56 which underwent voucher privatisation (see Table 32, p. 219). The state through FNM also retained large posts (21.1%), while the

\textsuperscript{73} ZVL Auto was majority owned (74\%) by a private firm (ESP), which in turn was owned by eight persons in the top executive management of ZVL Bearings/Auto.
share held by “private” owners was negligible in 1993. However, over time this latter group have become the largest owners, holding in excess of 56, 52 and 54 per cent of the shares at end-1996 in our case study sample, the Sample-of-56 and the Top-60, respectively (see Figure 22). The trend towards increasing private ownership is statistically significant throughout the period and there are no major differences among the samples in this respect. The corresponding trend has been the very speedy decline of state ownership as privatisation has proceeded over time. In the case study sample and the Sample-of-56 average holdings were at end-1996 a mere 1.1 and 1.5 per cent, respectively. State ownership had been significantly reduced also in the top performing firms, although state involvement remained significantly higher than in the Sample-of-56 and the case study sample. In our case study sample it was only in Hydronika that the FNM retained a stake in excess of five per cent at end-1996.

The reduced role of the state can, however, not explain the massive increase in “private” ownership; to do this one must look at the development of holdings by investment funds which had begun to diminish already in 1995 only to take a massive plunge during the course of 1996. At the end of 1996 their share in the case study group, the Sample-of-56 and the Top-60 had been substantially diminished, holding

Figure 22. Changes in ownership composition, 1993-1996 (per cent of total equity)

![Figure 22. Changes in ownership composition, 1993-1996 (per cent of total equity)](image-url)

Source: RM-S Database; own calculations (for the underlying figures, see Appendix D, TABLE 19 and TABLE 31-TABLE 33).

Comment: Note that all figures refer to reported holdings among the top-5 owners in each of the enterprises; generally only holdings in excess of 5 per cent are reported – thus resulting in that the sum total of the holdings by the private, fund and state owners seldom reach a full 100 per cent

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74 It should be noted that it is only the inclusion of ABB Stotz in the case study sample that brings the mean to 11 per cent, see Appendix D, TABLE 19 (p. 333).

75 See Appendix D, TABLE 31-TABLE 36. With the exception of the the already mentioned fact that the top performers (T60) had a significantly higher “state” ownership in 1993 (and a correspondingly lower amount of “private” ownership) than the random sample (S56), see TABLE 31, there are no statistically significant differences between groups.

76 See Appendix D, TABLE 33.
a mere 6.6, 10.3 and 5.3 per cent respectively, down from some 20-30 per cent three years earlier.

The mechanisms behind these changes, both with regard to the increasing concentration and the changes in composition of ownership, are mergers, sell-offs, purchases on the securities markets (then primarily through block trades) and, of course, the continued privatisation through direct sales. This increasing concentration has in fact been related with the illiquid stock market discussed in Chapter V where there has been more money to make from building up controlling stakes and selling on than from normal portfolio investments. Also, the reduction in holdings by investment funds is to a large extent explained by the above discussed transformation of investment funds into normal joint stock companies, thus entering the statistics as private owners (see Chapter V:2.7). Also, since these transformations are a late phenomenon, with the bulk of transformations taking place in 1996, there is a significant reduction counting only that year, with holdings being cut by some 50 per cent or more. Another factor behind this change was privatisation by means of direct sales, which clearly favoured private owners and meant a direct reduction of holdings by the state.

The implications of the above are difficult to assess in more detail, although a few things are worth noting here. Firstly, despite concerns about voucher privatisation leading to a dispersed ownership structure it has been noted that this did not occur. In an international perspective already the ownership a few months after privatisation was relatively concentrated. Secondly, still in an international perspective, ownership concentration in Slovakia has gone very far. Looking at the importance of the five largest non-state owners in the three samples taken together it is found that their share of outstanding equity had risen from an average of 29 per cent in 1993 to 61 per cent at end-1996. While this is similar to, for example, the Czech Republic it is significantly higher than in many developed market economies. Thirdly, these tendencies should, on the whole, be commended as there is good reason to believe that concentrated ownership is purposeful for establishing well-functioning governance structures when there is a division of ownership and control. Fourthly, and finally, the question about who the owner is, is not insignificant; and as has been learned from this section insiders have become the dominant owners which may raise some concerns with regard to the quality of ownership and governance, an issue which is returned to below.

To sum up, this section has provided some insights into how privatisation evolved in practice on the micro-level, and discussed the kind of considerations which may have been important for management during the process and the incentive-structure which in many cases led them to co-operate. The over-reaching aim of privatising

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* The per cent of shares held by the five largest shareholders in the United States, Japan and Germany were 25.4 (16.0), 33.1 (13.8) and 41.5 (14.5) per cent, respectively (standard deviation in per cent given within parentheses). Corresponding figures for the Czech Republic and China were in 1995 57.8 (17.5) and 58.1 per cent, respectively. Recalculating the Slovak figures to include all five largest shareholders (i.e. also the stakes held by the state through the FNM) give a total average for the three groups of 66.5 (176) per cent at end-1996. Sources: Xu and Wang (1997), p. 48; Dittus and Prowse (1996), p. 24; Claessens et al. (1997); RM-S Database; own calculations. The Slovak figures by group were as follows: C9 – 64.3 (26.4); S56 – 64.3 (13.6); T60 – 68.9 (19.3).
these firms has thus to a large extent been realised. In addition, the section has pointed to a process of significant recomposition of ownership following privatisation. Firstly, there was in all groups a significant concentration of ownership between 1993 and 1996. Secondly, in all groups there was a significant decrease in both “state” and “fund” ownership, coupled with a increase in “private” ownership. Interestingly, the sample of top-performers throughout the period of study had a significantly higher portion of “state” ownership than did the random Sample-of-56. This could in part be explained in terms of the state wanting to retain control over some of the more valuable firms.

Recalling the discussion in Chapter V we may posit that these developments have had an impact on the stock market in the sense that the high level of ownership concentration may serve to explain the low level of liquidity – in practice many firms were already in 1995 and 1996 closely held firms. At the same time, however, the process of ownership recomposition and concentration is in part reflected in the increasing market turnover in the same period. Moreover, the concentrated ownership and the dismal state of disclosure, coupled with the dismal protection of minority shareholders, may also serve as an explanation for the general lack of confidence in firms and the market. Thus, concentration of ownership has come at a price, one largely paid by the minor shareholders.

3. Organisational restructuring and corporate governance

This section is divided into two main parts. In the first part (Section 3.1) is discussed the organisational restructuring which was observed in some of the case study firms, and its implications for corporate governance. Such changes can be seen as part of the transformation from SOEs to more modern and market-oriented firms. In the second part (Section 3.2), focus is turned towards the development and characteristics of governance of firms post-privatisation.

3.1. Organisational restructuring

Regarding organisational restructuring, two trends have been especially notable. The first is that firms have been trying to streamline their organisations by getting rid of many of the “extraordinary” activities that had been part of the producing firms during communism, for example housing facilities, sports facilities, holiday houses for employees etc. As mentioned, privatisation of ZPA Krizik for example implied that surrounding facilities like apartments, previously part of the SOE, at the time of privatisation were transferred to the municipality free-of-charge. Also at Ozeta some auxiliary functions were sold off and the company instead chose to buy services from private firms. At Slovenske lodenice, the production programme was revamped, with a much clearer focus on ship-production than previously. At Hydronika some units were broken out in 1991 prior to privatisation and in September 1992 the production unit in Dunajska Streda was sold (see Section 2.1). Actions like these ought to be looked generally positively upon as they contribute to transparency and evaluation of firm performance.
A case where the changes have gone further than this is the bearings producer in eastern Slovakia, ZVL where privatisation and deep organisational restructuring went hand in hand in a rather complicated process which involved many different actors and groups of assets. As a state-owned enterprise ZVL was comprised of three different production sites, the most recent one finalised in 1989. At the time of privatisation management handed in a PPP which catered for the privatisation of all units; however, the same management handed in also a competing project which foresaw the division of the company into two units, the older sites for production of smaller bearings and the 1989-site for larger bearings. The competing project was however, as in most cases, rejected by the Ministry of Economy and the Ministry of Privatisation, and the whole firm was privatised with the help of vouchers (see Table 31 and Table 32). The General Director was very critical of this, claiming that privatising the whole company at once made ZVL Bearings a very debt-ridden company as it had to take on the debts (app. Sk 300 mn [$10 mn]) resulting from the protracted construction of the 1989-plant, thus being the source of many of its problems. The period 1992-1994 was indeed one of great losses for ZVL Bearings, with accumulated losses amounting to current Sk 398 million ($13.1 mn) for the period.

As a consequence, with the support of existing owners as well as the major creditor, VUB, a strategy for making operations financially viable was worked out. In 1993 a new limited liability company was established, ZVL Auto; majority owned (74%) by a private firm ESP, which in turn is owned by eight persons in the top management of ZVL Bearings/ZVL Auto. Then, between July 1993 and July 1994 a gradual transfer of the production of auto bearings to the new company took place, with ZVL Auto buying both technology and facilities from ZVL Bearings over time. Parts of the proceeds were used by the latter to pay some of the debts of the firm. Thus, by moving the profitable activities to the new company the transformation resulted in the establishment of one progressive company (ZVL Auto), leaving the losses in ZVL Bearings. From the view of the future, Mr. Vysoky says, it was a good way to solve the problems. Mr. Vysoky explained that the funds understood that the only way to keep up production was further restructuring and a division of the firm. This was accepted by the funds at the General Assembly in

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78 The construction of the latter was initiated in 1985 by the state and the idea was that bearings production targeted for military purposes but located in Povaszká Bystrica would move to this new site in Presov.
79 In accordance with the primary project which allocated the maximum 97 per cent for voucher holders ZVL Bearings a.s. was established on 1 May 1992 and subsequently auctioned off. The majority of shares (61%) was dispersed among DIKs. The remaining 36 per cent of shares were held by four investment funds; two with 12 per cent stakes and two with 6 per cent stakes.
81 Vysoky (1995) [interview].
82 In addition, ZVL Bearings held a 12 per cent share and the two investment funds, Cassoviainvest and Zlaty Pramen, each held a 6 per cent share. Initially a larger portion of the shares were held by investment funds, these however sold their posts to ESP.
83 The prices paid for the transfer of assets are not disclosed by Mr. Vysoky.
84 It is undeniable that the restructuring had a positive effect on the developments of ZVL Auto. Its production is geared towards the auto industry, e.g. personal cars, tractors, trucks and agricultural machinery. Investments have been made into the production of rollers for the bearings, previously not produced in Presov, but money have been used also for the further education of the workforce.
The case of ZVL Bearings-cum-Auto thus well illustrates some of the problems with voucher privatisation and the ways in which legitimate demands for restructuring and the equally legitimate interest of the individual shareholders may pull in different directions. One problem is the lack of legal minority protection, which could guarantee them certain minimum rights at times of a buy-out or take-over. Mr. Vysoky is very clear, and most likely very correct, when he says that he sees privatisation as a two-step change; the first step was to reduce the influence of the state, the second step implies the consolidation of ownership. This second step, under the present conditions of a very weak position for minority owners, implies that many of them will lose confidence in the capital market – with potentially serious long-run consequences for the ability to raise finance for the capital starved Slovak enterprises. However, an even more basic problem is the general lack of information, in terms of both quantity and quality. As an example of this, Mr. Vysoke mentions that at the time of privatisation not many of the actors on the market were aware that ZVL Bearings had a Sk 400 million ($14 mn) debt to the state. At the time of the interview, Mr. Vysoke said he believed that ZVL Bearings would soon be liquidated. He would be proven right. After a meeting in November 1995, the main creditors (VUB, IRB, Agrobanka and Polnobanka) decided to go ahead with bankruptcy proceedings against ZVL Bearings a.s. The company then had Sk 300 million ($10 mn) in debt dating back to the construction of the arms plant.

The other trend, which was observed in the case studies regarding organisational restructuring, was one whereby companies established complex holding company structures and many limited liability companies for certain activities, leading to a high degree of atomisation. The steel producer VSZ in Kosice is a good example of this where a major reorganisation took place prior to, and during, the process of privatisation. The result was a complex and, not least, complicated organisational structure focusing around VSZ a.s. which in effect works like a holding company with no production itself. The majority of production is instead located at VSZ Ocel, s.r.o., which produces and sells flat rolled steel products and accounted for 93 per cent of total production (1994) and about half of the groups consolidated revenues. The subsidiaries (see Figure 23) are in turn divided into divisions and have control of various companies. In the figure is also pointed to the ownership structure of

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85 Interesting is a comment by Mr. Vysoke where he says that the owners (unclear what he refers to) would never have accepted this type of privatisation.
86 In return, the bank demanded that they would retain the same bank after the restructuring.
87 Hospodarske Noviny, 28 November 1995. Interesting, and also a sign of the lack of information, is that ZVL Bearings still in October 1995 made the news with a bright future depicted. Turnover was forecast to reach Sk 500 million ($16.8 mn) and monthly turnover for the third quarter was reported at Sk 38 million ($1.3 mn), see Hospodarske Noviny, 26 October 1995.
88 VSZ Ocel, s.r.o. is divided into seven divisions, and also is the full owner of three limited liability companies and partial owner of yet another joint-stock company. VSZ Industria, s.r.o. is the second largest subsidiary with some 4 per cent of total production. It is an engineering product company which produces e.g. spiral welded tubing, radiators for central heating etc. The objective of the company is thus to increase the number of final products produced by VSZ. The company exercises managerial control over some 25-30 companies, and is partially engaged in even more. One of the latter, in which VSZ holds a
VSZ, where the fully controlled Cassoviainvest a.s. through their investment funds had acquired sizeable stakes in the mother-company.

Including the seven fully owned subsidiaries, the VSZ group in 1994 held stakes in a total of 128 firms (!). Participation varied from 100 per cent ownership (52 firms), to a safe majority (50.5-99.5%) in 31 firms, to minority holdings (20-50%) in 45 firms. 

On the whole, the reorganisation has led to an atomisation of the group which on many accounts has been negative. Mr. Link of VSZ explained the poor results in comparison with the size of the company exactly with this atomisation (see Appendix A). He said that the division gave room for pursuing personal interests on many levels in the company – and with the facts in hand, he said that they were aware that they brought this atomisation too far. At one time, there were some 140 more or less independent companies within VSZ, i.e. 140 directors which were ‘created practically from evening to noon.’ As a reaction there was a certain process of concentration, aimed at bringing some subsidiaries and affiliates back into the concern proper again. This caused protests from managers and workers, but there seemed to be a determination to go through with this process of re-concentration.

![Figure 23. Basic organisational structure of VSZ, 1995](image)

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48.5 per cent share, is Contexco a.s. which in co-operation with Slovenské lodenice produces containers.

VSZ Keramika, s.r.o. manufactures refractory and building material for heating units, mainly for inward use within VSZ Ocel. VSZ Inziniering, s.r.o. provides engineering and technical service for product development and is thus responsible for much of the technical restructuring and modernisation. VSZ Zos, s.r.o. is a subsidiary responsible for export marketing and thus accounts for some 35 per cent of consolidated revenues of the group. VSZ Informatika, s.r.o. provides, develops and operates computer networks, automated systems and information systems for the group. VSZ Servis, s.r.o., finally, provides service functions for other companies in the group, e.g. catering, travel services, recreational housing, kindergarten etc.

As an example of the diverse interests held by VSZ it deserves to be mentioned that in May 1996 VSZ/Manager s.r.o. bought a 93 per cent stake in the Czech soccer team Sparta Praha for Sk 900 million ($29.1 mn).

Link (1995) [interview].
In the case of ZPA Krizik the major organisational changes took place after privatisation. Following the purchase of ZAT (the robot production facility, see Section 2.2, p. 226), which was renamed ZPA Armact on 1 March 1995, the firm was reorganised into a holding company structure effective as of 1 October 1995 (see Figure 24). Although actual production is divided among three basic units, all of them with departments for production as well as research and development,91 the firm was fragmented into a high number of subsidiary companies. The real fields of competence for the different firms are not really clear; nor is the ownership structure. In charge of the whole group, however, was the newly created ZPA Krizík Holding, a.s. which is fully owned by the same nine managers who control 70 per cent of ZPA Krizík, a.s.92 The original ZPA Krizík was made the mother company of ZPA Armact, a.s. even though FNM at the time still controlled 49 per cent in the latter.93 Stratex was set up as a trading company oriented towards the Baltic states, and has set up a company in Vilnius. It functions a little like the company “libero”, engaging in many different types of business. Lineas is a daughter company, which includes some activities not directly related to production, for example hotels and

Figure 24. Organisational structure (1995) of ZPA Krizik Holding, a.s.

Source: Sandor (1995) [interview]; various written material from the firm

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91 The first and dominant division is Electricity Meters and Equipment (EME) which produces electricity meters; the second is the Pneumatic Division, producing valves and pneumatic cylinders for industry automation; the third and smallest is an electromechanical plant which produces transformers and water meters.

92 In essence the holding company is the transformed limited liability company ESIC, s.r.o. Also, the equity of the company is surprisingly small, initially only Sk 1 million ($33,600), later raised to Sk 1.5 million ($50,400).

93 Leading managers are involved in the running of all the daughter companies.
restaurants. *Union* is a company set up to service machinery and buildings. The group even has its own transport company, *Metrans*, which for example owns all company cars. *ERB* functions as the legal department. *ZPA Pneutrade* is yet another trading company, specialising in selling pneumatic products. *ZPA Wakmet Armatúrka* is a new venture, which together with Polish partners produces valves destined for export to Poland. *Antact*, located in Prague, is the trading company in the Czech Republic. *ZPA Armont* is yet a new project; it is also basically a trading company, working on the Czech market in co-operation with Antact. *Krizik-MZEP* Moskva is the joint-venture set up in mid-1995 in Moscow the production of electricity meters.

It is only possible to speculate in the rationale behind these changes, and the breakdown of the company’s activities in such a large number of units. The official explanation given by Mr. Sandor, is that it should provide necessary flexibility for the firm. Another clear objective has been to separate sales from production by having limited liability companies handling the vast majority of trade. *ZPA Krizik Trading s.r.o.* is but one example. A possible and perhaps more plausible explanation, suggested by some observers, is that the real reason is to be able to “play around with the money”.

Whether the latter is a true conclusion or not it at least illustrates a problem with this trend towards an excessive atomisation of organisations, namely that it increases the possibilities for insiders to tunnel money to and from different firms through transfer-pricing should they wish to do so. Thus, this second trend in organisational restructuring is not beneficial from the viewpoint of transparency and consequently not for outside shareholders without any direct channels into the firms; especially not given the poor reporting standards and the lack of protection of minority shareholders. If our example with the bearings producer was indeed one where there was an efficiency enhancing aspect, although at the expense of minority shareholders, there are no indications that the organisational restructuring of VSZ and *ZPA Krizik* has brought with them any such positive changes.

* * *

To sum up, restructuring of the firms has in many cases implied spinning off auxiliary plants and “extraordinary” activities which during communism often were an integral part of the SOEs. This must be seen as a generally positive development as it makes firms more transparent. A trend working in the other direction, however, is the complicated organisational structures with many associated companies and subsidiaries, which many firms established – a notable example is VSZ. This decreases transparency and has reportedly in many cases been used by the majority owners for “tunnelling” money out of the enterprises through transfer-pricing etc. – thus moving the profits out of the enterprises to other companies and “cheating” minority shareholders.

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94 One of the interviewed persons, wishing to be anonymous on this issue, was however unsure as to whether that was a viable solution since there were some legal constraints since the FNM still had an interest in the company – only the first instalment had at the time been paid. According to the informant, with good insight into the company, they would then be violating the regulations stipulating that if not all money is paid, one is not entitled to create daughter-companies.
3.2. The development of new governance structures

One aim with the case studies was to gain some deeper insight into how governance of firms changed post-privatisation. Questions touched upon during the interviews with regard to these issues can be divided into three broad areas: (i) the role and competence of the various formal governing bodies; (ii) the development and nature of the working relations established with the new owners, for example whether investment fund representatives were active or not, whether they were perceived as legitimate “real owners” or not, and how their behaviour, competence and commitment was perceived by managers; and (iii) how relations with the financial sector had developed. The results from these inquiries are each cited below.

3.2.1. Formal governance: the role of different bodies

In all joint-stock companies, the highest decision-making body is the General Assembly. Of course only the major owners can expect any real influence and the mechanism whereby they can exert their influence is by representation on the formal governing bodies. In Slovakia, as discussed in Chapter V:2.4.1, a two-tier system of boards has developed with both a Supervisory Board and a Board of Directors. In addition a semi-formal “Board of Managers”, comprising the General Director and other top executive managers, exists. The real influence of these bodies has however differed among firms, differences that form the topic of this section where special attention is paid to the relative strength of the boards, as well as their composition and stability over time. The issue of the relative representation of various stakeholders is studied by categorising owners into three types: (i) representatives of the Fund of National Property (FNM); (ii) representatives of the banks; and (iii) other private owners, incorporating both representatives of investment funds and other large private owners. Bank representatives were included so as to get some idea of the involvement of creditors. The reason for omitting DIKs is that they could not be expected to exert any real influence given that there in Slovakia has been established no formal organisations that work to defend the interests of small shareholders.

The role and competence of the two boards differs between companies, and it is on the basis of our material difficult to draw any far-reaching conclusions as to whether the more “American model” with a strong Board of Directors was predominant over the more “German model” with a strong Supervisory Board, although there is a minor tendency for owner representation to be more prevalent on

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95 A striking feature is, however, the low interest which individual shareholders (DIKs) reportedly show. Usually only the major owners are represented at the General Assemblies. In Cosmos, for example, only one DIK turned up on the 1995 General Assembly – a personal friend of the General Director. The limited interest is however understandable given that in many cases most issues of interest are discussed and agreed upon prior to the actual meeting. Yet a factor reducing the interest of DIKs is that the majority of firms supply their shareholders with annual reports only upon request.

96 See Chapter V:2.4.1, p. 179, on the formal role of the different bodies according to the Slovak Commercial Code.

97 In terms of the categorisation used in Section 2.4, this group thus incorporates both “fund” and “private” owners.

98 It should be remembered that in the case of bank-controlled investment funds, e.g. VUB Invest/VUB Kupón, it is difficult to differentiate between in what capacity the board member has his/her seat.
the latter (see Table 34). However, some minor inferences can be drawn from the material. In Chapter V:2.4.1 it was for example suggested that the Supervisory Board in firms with a high degree of FNM ownership tended to be strong. Such a proposition finds some support in, for example, the case of Cosmos where FNM ownership has been the most prevalent and the Supervisory Board indeed was assessed to be stronger than the Board of Directors.99 The FNM for long had a significant stake in VSZ and also in this case they preferred their representatives to take seats on the Supervisory Board.

Firms with strong private owners have also shown similar characteristics, i.e. relatively strong Supervisory Boards with owner-representation. This holds in for example ABB Stotz, Ozeta, Slovenské lodenice and ZVL Bearings/Auto (see Table 34). The difference in these cases as compared to firms with FNM ownership is that at least in the latter three cases owners reinforced their control over firms by also taking seats on the Board of Directors.100 Thus, also here there is some support for the proposition in Chapter V that investment fund ownership would imply a direct representation on the Board of Directors in order to counter the reluctance of in-

Table 34. Composition of Board of Directors and Supervisory Board, 1995

| Firm          | Supervisory Board | Board of Directors | |
|---------------|-------------------|--------------------||
|               | Sum FNM | Bank | Priv | Pos¹ | Sum FNM | Bank | Priv | Pos¹ |
|               | No | No | %  | No | %  | No | %  | No | %  | No | %  | No | %  |
| ABB Stotz     | 6  | 0  | 0  | 0  | 6  | 100 | S  | 4  | 0  | 0  | 0  | 0  | 0  | 0  | 0  | W  |
| Cosmos        | 6  | 3  | 50 | 0  | 0  | 1  | 17 | S  | 3  | 0  | 0  | 0  | 0  | 0  | 0  | 0  | W  |
| Hydronika     | 3  | 0  | 0  | 0  | 2  | 67 | W  | 5  | 0  | 0  | 0  | 4  | 80 | S  | 0  | 1  | M  |
| Ozeta         | 8  | 0  | 0  | 1  | 13 | 5  | 63 | S  | 6  | 0  | 0  | 1  | 14 | 2  | 33 | M  |
| Slov. lod.    | 9  | 0  | 0  | 1  | 11 | 6  | 67 | S  | 7  | 0  | 0  | 0  | 2  | 29 | M  |
| VSZ           | 8  | 2  | 25 | 0  | 0  | 2  | 67 | W  | 5  | 0  | 0  | 0  | 0  | 3  | 60 | S  |
| ZTS Sabinov   | 3  | .  | .  | 0  | 0  | 2  | 67 | W  | 5  | 0  | 0  | 0  | 0  | 3  | 60 | S  |
| ZVL Bear.     | 7  | .  | .  | 2  | 29 | .  | .  | S  | 5  | 0  | 0  | 0  | 3  | 60 | M  |
| Avg. case-8²  | 6.2| 0.8| 13 | 0.5| 7  | 3.7| 63 | –  | 5.0| 0.0| 0  | 0.1| 2  | 2.4| 45 | –  |

Sources: Interviews; Annual Reports; Kniha Faktov (1993-1996); own computations

Notes: ¹ Indicates the relative assessed strength of the respective governing body; W = weak, S = strong and M = moderate influence. º Given that ZPA Krizik has not reported board composition, neither during the interviews nor subsequently, it has been omitted. Since it is a closely held firm it is not included in any of the databases and secondary data has not been obtainable either. ² Of the two private owners, one refers to the General Director, Mr. Beljajev, see below.

99 In 1995 the then General Director, Ms. Moserová, described the Supervisory Board as having ‘a very strong position’ and described the Board of Directors, which in Cosmos was small and made up exclusively from executive managers, as ‘quite limited in its decisionmaking rights’ and characterised their own role as managers as mere ‘administrators’, see Moserová (1995) [interview]. Thus, in Cosmos, the situation was such that almost all important matters required the approval from the Supervisory Board.

100 In our case study these are the only two firms where FNM also after privatisation held stakes large enough to render them representation.

101 The fact that the owners of ABB Stotz have chosen not to be represented on the Board of Directors can be explained partly by its minor size, partly by their other control structures. The Board of Directors, which comprises of the executive management, meets with the Supervisory Board three to four times per year. In addition there are close and frequent contacts between the General Director and the owner representatives to which the General Director has to submit frequent and thorough reporting of the results.
cumbent director to accept and accommodate for the legitimate interests of the new owners, despite the fact that such representation on the whole is more time consuming. It is also interesting that in the same three firms there are also bank representatives on the Supervisory Board. Even though the general tendency in the case study sample is for the more German model there are two cases which go against this trend, and where the Supervisory Board is described as being very weak with all real power with the Board of Directors, namely Hydronika and ZTS Sabínov. However, the ownership structure differed quite significantly between the two. Whereas Hydronika was a firm controlled by investment funds with industrial experience, ZTS Sabínov gradually evolved into an insider controlled venture.

On the whole, it is possible to observe a tendency where the situation at the Board of Directors with regard to powers was most often a mirror image of the Supervisory Board. Table 34 illustrates that in firms where the Supervisory Board was strong, in general the opposite was true for the Board of Directors. Upon analysis of the differences, there are some casual observations to be made. Firstly, the degree of insiders on the respective board does seem to matter. A relatively weak Board of Directors was characterised by a dominant position for insiders, as is the case in for example ABB Stotz and Cosmos (see Table 36). Likewise, a strong Supervisory Board often had a low number of insiders as is illustrated in Table 35 below.

Thirdly, the ownership structure matters; as is illustrated by both VSZ and ZTS Sabínov, a strong Board of Directors can of course coexist with a high degree of insiders if these are also the representatives of prominent ownership interests. Fourthly, the size of the firm seems to make a difference for the board structure and the perceived necessity for representation. In relatively minor firms, for example ABB Stotz, Cosmos, Hydronika and ZTS Sabínov, owners seemed to find it sufficient with representation on one board only. However, in larger firms where external owners have a relatively strong position, the pattern discussed above and in Chapter V still holds, i.e. that active owners tended to be involved on both boards. This was the case in for example Ozeta and Slovenské lodenice where outside owners were present on both the Supervisory Board (a majority, see Table 35) and the Board of Directors (a minority). In these, and also at ZVL Bearings/Auto, the out-

102 In the case of ZVL Bearings (later ZVL Auto), the main bank had two representatives which took a very active part in the transformation of the company.

103 In 1995 the then Chairman of the Board of Directors held 15.6 per cent of the shares through his Beljajev, spol. s r.o., a figure which in 1996 had increased to 28 per cent. In 1996, Mr. Beljajev was also promoted to the position of General Director whilst retaining the post of Chairman of the insider dominated Board of Directors, see Table 36 (N.B. that the 1995 figure for insiders does not include Mr. Beljajev himself). Also, with such a strong hold on the firm, it must be judged of minor importance that the main owner and insiders are absent from the Supervisory Board (see Table 35).

104 It should be noted that, according to the Commercial Code, one-third of the members on the Supervisory Board should be elected by the workers collective. In most cases they seem to appoint somebody from the top management, and they would thus be included in the group of insiders. However, when, as for example in Slovenské lodenice, they do not appoint anyone from the top-ranking executive directors, the figures reported in Table 35 and Table 36 will underestimate the extent of “insider” representation, or more correctly, give a biased picture to the extent to which outside stakeholders have a position on the respective board. The reason for still applying the definition of insiders as those that have or have had a position on the “Board of Managers” is that it allows a comparison with the larger samples of firms (Sample-of-56 and Top-60) where the detailed information necessary for a more “accurate” description has not been available.
side stakeholders position was further strengthened by the fact that creditors have held board seats.

* * *

Turning to the issues of board composition and stability over time, it is possible to complement the case study results with our two other samples. Beginning with the issue of stability, there is some support for the statements in Chapter V:2.4.1 that incumbents remained in most firms and that changes in board structures were initially rare. Regarding the Supervisory Boards (see Table 35), there were indeed changes in the 1993-1995 period, with an average turnover of 40, 55, and 54 per cent for the case study sample, the Sample-of-56 and the Top-60, respectively. A slightly lower turnover is recorded the Board of Directors where the corresponding figures were 42, 46, and 42 per cent, respectively (see Table 36). However, in a number of firms, stability was near to complete in the pre-1995 period – up until late 1995. In Ozeta, for example, there was only one change in the governing bodies over-all prior to end-1995.105 At Slovenské lodenice the situation was similar, at least with regard to the Board of Directors, which in October 1995 was identical to the set-up following the first General Assembly in 1993,106 also at the Supervisory Board there had at the time been only one change.107 Thus, the turnover figures in Table 35 and Table 36 reflect more on what happened towards the end of 1995 than the period as such.

Two firms in our case study sample where turbulence was higher are Cosmos and VSZ. In both of these the FNM has held significant stakes, and at least in Cosmos the blame for the many changes was put on the FNM, whose representatives recorded the highest turnover of all owner representatives.108 Such an explanation is also quite plausible given that new governments have tended to move quickly to take control of the FNM and also changed the staffing. This tendency was extra pregnant in the fall of 1995 when there were substantial re-shufflings in the board-rooms (and in public administration) when the Meciar government moved to install their own people in firms where the state held a stake through the FNM.109

Taking a step forward to examine the most recent period included in the study, that is 1995-1996, the above discussion about relative stability no longer holds. Quite to the contrary this period – beginning already in 1995 – saw major changes in the governing bodies in many firms. Regarding the Supervisory Boards, the average turnover in this 12-month period was 38, 32, and 34 per cent for the case boards.

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105 This was when Credit Fond increased its ownership participation beyond that of Púchovsky IF and thus replaced the latter’s’ representatives on the Supervisory Board (Franstísek Siejlik) with one of their own men (Peter Ostrica). However, as can be seen in Table 35 one more replacement took place towards the end of the year.
106 At this meeting, two members from the pre-privatisation period were replaced by two new owner-representatives, Peter Hrinko and Ladislav Mazacek. With these two exceptions, the composition of the Board of Directors had been the same since the establishment of the joint-stock company in 1992.
107 This was when Cassoviainvest replaced Zoltán Berhauer with their own representative Vladimir Hudec following an increase in ownership.
108 Also at Slovenské lodenice, where FNM ownership was minimal, the same tendencies among other companies had been observed and the Economic Director, Mr. Kóňa, explained that with a larger FNM ownership the stability in governance experienced at the company would not have been possible, arguing that it proved that the choice of method for privatisation was a good one (i.e. voucher privatisation).
study sample, the Sample-of-56 and the Top-60, respectively (see Table 35). Turn-over in the Board of Directors was approximately the same, with the corresponding figures being 52, 32, and 28 per cent, respectively (see Table 36). An explanation, in addition to that mentioned relating to political control of firms, relates to what was pointed to in Section 2.4, i.e. that the ownership structure went through great changes in 1995 and 1996 during the so-called “third wave” of privatisation and the increasing pace of direct sales. The new owners thus moved quickly to ascertain their interest in the companies. Such an explanation finds strong support in the case study firms where those that experienced the largest changes in ownership structure also were the ones with the greatest reshuffling in the governing boards.

Another aspect of the board composition that was studied was the degree of insider representation. As can be seen in Table 36 the Board of Directors in all three samples was more or less dominated by insiders, while their presence on the Supervisory Board generally was limited to one or two representatives from the ranks of executive management. Interesting to note is that the Top-60 sample had a significantly higher ratio of insiders on the Board of Directors than did the random sample of S56, both in 1995 and 1996; in the latter sample there was even a significant decrease between 1993 and 1996.110

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110 See Appendix D, TABLE 44, TABLE 45 and TABLE 47. It can be noted that no such significant differences were found with regard to insiders on the Supervisory Board – neither between groups nor over time, Appendix D, TABLE 37-TABLE 39 and TABLE 41.
Turning to look at how these changes have affected top management (see Table 37), it is clear that it also there has taken place substantial changes during the period of study. In the case study firms, for example, the management boards recorded a turnover ratio of 42 per cent in 1995-1996. This, on the other hand was significantly higher than both the S56 and the T60 sample. However, in the preceding period (1993-1995) the pattern was the reversed, i.e. stability among executive management was significantly higher in the case study firms. In Table 37 we can also see that the changes in the management boards not seldom were coupled with replacements on the post as CEO. A conclusion from this has to be that owners indeed were somewhat active.

In conclusion, we have seen that there were indeed substantial changes in the governance structures post-privatisation. Interesting is that there are signs, both from the case study firms and other sources, that the period prior to 1995 was characterised by relative stability and that a new phase was begun in the second half of 1995. This is also in congruence with the picture that emerged from the above analysis of investment fund behaviour. We can offer no real explanation to this change, but it may be speculated that it in part a consequence of the changes in ownership discussed above, and in part was a consequence of the aforementioned politically initi-

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Table 36. Characteristics of Slovak Board of Directors, 1993-1996

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<td>N</td>
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<td>8</td>
<td>6</td>
<td>7</td>
<td>6</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Avg. S-of-56</td>
<td>5.1</td>
<td>4.5</td>
<td>4.4</td>
<td>2.0</td>
<td>46</td>
<td>1.5</td>
<td>32</td>
<td>2.9</td>
</tr>
<tr>
<td>Std. dev</td>
<td>1.23</td>
<td>1.15</td>
<td>1.25</td>
<td>1.39</td>
<td>31</td>
<td>1.55</td>
<td>34</td>
<td>1.84</td>
</tr>
<tr>
<td>N</td>
<td>56</td>
<td>52</td>
<td>54</td>
<td>52</td>
<td>52</td>
<td>54</td>
<td>54</td>
<td>55</td>
</tr>
<tr>
<td>Avg. Top-60</td>
<td>5.1</td>
<td>4.6</td>
<td>4.7</td>
<td>1.9</td>
<td>42</td>
<td>1.3</td>
<td>28</td>
<td>3.3</td>
</tr>
<tr>
<td>Std. dev</td>
<td>1.56</td>
<td>1.77</td>
<td>1.84</td>
<td>1.73</td>
<td>36</td>
<td>1.72</td>
<td>36</td>
<td>1.98</td>
</tr>
<tr>
<td>N</td>
<td>38</td>
<td>55</td>
<td>61</td>
<td>34</td>
<td>34</td>
<td>60</td>
<td>60</td>
<td>38</td>
</tr>
</tbody>
</table>

Sources: Interviews, Annual Reports, Kniha Faktov (various volumes)
Notes: 1 Refers to the number of new representatives on the board in 1995 and 1996 compared to 1993 and 1995, respectively; as the total number may have increased the per cent figure may exceed 100.
2 The number of insiders on the board, defined as persons listed as being or having been (prev. year) on the Board of Managers (i.e. top executives) of the firm in question. 3 Given that ZPA Krizik is a closely held firm, which have failed to report board composition, it has been omitted.

Turning to look at how these changes have affected top management (see Table 37), it is clear that it also there has taken place substantial changes during the period of study. In the case study firms, for example, the management boards recorded a turnover ratio of 42 per cent in 1995-1996. This, on the other hand was significantly higher than both the S56 and the T60 sample. However, in the preceding period (1993-1995) the pattern was the reversed, i.e. stability among executive management was significantly higher in the case study firms. In Table 37 we can also see that the changes in the management boards not seldom were coupled with replacements on the post as CEO. A conclusion from this has to be that owners indeed were somewhat active.

In conclusion, we have seen that there were indeed substantial changes in the governance structures post-privatisation. Interesting is that there are signs, both from the case study firms and other sources, that the period prior to 1995 was characterised by relative stability and that a new phase was begun in the second half of 1995. This is also in congruence with the picture that emerged from the above analysis of investment fund behaviour. We can offer no real explanation to this change, but it may be speculated that it in part a consequence of the changes in ownership discussed above, and in part was a consequence of the aforementioned politically initi-

---

ated changes. It is also possible that investment companies started to behave differently once it was clear to them that the government would be pressing ahead with the restrictive policies against investment funds. Nevertheless, it points to that owners indeed showed an interest in being represented on the governing boards. However, we can make no assessment as to whether this interest was derived from a genuine interest in the firms and their long-term survival and restructuring, or whether it was seen as a mean to acquire insider-information for the owners to act upon in the short-term. Another interesting observation is the way the Board of Directors was dominated by insiders. The high figures become even more remarkable if we recall what was stated in Chapter V to the effect that it was desirable for owners wishing to get real insight to be represented on the Board of Directors rather than only the Supervisory Board. With regard to this it must be pointed out that the high turnover ratios on the boards may have been counterproductive from the point of view of owners in that it (i) did not provide the long-term stability and support for management, and (ii) that turbulence may in fact have served to enhance the discretion of owners.

3.2.2. Governance relations

One of the major challenges following privatisation was to establish functional relations between owners and managers. For both types of actors, the situation faced in 1993 was a completely new one. On the part of the owners, in most cases syn-

<table>
<thead>
<tr>
<th>Firm/Group/Indicator</th>
<th>Members</th>
<th>New appointments</th>
<th>New CEO</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB Stotz</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Cosmos</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Hydronika</td>
<td>5</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Ozeta</td>
<td>13</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Slov. lod.</td>
<td>7</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>VSZ</td>
<td>.</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>4</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>ZVL Bearings</td>
<td>8</td>
<td>6</td>
<td>.</td>
</tr>
</tbody>
</table>

Avg. cases: 6.7, 5.3, 6.2, 0.5, 13.9, 3.0, 42.2, 0, 50
Std. dev: 3.62, 1.28, 2.23, 0.84, 27, 2.37, 30, --, --
N: 6, 6, 8, 8, 6, 6, 6, 6, 6

Avg. S-of-56: 4.6, 4.4, 4.1, 2.0, 43.4, 0.9, 18.4, 33, 23
Std. dev: 1.70, 1.84, 1.69, 1.69, 34, 1.19, 25, --, --
N: 55, 52, 54, 51, 51, 52, 52, 51, 52

Avg. Top-60: 5.4, 5.0, 4.9, 2.3, 43.5, 0.9, 16.2, 27, 14
Std. dev: 2.71, 1.94, 2.32, 1.91, 32, 1.53, 25, --, --
N: 35, 54, 61, 30, 30, 51, 51, 30, 51

Sources: Interviews; Annual Reports; Kniha Faktov (1993-1996); own computations.
Notes: 1 Refers to the number of new representatives on the board in 1995 and 1996 compared to 1993 and 1995, respectively. 2 CEO = Chief Executive Officer – the average figures in the table refer to the percentage of firms in which there was a change of CEO in the respective period. 3 Given that ZPA Krzik is a closely held firm, which failed to report board composition, it has been omitted.
onymous with investment funds, it was a matter of gaining insight and control in a very high number of firms about which they had very little a priori knowledge, subject to the constraints of very little experience of how to behave in boardrooms. On the part of managers it was a matter of accommodating for a totally new type of owner interest, represented in most cases by strangers, and establishing new boundaries between areas of competence. The latter was of course complicated not only by the communist heritage, but also by the fact that managers had experienced a period of very great autonomy (1991-1993) when they were solely responsible for initiating restructuring – something which they in many cases did with great vigour as is illustrated in Appendix A. Still, in many cases the crisis was far from over, thus further complicating the process of finding routes towards mutually beneficial working relations between managers and outside stakeholders. Such a process would most likely have been easier if the economic situation of firms would have been better and more stable and thus offered some leeway while working out new routines and finding ways to establish cooperating. However, in 1993 the situation was still far from stable, many firms were facing difficult problems and in pressing need of economic restructuring.

This situation did not only make it difficult for owners to get a full grip of what was happening; it was also contributing to management’s unrealistic expectations on the new owners with regard to what they were supposed to do. Even though the formal institutions in the shape of laws, for example the Commercial Code, to some extent were in place, they gave little guidance as to how cooperation with outside stakeholders should evolve and be shaped in practice on a day-to-day basis. It seems clear from our case studies that the expectations on behalf of incumbent management regarding the role of owners initially was somewhat misinformed, and there was also a high degree of mistrust towards the new owner representatives which in most cases had their background in, as put by the Confidential Clerk of Ozeta, ‘offices and banks’. One major cause for concern in the early days, one which Mr. Briestensky shared with many of the interviewed managers, was exactly that the owner had very little hands-on knowledge of actual production.

How relations with the new owners later worked out differed substantially between firms, depending much on the type of owner, the economic situation of the firm and their relative indebtedness and the size of the firm. Regarding differences between types of owners, there were among the case studies examples of all three ownership types discussed in Section 2.4 above, i.e. dominant ownership by the FNM, investment funds and other private owners, respectively.

Beginning with FNM ownership there were two cases (VSZ and Cosmos) where they had a dominant stake, although only one case where management was actually outspoken about their behaviour, namely the toothbrush manufacturer Cosmos.

112 Briestensky (1995) [interview].
113 At VSZ they were very reluctant to give any information on how co-operation with the owners had evolved. However, given the close political ties between VSZ and the ruling HZDS it was hardly surprising that they were not outspoken. That criticism of FNM representatives is a sensitive matter is illustrated by Cosmos where the General Director explains that colleagues had been forced to leave the company for criticising the behaviour and competence of the FNM-representatives on the Supervisory Board, see Moserová (1995) [interview].
In this case, the General Director expressed deep dissatisfaction with co-operation, especially regarding the numerous changes (see Table 35) of representatives and their lack of competence and lack of strategy for the firm. She said that the situation would improve if some persons who were acquainted with production – without party-affiliation – would be allowed to become FNM-representatives. It is also pointed out that the situation worsened following the 1994 election victory of Meciar and his HZDS when they quickly regained control of the FNM (see Chapter IV:3.4). As an example of the negative influence of the FNM as an owner, the General Director points out that they in 1993 blocked a Sk 32 million ($1.04 mn) emission of equity. Ms. Moserová says that all consecutive problems for Cosmos are a result of blocking this deal.

In comparison to the FNM, the investment funds and their representatives come out in a much more positive light. One question posed initially was whether investment funds would actually be accepted and looked upon as “real owners”. As can be seen from the summary in Table 38, this was indeed the case in most firms with some investment fund ownership, although we found some significant differences between firms. Whereas the managers in Slovenské lodenice, Ozeta and Cosmos were very positive towards investment funds the opposite was true in, for example, Hydronika and ZTS Sabinov. Much of the differences between these two groups seem to be connected to the perceived activity of investment funds as owners. Overall, there seemed to be a call for “real”, active and strong owners, and if perceived as being active as owners they were looked upon positively, otherwise not. The economic director of Hydronika said that the situation with investment funds as owners was no better than it would have been with a very widespread ownership. He said that one million DIKs, or the funds, would not make any difference for Hydronika. The activity of funds, in turn, seemed to be positively correlated to size and performance of firms, for example in Slovenské lodenice and Ozeta funds were very definitely taking on a role as active owners, whereas in the minor loss-making firms Hydronika and ZTS Sabinov they were described as being very passive. Mr. Jancík of ZTS Sabinov, for example, said that funds could function as good owners if they only were more knowledgeable and put more time and effort into the companies in their portfolio, complaining that there was a lack of experience and commitment on behalf of investment funds.

It also seems likely that the view of investment funds is influenced by the position of management; if the firm is experiencing problems, managers seem to expect a very different kind of support from the owners. In both the mentioned firms, there were deep concerns that the owners could provide no capital for investment. They also seemed to expect that the owners should “manage” the firms more directly.

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114 See discussion in Section 4.3 (p. 263) on equity issues.
115 In the case of VSZ, their representatives were reluctant to talk about the role played by investment funds and the negative stance indicated in Table 38 (column three) is based also on interviews with owner representatives from VUB Invest and HC&CS.
116 Pekár (1995) [interview].
117 Also in Cosmos, the same tendencies are visible, i.e. that there were expectations for the owners to find more capital for the firm, and for the owners to take a more direct responsibility for the daily life of the company. However, in the case of Cosmos the blame was put on the FNM rather than the dominant investment fund.
However, in none of the cases where funds were looked upon positively had they injected capital. Thus, the clash between managers and investment funds may be due to too high expectations of what the role of an owner actually is.

An interesting aspect which can be seen in Table 38, is that even in those cases where management voiced a negative attitude to voucher privatisation and investment funds, they still explained that good working relations had been established with the fund representatives. This was the case in Hydronika as well as ZVL Bearings. In the former, the same person who explained that fund ownership was no better than no owners at all, on the whole seemed quite content with the set-up of the Board of Directors (where owners are represented) and explained that he saw all members as competent and proclaimed confidence in them all.118 In the latter case, the General Director, who in general was very critical of investment funds, claiming that they in general should not be the owners of firms, said that ZVL Bearings were lucky with their investment funds and that co-operation with them had been very good. He said that with the state as an owner, or funds other than the ones they had, the company would have been closed down. Part of the good co-operation is ascribed to the fact that the funds were those that had experience and knowledge about industry, for example Cassoviainvest.119 Perhaps the statements of the CFO of Ozeta, Mr. Briestensky, catches the core of the issue when he explained that the

Table 38. Some qualitative aspects of manager-investment fund relations (1995)

<table>
<thead>
<tr>
<th>Firm</th>
<th>Fund ownership?</th>
<th>Funds seen as “real owners”?</th>
<th>Positive to VP and IFs?</th>
<th>Funds active as owners?</th>
<th>Good relations w. funds?</th>
<th>Positive to ban on fund repr.?</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB Stotz</td>
<td>No</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>No</td>
</tr>
<tr>
<td>Cosmos</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes/No</td>
<td>Yes</td>
<td>No</td>
<td>Yes/No</td>
</tr>
<tr>
<td>Hydronika</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>OZeta</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Slovenská lodenice</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>VSZ</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>ZPA Křikík</td>
<td>No</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>ZVL Bearings</td>
<td>Yes</td>
<td>.</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>“Average”</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Interviews

Notes: 1 Expresses no strong support for voucher privatisation but are far more critical of the policy of direct sales which replaced it; 2 The investment funds were active, although control was retained by the FNM; 3 Funds are seen as owners but it is pointed out that the position of the banks are stronger; 4 Expresses the opinion that the ceiling should be increased to 30 per cent.

However, in none of the cases where funds were looked upon positively had they injected capital. Thus, the clash between managers and investment funds may be due to too high expectations of what the role of an owner actually is.

An interesting aspect which can be seen in Table 38, is that even in those cases where management voiced a negative attitude to voucher privatisation and investment funds, they still explained that good working relations had been established with the fund representatives. This was the case in Hydronika as well as ZVL Bearings. In the former, the same person who explained that fund ownership was no better than no owners at all, on the whole seemed quite content with the set-up of the Board of Directors (where owners are represented) and explained that he saw all members as competent and proclaimed confidence in them all.118 In the latter case, the General Director, who in general was very critical of investment funds, claiming that they in general should not be the owners of firms, said that ZVL Bearings were lucky with their investment funds and that co-operation with them had been very good. He said that with the state as an owner, or funds other than the ones they had, the company would have been closed down. Part of the good co-operation is ascribed to the fact that the funds were those that had experience and knowledge about industry, for example Cassoviainvest.119 Perhaps the statements of the CFO of Ozeta, Mr. Briestensky, catches the core of the issue when he explained that the

118 Pekár (1995) [interview]. One possible explanation for these good relations is that one of the fund representatives previously was a director at Hydronika, and yet one had a background within machine-building industry.

119 Vysoky (1995) [interview]. The investment funds have according to Mr. Vysoky trusted the judgement of management, thereby creating a good, co-operative and constructive climate. An example of this trust is that the owners were prepared to go ahead with the restructuring and establishment of ZVL Auto despite the fact that they knew that the value of their shares in ZVL Bearings was bound to drop to close to zero. With such a relatively good experience, Mr. Vysoky is critical of the changes which would ban fund-representatives from the Board of Directors, saying that it is normal and logical that owners should be represented there to effect the changes.
situation had improved over time, and said that co-operation is not what they thought it would be – but it is the way it should be. Despite the initial mistrust shown towards fund representatives, what happened in Ozeta may be interpreted as a process whereby mutual trust made it possible to accept and accommodate for the two different roles of managers and owners, respectively. In many other cases, however, this process of learning was made more difficult by the uncertainty surrounding the rules of the game, for example, were the representatives of the investment funds there to stay – or would they be a temporary phenomena? In relation to this there were two more observations of interest from the case studies relating to the attitudes towards investment funds: (i) all managers interviewed were negative to the state regulation aiming to ban fund representatives on the Board of Directors; (ii) also those being negative to voucher privatisation, saying they would prefer a system of direct sales to core owners, were negative to the policy of direct sales as it worked out during Meciar (i.e. sales on soft terms to political allies).

4. Relations with the capital market

In Chapter II:4.3, the question as to whether Slovakia would develop a bank- or market-oriented system for finance was posed, i.e. whether finance would be dominated by debt or equity. An aim with the case studies was also indeed to probe into whether the patterns of finance had changed away form the previously only available type, i.e. debt, and to try to map the attitudes of management towards different new sources of finance. Also managements’ perceptions of how banking relations had changed, and what kind of problems they experienced when dealing with the banking sector, were part of the inquiry.

Below the results from these inquiries will be outlined and discussed. Section 4.1 begins with a brief outline of how the structure of the banking sector in Slovakia changed during the early 1990s. The section also connects to the questions discussed in Chapter V, i.e. about the banks’ role as indirect holders of equity through the bank-sponsored investment funds and investment companies. In Section 4.2 focus is on the relations between firms and banks. Questions touched upon include whether firms keep a house-bank and map the main problems in banking contacts as perceived by management. Follows does a section which analyses the patterns of firm finance, with special attention paid to the use of, and attitudes of management towards, new sources of finance like bonds and emissions of equity (Section 4.3). Finally, in Section 4.4, is turned to the question of firm transparency in an attempt to link this issue to their valuation on the stock market.

4.1. Banking in Slovakia

History left Slovakia, like most other formerly centrally administered economies, with a severely underdeveloped financial system bearing little or no resemblance to the requirements posed by modern open market economies. Characteristic for the

120 Briestensky (1995) [interview].
The communist era was a by and large passive role for money, administered by a monobank system where one bank acted both as a central bank and as the dominant commercial bank. In the case of Slovakia (then CSFR), the banking system was made up from five different organisational entities: the State Bank of Czechoslovakia (Statní Banka Československá, SBCS) as a central bank and organiser of the payments system as well as the largest commercial bank and main creditor; one savings bank in each republic, Slovenska Sporitelna Banka (SSB) in Slovakia and Česká Sporitelna Banka (CSB), which administered savings and loans for individuals; a joint foreign trade bank servicing domestic and foreign companies, the Czechoslovak Trade Bank (Československá Obchodní Banka, CSOB); and finally a bank handling foreign exchange transactions for individuals, the Entrepreneurial Bank (Zivnostenská Banka, ZB).

The first administrative steps taken to reform the banking system was when, as of 1 January 1990, SBCS received the formal status as a central bank, separated from the state budget. Also in 1990 the other banks were granted universal banking licenses and a two-tier banking system was established, leaving the SBCS with the normal functions of a central bank, i.e. to implement monetary policy and regulate the commercial banks. At the same time two commercial banks were created to take over the handling of deposits and credits, in Slovakia the General Credit Bank (Všeobecná Uverová Banka, VUB) and in the Czech Republic the Commercial Bank (Komercní Banka, KB). Later, in 1991, the Investment Bank (Investiční Banka, IB) was set up jointly for both republics and took on the long-term enterprise credits from the SBCS. One year later, already prior to the division of the country, IB was divided into two different entities according to a two-to-one ratio, with the Slovak off-spring named the Investment and Development Bank (Investičná a Rozvojová Banka, IRB) as of 1 January 1992. Then, on 1 January 1993, also the central bank was divided and the National Bank of Slovakia (Národná Banka Slovenska, NBS) was born. In addition, two specialised banks had been established by the state, Konsolidacna Banka Bratislava (KBB) and Slovenska Zaručna Banka (SZB). The former was set up with sole purpose of taking on badly performing loans from industry.SZB on its side, was set up to issue guarantees to

122 A detailed account for banking reform in Slovakia is found in Komínková and Múcková (1997a). ZB is not included in the figure as it became a predominantly Czech bank.
123 The legal foundations for these changes were contained in the Act on the State Bank of Czechoslovakia (Act no. 22/1991) and the Act on Banks (Act no. 21/1991)
126 KBB was initially set up as Konsolidacna Banka (KON) in February 1991 in CSFR and later divided on 1 January 1993 when KBB took over the Slovak Republics part of KON.
127 The purpose of the bank was to prevent bankruptcies through a chain reaction due to large inter-enterprise indebtedness. The bank bought a total of Kcs 125 billion ($4.2 bn) of bad and doubtful debt from other state-owned banks, a figure which in 1991 was equivalent to one-quarter of domestic credit liabilities. Finance came from the state bank and other banks at low interest rates. Source: Brom and Orenstein (1994), pp. 900-901. Most of the bad debts consisted of the former revolving credits of firms (app. Kcs 110 bn; $3.7 bn), see Komínková and Múcková (1997a), pp. 271-272. These revolving credits were instituted in 1976 when the state withdrew the funds held by the SOEs in order to get their hands on the cash. The revolving credits were thus, in practice, an interest-free credit-line forced on all companies to finance inventories. However, in 1990, it was decided that firms would have to pay back these
small- & medium-scale businesses. Thus, by early 1993, the state was the sole owner of five different banks, in addition to the NBS, most of them offsprings from the former mono-bank system (see Figure 25).\textsuperscript{128}

The number of commercial banks operating in Slovakia later increased substantially, following liberalisation of entry rules. On 1 January 1996 there were a total of 33 banks in operation, up from 22 three years earlier. The major increase was among banks with either partial or 100 per cent foreign capital participation (+9), up from three to seven and zero to five, respectively.\textsuperscript{129} Despite this increase, the offsprings from the state-banking system remained in an oligopolistic position.\textsuperscript{130} The three giants, VUB, IRB and SSB accounted for 60.8 per cent of banking assets at end-1996, down only from 75.6 per cent three years earlier (see Table 39). The situation with regard to their share of loans and deposits was similar, still holding 62.4 and 70 per cent, respectively. Among the big three VUB is dominant with regard to commerce and enterprise credit,\textsuperscript{131} followed by IRB whose main importance is in investment banking and as a creditor to heavy industry. On the side of retail savings, Slovenska Sporitelna with some 700 branch-offices has maintained its po-

\textbf{Figure 25. Transformation of the mono-bank system in Slovakia, 1989-1993}

<table>
<thead>
<tr>
<th>Time</th>
<th>SR</th>
<th>CSFR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-1990</td>
<td>SSB</td>
<td>SBCS</td>
<td>CSOB</td>
</tr>
<tr>
<td>1990</td>
<td>SSB</td>
<td>VUB</td>
<td>KB</td>
</tr>
<tr>
<td>1993 (SR only)</td>
<td>SSB</td>
<td>NBS</td>
<td>KB</td>
</tr>
</tbody>
</table>

\textit{Abbreviations: SSB = Slovak Savings Bank; SBCS = State Bank of Czechoslovakia; CSB = Czech Savings Bank; CSOB = Czechoslovak Trade Bank; VUB = The General Credit Bank; IB = Czechoslovak Investment Bank; KB = The Commercial Bank (Czech Republic); NBS = National Bank of Slovakia; IRB = The Investment and Development Bank (Slovak Republic); SZB = Slovak Guarantee Bank; KBB = Consolidation Bank of Bratislava.}

loans by 1995; many could not and thus the KB extended credits. In the case of Hydronika KB for example extended a Sk 20.8 million ($0.7 mn) credit, also Cosmos got part of these new credits.\textsuperscript{128} Further to that, the state was the owner of the dominant insurance company, Slovenska Poistovna.\textsuperscript{129} \textit{Statistická Rocenka SR 1998}, Table II. 2-18.\textsuperscript{130} See e.g. discussion in Borish et al. (1997). The situation in other Central European transforming economies is not very different; in all of these countries off-plies account for the majority of banking assets although Slovakia in 1995 held a top-position with regard to concentration with the top-five banks accounting for 79 per cent of total bank assets, see EBRD (1995), Table 10.2, p. 161.\textsuperscript{131} VUB was at end-1993 the sixth largest bank in the whole of Eastern Europe with a capital of $300 million, see \textit{Central European Economic Review}, Vol. 2, No. 4, 1994, p. 38.
sition, having more than 50 per cent of deposits (1993), making it the largest lender on the inter-bank market.132

The position of new entrants has, as can be seen in Table 39, gradually been strengthened, although they have a long way to go before they pose any serious threat to the three giants. Among the new banks with partial foreign participation, it is Istrobanka that has risen to prominence. The bank was established in 1992 with a 10 per cent stake owned by GiroCredit from Austria and has grown to become the fifth largest in the country (1993).133 Another quickly growing group was the ING-Group whose assets skyrocketed during 1996, up from Sk 8.5 billion ($287 mn) to 60 billion ($1,881 mn).134

As for problems with the banking sector, other than its oligopolistic nature, there are three areas for concern which relate to their relationship with firms and therefore deserve some further discussion: (i) their dismal credit portfolios; (ii) their dual role as creditors and indirect owners of firms through their investment companies; and (iii) their ownership structure, with the state retaining a dominant role. Beginning with the credit portfolios of banks, non-performing loans constitute a major problem in Slovakia as elsewhere in the region. The high figures are partly a result of the banks inheriting a stock of doubtful credits from the communist era, and partly a consequence of a ‘failure to apply sound banking principles in post-reform lending.’135 The figures in Table 40 show a staggering increase, but it is also a consequence of the introduction of new classification rules – in Slovakia this was done in 1995.136 Although the bad debt problem is not a prime concern for this study, it does, given the strengthened capital adequacy and provision requirements, limit their potential to provide funds for domestic firms.137 Also, the flow of new bad

<table>
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<th>Indicator</th>
<th>12/93</th>
<th>12/94</th>
<th>12/95</th>
<th>12/96</th>
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<td>66.4</td>
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</tr>
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<td>86.9</td>
<td>81.8</td>
<td>76.2</td>
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</table>


133 Central European Economic Review, Vol. 2, No. 4, 1994, p. 41. The remaining 90 per cent was however owned by the Slovak insurance company, Slovenska Státni Poistovna which in turn was fully state-owned.
134 See TREND Tyždenník o hospodářstve a podnikání, No. 19, 1997. ING has chosen to stay out of retail banking, an area where most new entrants have problems to compete given the extensive networks of offices inherited by the big-three, something which explains its low amount of deposits (only some Sk 3 bn [$95 mn]).
135 EBRD (1997), p. 84.
136 National Bank of Slovakia, Provision No. 3/1995. The changes in classification was calculated to equal a increase by 81.2%, see Zominkova and Muchova, October 1997, p. 22.
137 The capital adequacy ratio had gradually been raised to the international level of 8 per cent, a figure which all banks were supposed to have reached as of 1 January 1997. Provisions requirements (reserves) were set to 5 per cent for special mention claims (≥ 30 days ≤ 90 days), 20 per cent of substandard claims (≥ 90 days ≤ 180 days), 50 per cent of doubtful & litigious claims (≥ 180 days ≤ 360 days), and a
debts points to the fact that banks either have not had the internal capacity to assess firms as lenders, or have they lacked the insight and/or proper information from firms to make such judgements, or have they lacked the proper incentives to cut off credit lines to loss makers.138

The latter proposition could very well be related to the second problem area mentioned above, namely the banks dual role as both lenders and indirect owners of firms. With the holdings of investment funds administered by the bank-owned investment companies which thus did not have any side in the upside risk, they were left free to pursue a host of objectives other than profit maximisation. A worrisome tendency has been for the banks to use this influence to tie up the firms as customers for non-competitive banking services rather than to engage in hands-on restructuring. This has retarded the growth of other types of finance at the same time as banks themselves have been reluctant to extend long-term credits. This mix of interests has for sure contributed to continued misdirected lending. A long-run solution could imply that portfolio-management is handled by daughter companies less directly connected to the bank than has been the case so far.

The incentive structure of banks has of course been further complicated by the ownership structure of banks and the fact that a dominant part of the banking sector remains indirectly controlled by the state. In the first wave of large-scale privatisation, two of the four major financial institutions were partly privatised, namely VUB and IRB, where 49 and 48 per cent of shares were put on offer, respectively.139 However, with regard to the other two large financial institutions, Széchenyi and the dominant insurance company Széchenyi Pénzügyi, nothing happened. Likewise, KBB and SZB remained fully state-owned. Thus, still at end-1996, the state controlled 40.6 per cent of the total subscribed banking capital in the country.140

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<td>20</td>
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</tbody>
</table>

Sources: EBRD (1997), Table 5.3, p. 85.
Comment: As classified (non-performing) are defined those loans that are overdue more than 90 days.

138 During 1996 three banks, all of which were branches of failed Czech banks, lost their license.
139 There were no special rules regulating the privatisation of banks, rather they were sold within the general framework for large-scale privatisation as described in Chapter IV. The ownership structure following privatisation in VUB was such, that the state retained 50.8 per cent if adding the interests held by FNM in the Slovak and Czech Republics and the RIF. Investment funds gained control over 34.9 per cent (of which VUB Kupón initially was the largest with 10.8 per cent) and the rest was controlled by DIKs. Following a capital increase in 1995, the private share in IRB rose to 62.7 per cent; the figure is based on an exclusion of the share held by RIF from the private sector, see Borish et al. (1997), p. 1199.
140 Of the total equity capital of the banking sector (excluding the NBS and branch offices of foreign banks), of Sk 23.5 billion the state held 12.9 per cent through the ministries, 20.0 per cent through the FNM and 7.7 per cent through state-owned firms at end-1996, see Komínková and Máčková (1997b).
In fact privatisation of the financial institutions turned into one of the most politically infected issues in Slovakia and has been surrounded by an, even by Slovak standards, unusual amount of uncertainty and confusion. Slovenska Sporitelna was for example slated for the second wave of large-scale privatisation, but was in 1995 following the return to government of PM Meciar initially removed from the list. Then, in September 1995 rumours surfaced that Slovenska Sporitelna as well as Slovenska Poistovna would be sold off to a minor number of domestic industrial firms, notably VSZ and Slovnaft. These rumours were confirmed when PM Meciar on 25 January 1996 shocked observers as well as the National Bank of Slovakia by announcing that the ‘banking sector should be privatized by the end of January or in the middle of February at the latest.’ The announcement came only three days after that the FNM spokesman, Oto Balogh, said that there was no sign of the privatisation of the largest banks and there was still the possibility that the banks would not be privatised at all. By mid-February Minister of Finance, Sergej Kozlik, increased the amount of confusions by saying that the privatisation of banks would be delayed and completed sometime by mid-1996, only to find that PM Meciar days later reiterated his initial promise that the deals would be concluded by end-February, and also adding that the deal would include a merger of the four entities into two. This type of delays and discussions continued the whole of the spring, until Meciar on 8 May announced that the privatisation of the four main financial institutions had been indefinitely postponed, an announcement that came in the midst of a government crisis.

The background to the disputes and the government crisis concerned the way in which Meciar foresaw the privatisations to take place. The plan had apparently been to sell off the bank to the major industrial firms, and Meciar already in February said that an agreement had been reached about buyers and their future stakes in the banks. Rumours held that VSZ was the buyer-to-be of Slovenska Sporitelna and that oil-refiner Slovnaft would become the owner of VUB; these rumours were later confirmed by FNM President Stefan Gavornik who said that the government planned to sell one bank each to the largest domestic industrial firms. This plan, however, was not very well anchored and Jan Porvazník at the FNM said that the FNM ‘so far has not received a concept for the privatisation’, adding that ‘I have not heard anything of the mergers’. Also the NBS had been kept in the dark about the plans, although the central bank formally has to approve of any sale of bank-shares exceeding 15 per cent. Also the banking community expressed great worries about the plans, pointing to the necessity for recapitalising banks and solving the

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141 Slovenska Poistovna is the dominant insurance company, fully state-owned.
143 BBC Monitoring Service: Central Europe & Balkans, 1 February 1996.
145 Reuters News Service, 14 February 1996.
146 Reuters News Service, 16 February 1996.
147 Reuters News Service, 8 May 1996.
148 In the interview the PM said that privatisation through political entities [sic] was not desirable, adding that no party was financially strong enough to guarantee a banks solvency, see CTK-Business News, 19 February 1996.
149 East European Banker, No. 4, 1996.

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problems of bad debts. The result, if the plans would have gone through, would have been that: (i) banks would have got their biggest debtors as their owners; (ii) banks would have got owners with no prior experience in banking; (iii) banks would have got owners without the financial muscle necessary for recapitalising them and who were more interested in extending the credit lines to themselves – as was the case with for example VSZ. Moreover, it would indeed have led to a very peculiar system of cross-ownership where in some instances the major companies would be part-owned by their managers, and part-owned by the investment funds (or their off-springs) which were controlled by the banks which were in the possession of the major companies. However, the plans were not realised. The issue that thwarted the plan was however not any of these economic arguments but rather disagreements within the coalition who would get what. There seems to have been an initial agreement that each party – through the firms that had been privatised to interests/persons close to the respective party – would indeed get one bank each. Meciars HZDS however did not stick to this plan but moved to gain control of Slovenska Poistovna by installing their own people. This led to an uproar within the coalition and the ZRS moved to join forces with the opposition to block the privatisation altogether.\textsuperscript{151} Thus, at end-1996, Slovak banking was still dominated by three major, undercapitalised and state-controlled banks.

4.2. Firms and banks: close but strained relations

One of the aims with the case studies undertaken was to try to get an insight into what patterns of finance that were prevailing at the time, and to see what perceived advantages and disadvantages that were connected to these solutions to the financial needs of the firm. An additional aim was to try to map whether any significant changes had, and/or were about to take place in this respect. An important factor in this latter issue was deemed to be, in accordance with the above discussions about the importance of managers, the attitudes of management towards different financial arrangements and actors. This below section attempts to describe and analyse one particular aspect of these financial relations, namely the firms’ relations to the above analysed banking sector. The two main issues touched upon are: (i) possible long-term connections to banks, and their relative influence on the firms; and (ii) perceived problems in these relations. The following two sections (Sections 4.3 and 4.4) reconnect to the theme of financial relations by taking up two particular aspects, namely the use of alternative means of finance and relations to the institutionalised capital markets in form of the stock exchanges, respectively.

4.2.1. House-banking and debt control

The one main conclusion from the part of the study which focused on banks and relations to banks was that firms seemed to have retained the banking relations previously established, and that one bank remained the most important contact in financial matters in something which is most closely described in terms of a “house-

\textsuperscript{151} Cf. Finance East Europe, Vol. 6, No. 12, 1996, pp. 16-17.
bank” system.\textsuperscript{152} With the notable exception of VSZ, and to some extent the joint-venture ABB Stotz, all firms in the case study describe VUB as the one dominant banking contact (see Table 41). The reason for having VUB, in most cases, seem related to the fact that it is the bank which “inherited” the outstanding credits during the revamping of the banking system and thus in a way inherited its dominant position in commercial banking.

The degree of involvement and control from the side of the banks however varied widely, from having a stronghold on the board(s) to no special involvement at all. Their relative activity tended to be, as could be expected, connected to: (i) possible direct/indirect equity stakes in the firm in question; and (ii) to the financial position of the enterprise. In all cases, however, their insight tended to be above average in the sense that it gathered information not freely accessible to the market as such. In Cosmos, for example, where VUB is not characterised as having a strong position (see Table 41), and does not hold board representation, they still demanded quite detailed quarterly reports.\textsuperscript{153} In firms where the banks have also held indirect equity stakes, for example Ozeta and Slovenske lodenice, their involvement has been much stronger and direct, leading to board representation (see Table 34, p. 242).\textsuperscript{154}

As to the question of how the banking relations were perceived on the side of the managers there tends to be a certain positive correlation between the active involvement of the bank and good working relations. In ZVL Bearings/Auto, Ozeta and Slovenske lodenice, all cases where the influence of banks was strong, contacts were described as very good. Not all firms, however, shared this positive view. In some of the cases banks were rather described as “incompetent” and “disinterested”. A common trait for those being very negative was that they were minor firms, often with some financial difficulties. Representatives of Hydronika, for example, expressed great disappointment with the behaviour of the bank. On the

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|c|}
\hline
\hline
ABB Stotz & Yes/No (VUB) & No & Good & No & Yes
\hline
Cosmos & Yes & VUB & Partial & Functional & Yes, reduced & Yes
\hline
Hydronika & Yes & VUB & No & Bad & Yes & Yes
\hline
Ozeta & Yes & VUB & Very active & Good & Yes, many
\hline
Slovenske lodenice & Yes & VUB & Yes, via IF & Good & No & Yes (app 10)
\hline
VSZ & No & No & Functional & Yes & Yes, many
\hline
ZPA Krizik & Yes & VUB & Not really & Functional & . & Yes
\hline
ZTS Sabinov & Yes & VUB & No & Bad & Yes & Yes
\hline
ZVL Bearings/Auto & Yes & VUB & Very active & Good & Yes, rather & Yes
\hline
\end{tabular}
\caption{Qualitative aspects of bank-firm relationships (1995)}
\end{table}

\textit{Source: Interviews}


\textsuperscript{153} As will be discussed in Section 4.4 below this is information which is well above, in quantity, regularity and quality, above what is available to other investors and interested parties.

\textsuperscript{154} ZVL is an example of strong involvement in the absence of equity stakes, see discussion of their involvement in the restructuring of the company in Section 3.1, p. 235 ff.
other hand the reluctance of the bank to provide more credits to the firm is quite understandable, given that Hydronika at the time held a credit of some Sk 66 million ($2.2 mn) to VUB which it had failed to service properly. Interesting, and probably quite correct, is the view of Mr. Pekár who was convinced that access to credits would be easier if Hydronika had for example VUB Invest as a partial owner. ZTS is another case in point, a rather weak firm, not connected to a bank through investment funds, and where the Sales Manager, Mr. Jancík, felt that there were problems in the communication with the bank(s) and that they were too hostile and inflexible, and that there was a lack of capital in the market.

Two exceptions to this tendency, i.e. that small firms have established positive banking relations in the absence of indirect bank ownership are Cosmos and ABB Stotz. In the former case, the CEO attributes the improved relations to a significant reduction of its indebtedness. In the case of ABB Stotz capital injections from the owners in combination with the implicit backing of the ABB concern made for good banking relations, despite the smallness of the firm. The importance of having a realistic option/alternative to VUB, namely in ING Barings, should not be underestimated either. This, however, is a luxury which few domestic firms have/had.

In conclusion, the impression from the case studies, is that banks are relatively strong in comparison with outside owners. Mr. Briestensky of Ozeta, for example, explained that it was the banks that had the most influence on the company, and that the owners were not strong in comparison. With a large exposure of firms (weak financial position) in combination with the highly concentrated banking structure the strong position of the banks is no surprise, especially since banks were able to gain stakes also on the equity side. In addition, the situation must be deemed likely to persist as long as competition on the banking market does not increase and/or firms begin to seriously improve their financial health.

4.2.2. Perceived problems with the banking sector

An interesting feature is also that, although having VUB as a “house-bank”, all of the firms maintained one or more additional bank contacts. The reason(s) for maintaining such additional contacts seem to be connected to what managers perceived as the major problems with the banking sector in Slovakia, namely the slowness and delays in transactions.

Managers all agree that transaction delays are com-

155 Efforts to clean up the balance sheet of Cosmos had resulted in the reduction of outstanding debt to about one-third of its 1992-level (which then amounted to Sk 15.5 million ($548,000), including the Sk 1.9 million ($67,200) debt to Konsolidacna Banka, see footnote 157, p. 259). The figure had been reduced to Sk 10.9 and 6.9 million ($328,000 and $221,000) at end-1993 and end-1994, respectively; and then further reduced by some Sk 2 million ($67,000) during the first nine months of 1995.

156 The firm has two “house-banks”, one domestic (VUB) and one foreign (ING Barings) and if the firm would indeed need new credits Mr. Fabišák said that they could turn to either. Also, although the majority of existing debts was indeed held by VUB it sounded like the CEO would prefer to turn to ING Barings. However, at the time there was no need for investment capital. When the firm was established in 1993 investments had been made in order to get production going, and to boost volume as well as bringing quality to ABB-standards. Following that there had been no real investments made, other than to maintain production and quality.

157 In some cases multiple banking contacts is also a result of their debts to the Konsolidacna Banka (KB), which took over the revolving credits that were instituted in 1976 when the state withdrew the funds held by the SOEs in order to get their hands on the cash. The revolving credits where thus in practice an interest-free credit-line, forced on all companies to finance their inventories. However, in 1990 it
mon and problematic. Ms. Moserová of Cosmos, for example, explains that every bank has the right to withhold money for three days, interest free. However, since the system for payments is underdeveloped the money often pass through a chain of banks, all of which use the possibility to withhold the money for the stipulated three days. Thus, Ms. Moserová says, a payment made in Prague for example on the 3rd can reach the company on the 15th.

One solution to this problem is to open accounts with a number of banks, often the same ones as their main customers. Also, the firms which are active exporters often have contacts with banks specialising in foreign transactions, not seldom the former monopolist in the field (CSOB) since this is a field where delays are even more commonplace. Slovenske lodenice, for example, has more than 10 different bank contacts. The explanation for this unusually large number of contacts is the dependency on bank guarantees when signing contracts with purchasers in combination with the need for short-term trade credits. If there is one area where the virtual monopoly of VUB seems threatened (in addition to foreign transactions) it is the area of short-term trade credits. Almost all the case study firms seemed to nurture such relations, and not seldom without the knowledge of the “house-bank”. When the CFO of one case study firm was asked about how this habit was viewed by the major banks the answer was simple: ‘They do not know about it’.\(^\text{158}\)

As for other perceived problems with the banking sector they are less general in nature and to a larger extent depend on the firm and its position in the market. However, one commonly voiced concern relates to the high interest rates and what is often perceived as excessive demands for collateral. At the time of the interviews, real interest rates were commonly around 10 per cent per annum. Of course firms with good banking relations and relatively low indebtedness face slightly better conditions, or as Ms. Moserová of Cosmos pointed out, one advantage of having a “house-bank” was that they received a slightly preferential treatment in comparison with other customers.\(^\text{159}\)

As for the requirements for collateral, at the time it seems to have been a rule of thumb that banks want about twice the amount borrowed in collateral or some type of financial guarantee. This is in sharp contrast to the earliest phase of economic transformation (1990-1991) which by one CEO is described as a time when banks provided credits for close to any project.\(^\text{160}\) In one sense, the changes should be seen as an improvement in that it reflects a hardening of the budget constraints of the banks. At the same time, however, it is a warning-bell for inflated values of real capital and/or a not-too-well-functioning market for the type of real capital that most firms can put up for collateral. The complaints from representatives of some of the weaker firms as to that not only were interest rates high, but they perceived

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\(^{158}\) Interview (1995) with the CFO of one of the case study firms, wishing to be anonymous on this issue.

\(^{159}\) With irony Ms. Moserová exemplified, saying that if the company has a debit balance on their account they can agree with the bank that they do not charge 30 per cent, ‘but only 25 per cent debit interest.’ Source: Moserová (1995) [interview].

\(^{160}\) Moserová (1995) [interview].
the situation to be such that they could not obtain credit at all – at any cost – should be seen in the light of these developments.

Lastly, but not least, the case of VSZ deserves some special mentioning. As was initially stated VSZ is not a representative company; this is true also when it comes to their relations with the capital market and banking sector. When discussing issues related to Slovak banking VSZ representatives emphasised that ‘they are too weak for such a huge industry which is here’, and that VSZ needs ‘[m]ore money than all the banks have at their disposal here in Slovakia.’\(^{161}\)

In accordance with this view that banks were not able to open the credit-lines necessary for such a big concern, despite using a variety of banks, VSZ chose a slightly “different” approach to “house-banking” in that they tried to gain control of as large portion of the Slovak banking sector as possible. Its holdings in IRB were discussed above in Chapter V:1.4.2. Also, discussions on VSZ-participation in SSB began in the fall of 1995, and if the plan by PM Meciar on how to privatise banks “the Slovak way” had not been toppled by inner disagreements and mistrust in the ruling coalition VSZ could very well have become the owner of the large savings bank. However, as discussed above, these plans failed – and with the benefit of hindsight it may have been just as well.\(^{162}\)

* * *

To sum up, it has been shown that the system of “house-banking” remains dominant for most firms. However, all the case study firms had banking contacts also with banks other than their “house-bank” – in many cases a number of them. This was often explained to be a consequence of a lack of service of their house-bank. The main problems which managers saw with the banking sector, in addition to high interest rates, was the long delays and high demands for collateral and in some cases a general unwillingness to provide credit at all. However, there were also major differences between firms – in general, it seemed to be the highly leveraged firms that experienced the most problems with the banking sector – especially if they were small.

4.3. New sources of finance?

With firms’ traditionally strong linkages to the banking system, which privatisation in one sense made even stronger by reinforcing the debt-control by giving the banks stakes also on the equity side indirectly through investment funds, the question remains whether the establishment of a stock market and the concurrent introduction of new financial instruments, made any difference for the financial patterns and behaviour of firms? If so, what instruments have been preferred? If not, the question remains why?

Beginning with the first question, i.e. whether any significant changes took place during these early years of economic transformation, the answer is that in Slovakia

\(^{161}\) Link (1995) [interview]

\(^{162}\) The latter conclusion is also based on the financial crisis which hit the expansive and diversifying VSZ in December 1998 when it defaulted on its debt. The crisis was followed by massive reshufflings in the boards and was still in early October 1999 unresolved, but a possible buy-out by U.S. Steel had been discussed.
as a whole, just like in the majority of transforming economies, debt remains domi-
nant.\textsuperscript{163} This is somewhat surprising, since normally in developing economies ex-
ternal finance dominate over internal and equity is more important than debt,\textsuperscript{164} whereas in more developed economies the situation is reversed, i.e. internal finance greatly dominate over external and debt is more important than equity.\textsuperscript{165} Thus, the fact that internal financing has initially been dominating in transition economies poses somewhat of a puzzle since, as discussed above, we hold it to be wrong to see this as a sign of the competitiveness of the banking sector \textit{per se}. Looking at the case study firms, the amount of funds raised through equity issues has been minuscule, and the ratio of bank debt to total assets has remained either constant or experienced a minor increase during the period of study. The same holds for the two other samples of firms, and there are no significant differences between the three samples (see Table 42).\textsuperscript{166} What has happened, however, is that the corporate sector as a whole has increased its foreign loans. The question is thus why we observed so little of, for example, equity finance.

* * *

While the case studies provide relatively little data on the financial patterns at large, they do provide some insight into what considerations that are underlying their be-


taviour in financial matters. One such suggestion is that a major reason for not even attempting equity financing – whether such attempts on a larger scale would stand a chance to succeed is a wholly different matter (cf. Section 4.4) – is a general fear of

Table 42. Bank debt as a per cent of total assets, 1993-1996

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<tr>
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<td>13.5</td>
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<td>.</td>
</tr>
<tr>
<td>Avg. Case-7</td>
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<td>13.1</td>
<td>13.3</td>
<td>18.7</td>
</tr>
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<td>Std dev.</td>
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<td>4.2</td>
<td>5.7</td>
<td>8.1</td>
</tr>
<tr>
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<td>Avg. Sample-of-56</td>
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<td>Std dev.</td>
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<td>10.1</td>
<td>11.0</td>
<td>10.8</td>
</tr>
<tr>
<td>N</td>
<td>43</td>
<td>47</td>
<td>51</td>
<td>49</td>
</tr>
<tr>
<td>Avg. Top-60</td>
<td>14.0</td>
<td>13.2</td>
<td>16.3</td>
<td>19.4</td>
</tr>
<tr>
<td>Std dev.</td>
<td>10.6</td>
<td>10.2</td>
<td>12.9</td>
<td>16.5</td>
</tr>
<tr>
<td>N</td>
<td>43</td>
<td>46</td>
<td>53</td>
<td>53</td>
</tr>
</tbody>
</table>

Sources: RM-S Database; own computations

\textsuperscript{163} Cf. EBRD (1995), Ch. 5.
\textsuperscript{164} Cf. Singh and Hamid 1992; Calvo and Kumar (1994).
\textsuperscript{165} Cf. Corbett and Jenkinson (1994).
\textsuperscript{166} See Appendix D, TABLE 55-TABLE 58; likewise there were no significant differences over time except for a tendency for an increase for the Sample-of-56 in 1994-1996, see Appendix D, TABLE 59.
losing the control which in many cases, managers and/or other influential industrial/financial groupings fought hard to establish.

In our case study sample it was only one firm that at the time of the case studies successfully had pulled off an equity issue, namely Ozeta, when it in May 1995 announced a new emission targeted at employees. The total value of the emission, however, was a mere Sk 35 million ($1.2 mn), increasing the basic capital to Sk 731 million ($24.6 mn). This example, however, does not go against the general conclusion that equity issues are held back by owners for fear of losing control, rather to the opposite. When the same company later suggested to make yet a new emission of shares a clash of interests became evident with the owners, despite the generally good co-operation between management and owners (see Section 3.2.2). The proposal for a new emission had been endorsed by the Board of Directors, but was rejected by the Supervisory Board. The CFO, Mr. Briestensky, was convinced that the reason for stopping it was a fear on behalf of the investment funds/Companies that it would have weakened their position too much. Also at ZVL Bearings/Auto the reasoning of the side of the owner/managers was similar, i.e. that a negative bi-effect of raising finance through equity issues would be that it affected ownership relations. That this seems to be an effect of a general strife for control, not only among private owners, is testified to by the case of Cosmos where management also had an interesting but failed experience with the issuance of new equity. On the general assembly in 1993, while the state through the FNM still held a blocking majority of 65 per cent, management had wanted to increase the basic capital of the company by Sk 32 million ($1.04 mn) in order to construct a new factory. The issue had even been secured in advance with one of the owners (CassoviaInvest). However, by abstaining in the vote, FNM representatives managed to block the deal to the detriment of the company. The results among case study firms with regard to this are summarised in Table 43, and as can be seen only a limited number of firms even planned equity issues – out of which even fewer

167 The emission, mentioned in footnote 29 (p. 221), was done in accordance with the Commercial Code which stated that five per cent of the basic capital could be newly emitted on preferential terms to employees. The emission was divided into two series. In the first series (70% of the issue) allocation depended on the duration of employment (min. three years) and the position in the company. The second series (30% of the issue), however, had no such preconditions. The rate of participation among normal employees varied between 50-80 per cent among the different plants. In the ranks of managers, however, participation was close to 100 per cent and everyone among the senior managers purchased shares – the CFO, Mr. Briestensky, explains that they saw it as their ‘duty’.

168 Mr. Briestensky also admitted that from the viewpoint of management it would indeed have been better to have a more dispersed ownership structure because it would give more discretion to the Board of Directors, see Briestensky (1995) [interview].

169 Given the effort put in to make ZVL Auto an insider-controlled venture, see p. 236 ff., this reasoning is not to surprise.

170 The central location of Cosmos had turned into a problem. The 160 year old building was obsolete and not fit for modern production. Upgrading existing facilities would have required substantial investments, one example is the boilers which, dating to 1902 (!), needed to be replaced at a cost of minimum Sk 15 million ($0.5 mn). An advantageous solution, according to Ms. Moserová, would have been to move to new location on the outskirts of Bratislava where further modernisation and a slim-lining of the organisation could reduce the workforce further to about 60. Such a move could have been financed by the failed equity issue.

171 Ms. Moserova in fact said that most of the consecutive problems for Cosmos were a result of the FNM blocking this deal and thus preventing the company from moving to new facilities.
could be deemed realistic nurturing such ambitions (unless the issue was only target-

As can be seen in Table 43, a different attitude was exhibited towards bond is-

Table 43. Attitudes and behaviour among case study firms with regard to new sources of finance (1995)

<table>
<thead>
<tr>
<th>Firm</th>
<th>Equity finance</th>
<th>Corporate bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Done? Plan? Comment</td>
<td>Done? Plan? Comment</td>
</tr>
<tr>
<td>ABB Stotz</td>
<td>N N limited liability company</td>
<td>N N minor firm; ABB backing</td>
</tr>
<tr>
<td>Cosmos</td>
<td>N N attempted issue; blocked by FNM</td>
<td>N N 'unaccustomed'</td>
</tr>
<tr>
<td>Hydronika</td>
<td>N N unlikely to succeed</td>
<td>N N –</td>
</tr>
<tr>
<td>Ozeta</td>
<td>Y Y first in May 1995; second blocked</td>
<td>Y Y two issues</td>
</tr>
<tr>
<td>Slovenske lodenice</td>
<td>N Y could succeed</td>
<td>N N –</td>
</tr>
<tr>
<td>VSZ</td>
<td>N N great hesitancy</td>
<td>N Y prev. international syndicated loan</td>
</tr>
<tr>
<td>ZPA Krizik</td>
<td>N Y unrealistic plans</td>
<td>–</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>N N closely held (?)</td>
<td>N Y (early 1997)</td>
</tr>
<tr>
<td>ZVL Bearings/Auto</td>
<td>N N closely held</td>
<td>N N –</td>
</tr>
</tbody>
</table>

Source: Interviews
Comment: The table above reflect the situation as it was perceived at the time of the interviews; later developments are commented upon in the text.

Another case in point is VSZ that, while showing great hesitancy to equity finan-
cing, had declared it a strategic aim to obtain financing by the issuance of cor-
porate bonds. Unlike Ozeta, however, the plans were to first target the international

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172 In the first case it was agreed that VUB would sell the bonds at all offices for a period of three months, VUB also guaranteed to buy any remainder of the bonds. Many employees bought bonds, but within a week the whole emission had been placed – the large majority were bought by VUB itself. The same thing happened with the second emission.
bond market with an offering sometime during 1996.\textsuperscript{173} As for the domestic market Mr Link of VSZ said that such financing may become real in the longer term, but that “the development of the capital market is slower than we originally had expected.”\textsuperscript{174} Even ZTS Sabinov 1997 made an emission of Sk 100 million in January.\textsuperscript{175}

However, the problem with bond issues as well as equity issues is that for the vast majority of firms this is not a viable option. First of all they lack the experience that has been building up for decades in western firms. Second, many firms are excessively small to be able to successfully make a placement – there is in this context a certain minimum size of issues if they are to be attractive and successful. Thirdly, and as will be returned to below, transparency of firms is dismal thus frightening potential investors. A good example of this is ZPA Krizik which nurtured high-flying plans of replacing what was perceived as excessively expensive finance through bank credit through an introduction on three different stock exchanges in three different countries within three years, namely Bratislava, New York and one unnamed bourse in Asia. This development would have included new emissions to bring in capital for the company. The strategy had, according to the Commercial Director – who also admitted that much remained unclear – been worked out in cooperation with an unnamed London-based Singaporean business man. However, there are many reasons that cast some serious doubts on the plans. Firstly, the company was at the time closely held, not even listed on the BCPB. Secondly, and related to the discussion above, with a very low initial equity such a move would imply that the owner-managers would have had to give up their majority – something which seemed rather unlikely bearing in mind the effort put into the struggles to gain control over the venture. Thirdly, the lack of transparency of ZPA Krizik created by the many daughter companies (cf. Figure 24, p. 239) and the general reluctance to provide financial information would most likely have posed a strong deterrent to any serious potential investor.

* * *

To sum up, debt remained the dominant method of external financing for the case study firms – a pattern which is in congruence with the general picture of Slovakia and Eastern Europe. Larger firms have also sought international debt financing for some projects. To the extent that alternative sources of finance have been attempted it has rather been bonds than equity issues – which also, from the point of view of owners – have the advantage of not changing the control-structures of the firm in the same way. However, the extent to which such alternative means of financing are realistic is also related to firm size. The minor firms would, for example, most likely not have to great chances of pulling off bond-issues.

\textsuperscript{173} Some experience with the international capital market had already been gathered with an international syndicated loan of USD 123 million in March 1996. The loan had been managed by ING Barings and was oversubscribed, set at 140 bp over LIBOR, and ran with a three-year maturity.

\textsuperscript{174} Link (1995) [interview]

\textsuperscript{175} The emission was for five years, with an initial interest rate of 14 per cent, see \textit{Reuters News Service}, 14 January 1997.
4.4. Firm transparency and trade on the stock-market

The above example with ZPA Krizik in a sense embodies one of the main problems with institutional change, i.e. the complementarity of different formal and informal institutions. The example of ZPA Krizik and the establishment of a stock market show that actors can easily grasp some of the advantages of the “invention”, namely potential access to new instruments for finance. However, the deeper understanding of what type of behaviour and norms of conduct that underpins the workings of the stock market, may still be lacking and/or be underdeveloped, thereby raising transaction costs and hindering/distorting the “proper” functioning of a market.

An important example is information; as pointed out previously, raising finance is but one of the functions associated with a stock market. In fact, as argued by some economists, the information-generating function of a stock market may be perceived as its main potential advantage in a transforming economy.176 For example, the existence of publicly tradable companies creates the preconditions and demand for analysts which gather and disperse information about firms, thus generating information about firms and investment opportunities which otherwise would not be available. A *sine qua non* for these things to happen is nevertheless a readiness of firms and managers in helping with the widespread and equal access to information; in itself a cornerstone of the actual functioning of a market.

In sharp contrast to this stands one of the main findings from the case studies, namely that there is rather a general and widespread reluctance on behalf of managers/firms to provide and disperse this information. Indeed, for most companies it seemed that the only information provided to the outside world was the annual report, i.e. the minimum requirements according to the *Commercial Code*. Equally serious, and a potential explanation for the widespread insider dealing taking place on and off the organised markets, is that some actors – most notably the major owners and the bank – have access to quite different sorts of information. This was the case in for example ZTS Sabinov where the Sales Director, Mr. Jancík, explained that with regard to the public and minor owners the company only followed the minimum legal requirements with annual reports but also said that some owners had all the necessary information about the company throughout the year. The regulation introduced in 1995, which gave that firms had to publish reports and financial statements bi-annually did not seem to offer much comfort in this respect.

Yet a case in point is Ozeta which, although being far from the worst culprits in this respect – quite to the opposite, held that it was not in the interest of the company to inform the public. The CFO, Mr. Briestensky, expressed a somewhat naive view saying that share prices were only influenced by the results and hence that other information was not necessary. He also confirmed that it indeed was the case that many companies strove to hide their results – something which Mr. Briestensky had personal experience of from his work in the Association of textile and clothing industry – which despite being the lobby-group for the industry had great difficulties in obtaining even basic information from the member-companies since everybody was trying to hide results that were not too good. With such attitudes it is not to surprise that the market could not function properly.

Interesting, and pointing to a paradox, is that at the same time (as being reluctant to provide information) managers overall were complaining that share prices did not reflect any reality. This is indeed true for many firms. Looking at Figure 26 we see that of the case study firms there were only three of them which were continuously traded at the BCPB, i.e. Ozeta, VSZ and Slovenské lodenice. For these three it is reasonable to expect that the market provided a somewhat realistic evaluation – although also for these firms the P/E-ratios were somewhat absurd.\(^\text{177}\) For the other, as well as for the majority of firms, it is unreasonable to expect any kind of realistic evaluation given the very low levels of liquidity. As can be seen in the figure the other four firms among the case study firms, which were among the unlisted at the BCPB, were only traded every now and then. Thus, as discussed in Chapter V, many of the firms that were publicly traded – adding to the total market capitalisation but hardly to liquidity – would not be on the market in any other country.

Hydronika well illustrates the inability of the illiquid market to properly evaluate firms. Indeed, the firm had many problems and neither the order book nor the balance sheet offered much comfort for an analyst (see Appendix A). However, the price at which Hydronika was trading at RM-S for a long time (Sk 36 [$1.2]) gave that in theory all shares (if available) could have been bought for well below the market value of the land on which the workshops were located.\(^\text{178}\) Even with a price of about Sk 50 [$1.7], to which it rose following the announcement of the purchase

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\(^{177}\) On P/E-ratios for the case study firms as well as the Sample-of-56 and the Top-60, see Appendix D, TABLE 20 (p. 333). It can be noted that there were no statistically significant differences between the samples.

\(^{178}\) The “technical” minimum price at RM-S is exactly Sk 36, due to transaction costs. At the time of the interview trade in Hydronika shares only took place at the RM-S, not at the BSE.
of the 10.5 per cent stake by Sukromna s.r.o., would have implied a price tag of about Sk 24.5 million ($824,000) while the land price (about Sk 1,500/m²) gave a total value of just the facilities of about Sk 221 million ($7.4 mn), i.e. almost 10 times higher than its capitalisation on the RM-S. Still, the market is not totally deficient with regard to these rather illiquid issues either. In some cases the reactions of the market are quite “normal” – one case in point is ZVL Bearings whose share prices dropped to about one-tenth on the RM-S when it finally was announced that assets would be sold to ZVL Auto, i.e. an appropriate reaction. Interesting though, and also a sign of the lack of information, is that while in November 1995 the main creditors decided to press ahead with bankruptcy proceeding against ZVL Bearings the company still in October had made the news with a bright future depicted with rising turnover.

The picture painted of the stock market, both here and in Chapter V, leads to the conclusion that its role as a disciplining mechanism for managers must indeed be considered marginal. In Table 44 is given an overview of the attitudes among managers towards the market. As can be seen all managers closely followed the price developments of their respective issues on the market. However, none of them felt that the price-developments had any influence on operations – neither in terms of the potential for new finance nor in terms of their own positions. Mr. Jancík at ZTS Sabinov, for example, explained that prices only show whether shares are being sold or bought, and he could not see that there would be any rationale in that share prices would affect the creditworthiness and access to bank credit for the company, at least not during the conditions prevailing in Slovakia at the time. In the latter part of the assertion, we must give him right – and for the illiquid firms it may indeed be considered a realistic attitude. However, for VSZ, Ozeta and Slovenské lodenice the attitude is quite disturbing considering that they all belonged to the more liquid issues on the market at the time and were all listed at the BCPB.

Table 44. Qualitative aspects of firm-market relations (1995)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB Stotz</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>No</td>
</tr>
<tr>
<td>Cosmos</td>
<td>Yes</td>
<td>Not for minor firms</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Initially yes, later no</td>
</tr>
<tr>
<td>Hydronika</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Ozeta</td>
<td>Yes</td>
<td>Not compared to banks</td>
<td>No</td>
<td>Yes</td>
<td>Average</td>
<td>Yes</td>
<td>Relatively</td>
</tr>
<tr>
<td>Slov. lodenice</td>
<td>Yes</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>VSZ</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Officially yes; in practice no</td>
</tr>
<tr>
<td>ZPA Krzik</td>
<td>.</td>
<td>No</td>
<td>.</td>
<td>.</td>
<td>.</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>ZVL Auto/Bear.</td>
<td>Yes</td>
<td>For some</td>
<td>N</td>
<td>Y/N</td>
<td>Yes</td>
<td>N</td>
<td>No</td>
</tr>
</tbody>
</table>

Sources: Interviews
Nevertheless, given the state of the market at the time most managers were realistic about the potential for “exit” to work as a governance mechanism. The General Director of ZVL, for example, was very aware of the problems and their causes. He pointed to that the Slovak stock market still had a long way to go before it developed to a place where “normal” firms could raise finance, and identified the poor information available to investors as a major culprit – adding to the volatility of prices. As yet a reason for the problems of the stock market he pointed out that the introduction of all firms took place amidst a deep recession (see Appendix A). This meant that prices were so distorted by other factors, that good management, and real results, did not have corresponding effects on prices. Under such conditions, the General Director continued, the pressure from the stock market on management was not very effective. In the future however, once firms were getting in a better condition Mr. Vysoky felt that there indeed would be a place for governance through the market – for some firms. As can be seen in Table 44, Mr. Vysoky was rather alone in his opinion. This is not to say that other managers were totally unrealistic – the attitude of the CFO of Ozeta, for example, was of course influenced by the fact that VUB had a very strong hold on the company; thus it is quite natural that he saw the banks and their representatives as a more effective disciplining mechanism than “exit”.

* * *

To sum up, the perhaps most disturbing aspect of the relations and attitudes towards the market was the disinclination to provide information, especially considering that we posited one of the main potential benefits of the stock market to be its ability to generate information. The reluctance to provide information, in turn, may be seen as a consequence of the ownership structure of firms – where many were closely held by their owner, and the lack of stringent disclosure rules and enforcement mechanisms. Furthermore, given the little dependence of the majority of firms on the stock market there were few incentives for managers and owners to open up and improve the situation. However, prior to improvements in regulation as well as changes in attitude on behalf of firms and owners the chances of raising finance on larger scale through equity – and thus create this “dependence” on the market – must be considered slim.

5. Summary

The aim of this section is to provide a brief summary of some of the main findings in Chapter VI. The chapter has, in the terminology adopted, concentrated on micro-level developments, although with the aim of reconnecting the micro-level analysis with the macro-level. It thus deserves to be pointed out that the usage of the terminology of macro-, meso-, and micro-level does not imply that we see any boundaries which make them distinct analytical objects or that they represent separate spheres. Rather, taken together they represent an analytical tool that allows us to

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179 However, he still agrees that the market gives a correct evaluation of the company (!).
explain the way in which processes and forces involved in the economic transformation have unfolded.

This micro-level was approached by means of a number of case studies. These cases were, of course, not representative for all privatised companies. They did, however, provide good in-depth examples of the privatisation process, changing ownership and development of corporate governance in Slovakia during the period of study. The case studies were complemented by two statistical samples of industrial firms – one random (S56) and one retroactive with the most successful firms (T60). This way the ambition was to reconnect the micro-level analysis with the macro-level; it was also shown in the statistical analysis that in many aspects the small case study sample was not too different from the larger random sample (S56).

The focus of the chapter has been on the interplay between individual firms and the institutional environment with which they have been faced, i.e. both on the actual responses which new and changing institutions have provoked at the firm-level and on the attempts which have been made by individual firms/managers to adapt and/or circumvent these new institutions.

As regards the ownership structure it was shown that already at the outset it was quite concentrated, with investment funds being the dominant owners. An interesting finding was that the top performers had been privatised by means of vouchers to a lesser extent, pointing both to that the state may have wanted to retain control over important and profitable firms and that managers in these firms more successfully resisted the top-down pressure for voucher privatisation. Either way the consequence was that there was a significantly higher portion of state ownership of the top-performers. However, all groups surveyed experienced a rapid concentration of ownership – with the two largest owners holding on average a high 50 per cent of shares at end-1996. Furthermore, this concentration was coupled with a recomposition of ownership, with more private owners and less state and investment fund ownership.

Regarding the development of corporate governance relations it was pointed to that owners indeed had taken an active interest in representation on the governing boards – consequently turnover ratios on both the Supervisory Board and the Board of Directors was quite high during the period of study. It was also argued that these high turnover ratios implied that owners were not able to provide long-term guidance and support for management – and that a by-effect could be to increase the discretion of management. Interesting was that there were indications that activity (turnover) in the boardrooms experienced an increase from the second half of 1995 onwards – both as a consequence of the changes in privatisation policy and an interest from the state (government) to install their own people on the boards. As for executive management and CEOs we saw that also there had there being taken place quite extensive changes, although management continued to dominate the Board of Directors in the majority of firms.

The attitudes of management towards their owners was also surveyed. It stood clear from the case studies that the political nature of FNM-ownership was not appreciated. Also, investment funds were much more popular as owners in practice than in rhetoric – many managers were negative to investment funds per se – but appreciated co-operation with the representatives of “their” investment funds. A
common complaint, however, was that owners were not willing/able to provide capital injections for the firms.

Finally, with regard to the relations between firms and the capital market it was shown that the relations between banks and firms remained close – pointing to that the system developing in Slovakia bears close resemblance to a bank-oriented system with “house-banks” – although with the additional feature that many banks were also indirect owners of firms through investment funds in their custody. There was also a general and widespread reluctance to search for new sources of finance among managers – an unwillingness which in many cases could be traced to a fear of giving up control of firms. The reluctance to provide information to the market could be seen in the same light. Furthermore, there was a widespread scepticism among managers towards the usefulness of the market – both in terms of its ability to provide a proper evaluation (something which was traced to the low level of liquidity for the majority of firms) as well as its potential to serve as a mechanism for governance.
CHAPTER VII

Concluding analysis

'[i]n a fundamental sense, transformation is all about rents and distribution.'
Richard Portes

This study is an attempt to use economic historical methodology to analyse the process of ownership reform and corporate governance development in Slovakia during the period 1990-1996. This chapter summarises the findings of the study and discusses some of the implications of the research. The demise of the communist bloc has been a process of enormous historical, political and indeed theoretical significance. It is, however, a process that is both recent and ongoing. We should therefore be wary of drawing conclusions too positively at this stage. Indeed, it has been one of the themes of this study that researchers need to be more tentative and provisional in their conclusions about the transformation process in general, and privatisation in particular. This study represents a measured attempt to guard against the overly general and widesweeping conclusions; this is for example one of the reasons for the relatively detailed look at the general theoretical debates. It should also be remembered that this study constitutes one single case study of one single country in the process of transformation. Nevertheless, reviewing the results of this case study will allow us to make some qualifications of theory as well as the economic, historical and policy debates.

The further organisation of this chapter is that Section 1 recapitulates the main aims of the study in conjunction with a brief overview of the analytical framework. Section 2 provides an analysis of the actual process of ownership reform and the policy changes made. Section 3 deals with more specific results of the study, not least concerning corporate governance. Section 4, finally, concludes the study with some remarks of a more general and, to some extent, speculative nature.

2 The undoubted novelty and importance of the process, has led some, for example Eyal et al. (1998), to the contention that they want to draw conclusions – theoretical and historical – not just about "transition", but about the whole history and nature of capitalism.
1. Introduction

The overall aim of the study can be concluded in two distinct although interrelated questions. These were, in short: (i) to analyse how privatisation was achieved; and (ii) to look at what structures that emerged for corporate governance. This led to the pursual of two themes of analysis, the first of which was an analysis of the actual process of ownership reform in Slovakia. The theme focused on issues such as: what methods were chosen for privatisation; what goals were connected to the process; if, and in that case by whom and for what reasons, were the methods changed during the course of privatisation. The second theme of inquiry focused more on the results and implications of the processes of ownership reform and privatisation. The questions asked were quantitative as well as qualitative in nature. On the quantitative side it was, for example, deemed critical to establish both the extent of the process and who it was that became the main owners. Equally interesting, however, was to – on a more qualitative level – establish what structures, institutions and mechanisms that emerged for corporate governance. An integral part of this was to look at the consecutive changes in ownership structure, trying to identify possible trends in development. These questions, in turn, led to three areas of research. The first concerned the role of the institutional investors, where it was asked what role the newly established investment funds came to play in governance. The second area focused more on the interaction between ownership reform/privatisation and institution-building. It was, for example, asked to what extent the nascent capital market could fulfil the type of tasks normally associated with its existence. It was also asked what role the investment funds had come to play for the development of the market. The third area of research, finally, focused on the actual execution of ownership. Questions asked in relation to this included the following: What relations and perceptions were shaping the interaction between owners and managers? Were the new owners (investment funds) active or passive? What were the attitudes of managers towards outside stakeholders? What type of board-structures did develop?

To approach these questions – and guide research to focus on the issues of importance in economic transformation, ownership reform and privatisation – an analytical framework was developed. Since it was posited that at the core of transformation rested a change in the incentive structure, the choice was made to develop a framework which could (at least) point to the factors which were of importance for shaping this incentive structure. Since there is no such general theory to supply these insights, the framework came to draw on a mixture of approaches. The emphasis on competition, for example, was derived from the neo-classical approach; the importance of ownership was derived from the property rights approach; the need for institutions and mechanisms to align the interests of principals and agents was drawn from the corporate governance literature. The transaction cost theory, in turn, pointed to the requirements for efficient markets and the need for information and transparency; the institutional approach, finally, directed attention towards the importance of laws, norms and behaviour, the importance of politics and the existence of path dependency in economic development. The analytical framework was concluded with a section which summarised and brought together some of the more
important parts, and laid out the view taken in this study to economic transformation.

One implication of the analytical framework and the discussion about path dependency was that some background issues, which were deemed to be of possible importance for the resolution of the main questions of the study, were approached and explored in Chapter III. The conclusion from the chapter was that there were indeed aspects in the economic and institutional heritage of communism that would pose special requirements on the methods adopted for privatisation and ownership reform. It was, for example, shown that most of Slovak industry had been erected in accordance with the logic and demands of the centrally administered economy as part of the efforts to raise the development level of the previously predominantly agrarian Slovak economy. These ambitions were to a large extent successful – although per capita incomes in the Slovak Republic never fully reached the level of the Czech Republic. However, an implication was that in the late 1980s Slovakia had a predominantly heavy industry with a relatively low value added. This meant that privatisation not only had to achieve a change in title of ownership, it also had to create the preconditions for restructuring. In addition, the methods for privatisation would certainly have been different if the Slovak economy had been based more on small- and medium-sized enterprises.

Another heritage that could be expected to affect economic transformation was the legacy of the type of incentive structure established under communism. In the centrally administered economy managers had worked and become accustomed to a non-market system where output was guaranteed an outlet and where budgets had been soft, with the state always standing as an implicit guarantor of the liabilities of the individual enterprise. In short, the incentives provided by the institutional set-up encouraged managers to cheat on their principals (founding ministries and planning authorities) by concealing production capacity and maximising inputs. This meant that the new governance systems would face a demanding task in providing a new set of incentives strong enough to overcome that heritage.

This situation was also analysed in a property rights perspective, where it was concluded that incumbent managers had possessed a great deal of discretion with regard to the use of the industrial capacity; not least due to the “information deficit” their principals experienced. The state-of-affairs was thus not altogether different from what was discussed in terms of “communal ownership” in the analytical framework, even though the de facto property rights of management were not as pregnant in the Slovak setting as in many other communist economies, which had undergone more extensive reforms and decentralisation in the 1960s and 1980s. The situation could nevertheless be expected to put its specific demands on privatisation – not least in that reforms, at a very minimum, would be smoother if one could get the co-operation of incumbent managers. Finally, and perhaps the greatest challenge for developing, what in Chapter II was in accordance with Frydman and Rapaczynski termed a “private property regime”, was the much politicised nature of society. Under communism the political sphere had monopolised the economy and there had been, at least formally, a political governance of basically all productive resources. In the words of Rutland, socialism and economic planning had indeed
represented ‘the triumph of politics over economics…’\(^3\). Such a situation, it could be expected, would have left its traces among politicians and administrators.

* * *

To find answers to this rather broad spectrum of issues – which to a large extent are interrelated – we adopted a method that implied using three levels of analysis. In the empirical chapters of the study, these levels of analysis have been referred to as macro, meso and micro. The macro-level analysis thus referred to the focus of Chapter IV on privatisation policy and the political processes being part of the formulation and enactment of this policy. The meso-level, in turn, referred to the focus on markets and market-actors, representing a type of intermediate level, in Chapter V. The micro-level analysis, finally, referred to the focus on the responses on the level of the individual firms and their interaction with the institutional set-up which was the topic of Chapter VI. It is, however, important to note that this “division” should not be taken as representing separate spheres of analysis. Nor is it implied that the processes studied are isolated from each other. Rather, the methodology was applied in order to be able to highlight similarities (and differences), and above all, the interdependence of the processes that were taking place in different spheres of the economy. Furthermore, it is only when these processes are brought together in an analysis that some of the questions posed in the study can be approached, for example those relating to the development of new corporate governance structures (which is an issue which spans over all three levels of analysis). Thus, by having these levels of analysis it is in this concluding chapter possible to point out that the evolving processes on the different levels were highly interdependent and part of the same general processes.

2. The process of ownership reform

Privatisation in Slovakia proceeded according to three different avenues, i.e. small-scale privatisation, restitution and large-scale privatisation. In comparison, however, the latter must be considered the main vehicle for ownership reform. The process of large-scale privatisation was officially divided into two “waves”, ostensibly governed by the same institutional set-up in the form of the Act on the conditions of transfer of state property to other persons (Act no. 92/1991). The first wave initially was to include 751 state-owned enterprises (SOEs), a figure later lowered to 678 SOEs (see Table 45). This wave was officially completed by October 1993. The second wave, which was begun in 1992, initially included more than 1,000 enterprises with an estimated book value of Sk 260 billion ($9.2 bn).\(^4\) Together these two waves thus set to embrace firms making up some 80 per cent of the value of all state enterprises – excluded were initially only railways, post and telecom.\(^5\) The amount of property for the second wave was however gradually diminished, and in

\(^3\) Rutland (1985), p. 94.
\(^4\) Some firms were transferred from first to second wave when unable to meet the first-wave deadlines, see IMF (1995), p. 57
\(^5\) IMF (1995), p. 57

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the end included 610 SOEs with a book value of Sk 137 billion ($4.5 bn). Thus, altogether 1,288 SOEs with a book value of Sk 306 billion entered privatisation during the two waves. During the process these were transformed into a total of 2,376 privatisation "outputs", which were to be put in private hands. Formally, the second wave was deemed completed by end-1996 by the Ministry of Privatisation.

The analysis of the privatisation process, however, made it possible to divide the process into four rather distinct phases, rather than the official two waves. These phases largely "coincided" with the four different ruling coalitions in Slovakia during the period of study. Furthermore, as has been shown, it was not only privatisation policy which underwent changes as a consequence of the priorities of the different governments – this also applied to many other aspects of the institutional set-up that was of importance for ownership reform and corporate governance in its wider sense, for example the regulation of the capital market.

2.1. 1990-1992: Federally co-ordinated mass privatisation and the emergence of investment funds

The first phase of ownership reform was that of the federally co-ordinated large-scale privatisation programme in 1991-1992. The momentum of change was great, with the “Velvet Revolution” of 1989 still in fresh memory. The dominant method during the period was the non-standard voucher scheme, which ultimately was directed by the Federal Ministry of Finance and then Minister of Finance, Vaclav

Table 45. The official “two waves” of privatisation, 1991-1996, division among methods

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Value</td>
</tr>
<tr>
<td>Companies entering privatisation</td>
<td>678</td>
<td>– 169.1</td>
</tr>
<tr>
<td>No. of privatisation outputs</td>
<td>1,010</td>
<td>100</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct sale</td>
<td>330</td>
<td>32.7</td>
</tr>
<tr>
<td>Public tender</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Public auction</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Free transfer</td>
<td>116</td>
<td>11.5</td>
</tr>
<tr>
<td>Restitution (in kind)</td>
<td>7</td>
<td>0.7</td>
</tr>
<tr>
<td>Transformation to joint-stock co’s</td>
<td>557</td>
<td>55.1</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
</tr>
<tr>
<td>voucher privatisation</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>standard methods</td>
<td>–</td>
<td>3.4</td>
</tr>
<tr>
<td>RIF</td>
<td>–</td>
<td>3.8</td>
</tr>
<tr>
<td>FNM</td>
<td>–</td>
<td>47.7</td>
</tr>
<tr>
<td>other (e.g. state, reserve funds)</td>
<td>–</td>
<td>19.9</td>
</tr>
</tbody>
</table>

Source: Ministry of Privatisation; own computations
Comment: Data as of end-1996. These figures refer only to the results of the decisions of the Ministry of Privatisation and can thus not be taken as a indicator of to what extent property was actually privatised; as can be seen a large portion of the equity had only been transferred to the FNM. Furthermore, the figures for e.g. voucher privatisation underestimate the total extent of that method as it does not include shares in former federal enterprises, cf. Table 9 (p. 114).
Klaus. In Slovakia, the liberal Minister of Privatisation, Ivan Miklos, helped to push the scheme to a successful conclusion. In all, some 500 Slovak firms with a total book value of Sk 90 billion were privatised this way. In addition, the Slovak government under Prime Minister (PM) Carnogursky approved 181 direct sales and 8 public tenders, with a total book value of Sk 11.7 billion ($400 mn).

Given what was shown in this study about the consecutive changes in policy it is interesting to ask “how voucher privatisation could be achieved?”. Even though the programme was enacted and led from the federal level, we have seen that it also was a very decentralised process, relying to a large extent on the active cooperation of incumbent managers in the formulation of the primary privatisation projects (PPPs). Also, given what was said about the strong position of managers in Chapter III and their close to *de facto* property rights, it is somewhat surprising that this could be achieved. The explanation offered by this study is that a number of mutually reinforcing factors helped to create the atmosphere where many managers saw no alternative to cooperation. There was, as mentioned, a great momentum of change at the time – a momentum which was reinforced by a “no concessions” attitude of the government. Furthermore, given the poor state and bleak future of many of the SOEs, managers in some cases realised that they did not have much to lose. On the contrary, many saw privatisation as a means to achieve “freedom from the state” and the political governance which had been the case under communism. Indeed, this study found signs that a motivating force for accepting voucher privatisation was a belief that this “freedom from the state” would imply a freedom from any kind of external pressure.

However, they had then not reckoned with another consequence of voucher privatisation, namely the establishment of investment funds. As a direct consequence of voucher privatisation a new institutional solution developed, i.e. the investment funds and the investment companies. Their emergence was partly anticipated by the Federal Ministry of Finance, but their popularity took everybody by surprise. In total they attracted some 70 per cent of the bidding capital in the form of voucher points – something which destined them to a far more important role in corporate governance than initially foreseen.

**2.2. 1992-1994: New policies – testing the ground**

The June 1992 elections proved a turning point in the political and economic transformation of Slovakia. Vladimir Meciar was appointed second-time PM, on an electoral platform promising a slowdown and a change in the path of economic reform. As a consequence of the different views on economic reform and the aspirations for independence there developed irreconcilable differences between the Czech and Slovak governments, leading to a stalemate in the federal parliament and thus indirectly to the breakdown of the federation. This, in effect, meant that the new government was free to pursue its own policies with regard to privatisation, without the involvement (and momentum) from Prague. The result was a long period of hesitancy and a slow-down in the sell-offs. Nevertheless, despite the negative attitude of Meciar and his HZDS (Hnutie za demokraticke Slovensko, Movement for a Democratic Slovakia) towards voucher privatisation, the first wave was
brought to a close – not least since it had already been launched prior to the elections.

There were also considerable differences within the government, with Minister of Privatisation, Dolgos, being in favour of a continued use of the voucher scheme also in independent Slovakia. After his dismissal in the summer of 1993, however, when PM Meciar had appointed himself as acting Minister of Privatisation as well as head of the Fund of National Property (Fond Národneho Majetku, FNM), there was no longer any doubt about whose policies would be prevailing. From late 1993 privatisation started to gain pace, with the dominant method being sell-offs to incumbent management and other domestic industrial groups, often at prices well below market prices. Distrust in these policies by the opposition did however mount, and led to the threat of a possible vote of no confidence in mid-February 1994. As was shown in Chapter IV this resulted in a last thrust of sell-offs, when the government set to reward friends and allies by an unprecedented number of direct sales, at prices lower than ever before, the so-called “midnight-privatisations”. In terms of the quantity sold this second phase nevertheless implied a considerable slowdown in privatisation in comparison with the previous, more liberally oriented, government. In total, property with a book value of Sk 21.9 billion ($722 mn) was cleared for privatisation in 77 privatisation-related decisions; out of which 44 came during that last hectic period of sell-outs. Of the total volume of property cleared, only Sk 1.4 billion ($46 mn) had been allotted to voucher privatisation (cf. Figure 13, p. 125), and it stood clear that the method, for all practical purposes, had been shelved by Meciar.

The resistance against voucher privatisation is perhaps best understood in the light of the fact that it for a long time had stood clear that the funds, contrary to initial expectations, were to become very powerful actors on the arena for corporate control. During Meciar’s term in office the shares from the first wave had been distributed, and as was shown in Chapter VI the investment funds had acquired significant stakes in industry, holding some 40 per cent of equity on average. For managers who had trusted that privatisation would result in a larger degree of discretion this was a definite miscalculation – at least if they had not managed to establish “their own” investment funds as was the case with, for example, Eastern Slovak Ironworks (Východoslovenske Zelziearine a.s., VSZ). It may be speculated that managers got the feeling that “if the funds can get the shares for free, why cannot we get them instead?”. “Luckily” for the industrial lobby, they had their allies in government at the time.

* * *

The first wave of voucher privatisation did however leave its trace also on another level, namely in the establishment of an organised stock market. The “re-invention” of joint-stock companies was in itself a consequence of privatisation, which, in turn, created a need for secondary markets for trade in property rights. The scheme had thus resulted in two new institutional and organisational solutions, i.e. the stock market and the investment funds. A major point to be made here concerns the hasty establishment of these institutions and organisations. The speed of the process meant that there simply was not too much time to think about and develop a coherent regulatory framework – something which may serve as an explanation to the
problems that have been identified with it. For example, most investment funds and investment companies had been established and begun operating within less than 18 months after the right to free private enterprise had been re-established in Czechoslovakia in May 1990. Also, there was at the time (1991/1992) a strong belief that market forces would themselves sort these things out. However, as has been shown, the market forces were indeed speedy in establishing the formal organisations etc. – and in identifying the potential profits and trying to reap them. Unfortunately there were a number of factors which taken together made for short-term incentives and opportunism.

2.3. 1994: The Moravcik interim

The third phase in Slovak privatisation policy is intimately connected to the caretaker government that was installed after the dismissal of PM Meciar in March 1994. The new government was a left-right coalition headed by former HZDS-member and defector Jozef Moravcik. Initially there was again some hesitancy with regard to privatisation, which had been given a bad name during the previous government. However, time was running short and the government had made it a top priority to revive economic reform in general, and there was also a need to improve the international image of the still young Slovak Republic. The compromise which was reached implied that they set out to increase transparency in the use of standard methods (direct sales) as well as to speed up the process by means of reviving the voucher scheme – the latter in part to appease the international community in the form of the IMF and the World Bank.

Preparations were started and indeed concluded before the elections. The end-September elections, however, proved a miscalculation. Despite the fact that the voucher scheme had proven even more popular than the first time, with 3.4 million citizens buying their voucher booklets,6 and despite the fact that Meciar’s position on voucher privatisation was well known, they voted to reinstate Vladimir Meciar as PM. The government had hoped for some kind of “Klaus-effect” in repeating the elections in 1992 when Vaclav Klaus mustered support partly on behalf of standing as the personal guarantor of the voucher scheme. This did not materialise – instead the populist-national rhetoric of HZDS attracted enough votes from the elderly and from the areas with an overgrown heavy industry to allow Vladimir Meciar to form his third government. The rhetoric was of course helped by the elaborate election campaign staged by the HZDS, which was sponsored by for example VSZ. It may be speculated that the voting population shared the belief of the government that preparations had proceeded too far to be stopped – citizens held their voucher booklets (see cover) and had, once again, in the majority of cases allotted their points to investment funds (58%).7 As was shown, this belief was indeed erroneous.

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6 In the first wave there were 2.6 million who participated.
7 This was, however, a lower ratio than during the first wave when funds attracted 70.5% of the points.
2.4. 1994-1996: The new policies enacted

This time around it seems that the government was intent on letting nobody stop their ambitions to sell industry to their close allies, in effect it was “pay-back” time for real. The winter of 1994/1995 and first half of 1995 indeed proved a defining time with regard to ownership reform in Slovakia. Beginning already in November a number of changes to the formal institutional set-up was made, all of them implying greater government discretion over the decisions made. The Ministry of Privatisation, for example, was stripped of its powers in the privatisation process – powers that were transferred to the FNM where the government had installed their own people. This served to severely curtail transparency, especially since insight into the dealings of the FNM was minimised for opposition MPs. The changes affected not only the privatisation process per se, it also affected the capital market and, not least, the position of the investment funds and investment companies. Thus, with all powers concentrated to the ruling coalition the real policy of privatisation could begin. It seems that the government was tired of the stop-go policies which had characterised the last two governments as is illustrated by the great discrepancies between privatisation decisions made by the governments and the actual result in terms of sold property (see Table 46). The real policy that emerged under this adapted institutional framework was that of direct sales to incumbent managers and industrial groups at highly discounted prices.

One of the dangers with non-transparent policies rests exactly with the situation depicted in Table 46, i.e. that it creates the potential for reversing the decisions. In the case of the reversals which followed upon the 44 midnight privatisations the argument was that they to some extent were found to be illegal and not in accordance with the law. In the case of the reversals made by Meciar in 1994 during the so-called “night of the long knives”, the argument was that the sales decided upon by the Moravcik government after the official beginning of the election campaign should have contravened “moral codes of conduct”. Furthermore, as the aftermath of privatisation in Slovakia has shown this remains a serious problem. Even the

Table 46. Stop-go in Slovak privatisation, property approved and sold (Sk bn), respectively, with standard-methods and voucher privatisation during four phases

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Phase One</th>
<th>Phase Two</th>
<th>Phase Three</th>
<th>Phase Four</th>
<th>“Total”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved</td>
<td>102</td>
<td>22</td>
<td>100</td>
<td>103</td>
<td>327</td>
</tr>
<tr>
<td>Voucher privatisation</td>
<td>90</td>
<td>1.5</td>
<td>63</td>
<td>0</td>
<td>153</td>
</tr>
<tr>
<td>Standard methods</td>
<td>12</td>
<td>20.5</td>
<td>67</td>
<td>103</td>
<td>202.5</td>
</tr>
<tr>
<td>Sold</td>
<td>102</td>
<td>11</td>
<td>15</td>
<td>106</td>
<td>234</td>
</tr>
<tr>
<td>Voucher privatisation</td>
<td>90</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>90</td>
</tr>
<tr>
<td>Standard methods</td>
<td>12</td>
<td>11</td>
<td>15</td>
<td>106</td>
<td>144</td>
</tr>
</tbody>
</table>

**Sources:** Miklos (1995) p. 10; Slovak Monthly Report, April 1998; own computations
**Notes:** 1 Refers to the 1995-1997 period – the higher figure for property sold than for approved is explained by a time-lag between approval and sale; 2 Direct sales, public tender and public auction.

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8 It was then, in November 1994, during the first parliamentary session following the elections that HZDS and its would-be coalition partners moved to decisively take control over bodies with an influence in privatisation as well as radio and television.
sales made by the third Meciar government have started to be annulled – once again on grounds of corruption and illegality.\(^9\) Thus, much of what has happened has served to increase uncertainty. And, in fact, the firms privatised by means of vouchers are the ones that for the longest period have experienced non-disputed property rights.

As for investment funds and the second wave of voucher privatisation, it proved a difficult question for the government. The immediate response following the elections was that the programme was postponed. However, with such a great number of citizens being enrolled it would have been political suicide to cancel it. What happened instead was a gradual rollback of the scheme, where the amount of property allocated to it was being diminished. Finally, in June 1995, voucher privatisation was disbanded completely. In order to minimise the political damage of such a move the Ministry of Finance had developed the “bond-privatisation” method – which we showed would only result in a further subsidisation of direct sales. Although the final decision was announced by Meciar on 6 June, most likely the voucher scheme had been deemed politically unacceptable much earlier. What the industrial lobby most certainly did not want was to further reinforce the position of the investment companies and investment funds. These had by this time shown to be powerful actors in the boardrooms of privatised firms, having transformed their holdings into real influence.

Not only did the government curtail the opportunity for funds to increase their holdings, they also set out to minimise the influence derived from the existing holdings. With the general neglect and disinterest shown for the protection of minority shareholders, the restrictive policies imposed on investment funds most certainly cannot be interpreted as a means to try to achieve greater risk-spreading or the like. Rather, the policies constituted a clampdown on the funds and their influence. They were forced to reduce their holdings to a maximum of ten per cent in any one firm and were denied the right to be present on what we have seen was the most important statutory board, i.e. the Board of Directors. These policies, however, most likely represented a miscalculation of the government – they had not counted on the ingenuity in avoiding the restrictions that the new rules would breed.

The transformation of investment funds in 1996 meant that the funds after their transformation were unrestricted in gathering important stakes in companies. Thus, if the restrictions were meant to curtail their influence, as was concluded here, they indeed backfired in that they were influential in bringing this transformation about. In our analysis it was thus not only the greed of the fund managers (major owners) that led to their transformation – neither was it only the gradually more restrictive regulatory framework applied to their activities (as has been claimed by some representatives of investment funds) – rather the combination of the two. Nevertheless, part of the blame must be put on the regulatory authorities. Instead of trying to create the kind of framework which could work also for the funds that wanted to be-

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\(^9\) The new coalition government installed in November 1998 in their review of privatisation-decisions under the previous Meciar-government found such irregularities that they set out to “re-nationalise” some of the deals, the most publicised of which is the Nafta Gbely sell-off. In total, some Sk 10 billion ($245 mn; avg. ex.-rate January-June 1999) worth of deals have been disputed, see BBC Monitoring International Reports, 30 September 1999.
come strategic owners (as indeed was the case with many of them), and still would protect minority shareholders and provide the necessary transparency, they went in the opposite direction (still with great neglect of the minority shareholders). This, in a sense, provided the fund managers with the arguments that they needed for the transformation – placing these institutions for collective investment beyond any kind of supervision. A conclusion is therefore that the institutional environment in Slovakia was far from conducive, neither for investment funds nor for individual investors. The political insecurity about the rules of the game has consistently been too high and the enforcement of existing rules has been dismal and largely politicised.

* * *

When discussing methods and constraints for privatisation in Chapter IV the inherently political nature of the process of privatisation was emphasised; both in terms of the need for political support for the policies and in the risks for rent-seeking inherent in such a process. It was stressed that in order to counter the rent-seeking efforts of various groups, transparency and clear rules of the game would be instrumental. As this study has illustrated, this has not been the case in Slovakia.

The fate of the investment funds is a good example of the politicised nature of ownership reform. That the whole issue of stricter regulations for investment funds was driven by political considerations at least as much as the official policy of protecting small shareholders (which by all means failed) was, perhaps inadvertently, illustrated by FNM President, Stefan Gavornik, when accusing the funds of being ‘in the hands of the opposition’. However, in our analysis, the real issue was not so much about political opposition or not, rather it just happened that the Meciar-government had its strongest support from the industrial lobby rather than the new financial sector. This is not to say that the government had only foes in the financial sector. Instead there may be some truth to the statement by the Chairman of the Social-Democratic Party, Jaroslav Volf, when he said that ‘[p]rivatization funds do not fit into the calculations of the present government, because it does not have direct influence on the most of them. Some privatization funds were not related to political parties and they increased their economic power independently. On the other hand there were and still are funds that had and will have these connections. The funds, affiliated to the governing political structures, have to be rewarded. All what [sic] is happening now is carried out in order to strengthen those funds while getting the unacceptable ones out of the game.’ Such an interpretation of events could indeed shed some light on the somewhat discretionary behaviour of the regulatory agencies, for example in the treatment of the First Slovak Investment Company (Prva Slovenska Investicna Spolocnost, PSIS).

* * *

How should these changes during the fourth phase, which would prove a defining time for Slovak economic and political transformation, be explained? One possible explanation may start by recalling what was said in the analytical framework about the factors behind institutional change. Because, first of all, what we have wit-
nessed is not a matter of a one-shot institutional change that would abridge the gap between communism and capitalism. It has been more of an ongoing process of institutional change which, at the time of writing, is still far from finished. The institutional changes within this time-period should in analogy be interpreted in the same manner. That is, around 1994/1995 there was such an imbalance between the interests of the various actors and the institutional set-up that had been established in 1991/1992, that they saw advantages ensuing from a change in this set-up large enough to outweigh the costs. Furthermore, in economic terminology, the period of the second Meciar-government, when policies had been conducted largely within the existing framework, had perhaps shown that the potential for recontracting within the existing set-up were emptied. Such reasoning could serve to explain the far-reaching changes implemented by the third Meciar government in 1995, although beginning already with the “night of the long knives” in November 1994. Thus, the changes in privatisation policy and the restrictive policies on investment funds were part and parcel of the same change of direction.

The interrelation between economics and politics has in the Slovak case shown itself to have a defining impact upon the course and extent of the process of ownership reform and privatisation. The ability of the political sphere to quickly change the formal institutions guiding the process – and, above all, its enactment – created uncertainty and instability for markets and organisations. This problem is most likely connected to the lack of stability in the political system. In a mature and well-functioning representative democracy, institutional change often is a relatively slow process, and under such circumstances institutional theory is a well-functioning analytical point of reference. However, in transforming economies like Slovakia, the pace and scope of change is higher and more far-reaching, respectively – and they are not made in the context of the kind of mature systems for the interaction between politics and economy that are found in politically stable democracies. This opens for a strong presence of opportunism in political decision-making, and also allows it to be played out and influence the decision-making process. Institutional theory thus has certain shortcomings as an analytical instrument in the analysis of rapid change as well as ongoing change, not least if it is more or less all-encompassing.
3. The main results of the processes of ownership reform and privatisation

This section brings some of the main results of the study together, beginning with a look at the quantitative aspect, but then focusing on the more qualitative issues of who became owners and how corporate governance has developed.

3.1. How much and how fast?

An important theme of the study was of course the question of the extent of the process of privatisation, i.e. how much was privatised. Our conclusion has to be that during the period of study there were indeed significant changes and progress – this is not in dispute. However, it is important to point to the fact that privatisation has not been as extensive as initially foreseen – and also that the process indeed has been more time-consuming and complicated than was hoped for. Looking at Table 47, which is an attempt to summarise the extent of privatisation, we see that initially the pace of the process was very high with some Sk 90 billion ($3.2 bn) worth of property privatised in 1992 alone, out of which the majority was through the voucher scheme. After that, however, the stop-go policies discussed above, a result of the different views on “who should get what”, implied a slowdown. 1993 was in fact something of a lost year, with a mere Sk 9 billion ($293 mn) worth of property actually privatised. Not until after the change of direction by the third Meciar gov-

Table 47. Balance sheet of Slovak privatisation, 1992-1997 (Sk bn and per cent)

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<td>Sk  %</td>
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<td>Sk  %</td>
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<td>10</td>
<td>25</td>
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Sources: FNM SR; OECD (1996); IMF (1995); Slovak Monthly Report, No. 4, 1998; own computations.
Notes: 1 The figure has changed due to valuation changes, the one given is the most recent. 2 Asset transfers exempted from payments, restitution fund, held by other founding entities, sold to insurance companies and intermediaries, reserve funds of joint-stock companies where majority stakes are privately held. Comparable figures are missing for the 1992-1994 period. 3 Reserve funds of joint-stock companies where majority stakes are held by the FNM, other funds, non-produced output, price differentials. 4 Figures for 1992-1994 only included as a rough guide as to the relative amount left to privatise – exact figures are not possible to obtain due to valuation changes.
ernment did speed increase once again; then with Sk 67, 37 and 43 billion ($2.3, 1.2
and 1.3 bn) worth of property privatised in 1995, 1996 and 1997, respectively.
However, the value of property not privatised was still at end-1996 equal to 91.5
per cent of that actually privatised and 112 per cent of that sold in exchange for
money (standard methods) or vouchers.

3.2. What ownership structure?
Two features of the resulting ownership structure deserve mentioning here. One
concerns the level of concentration of ownership, the other the type of owners that
emerged. It was shown in Chapter VI that already at the outset the firms privatised
with vouchers got a fairly concentrated ownership structure. This, however, was
only the start of the process. During the period of study, a significant increase in
ownership concentration took place for all the three samples of industrial firms un-
der scrutiny. The one sample with the highest level of concentration was the Top-
60, where the two largest owners on average held 49.8 per cent of equity (end-
1996). There were, however, no significant differences among the samples in terms
of ownership concentration in 1995 or 1996. The high concentration of ownership
is indeed what would be expected if there is a poor quality of regulation and en-
forcement of property rights, i.e. if transaction costs (agency costs) for executing
ownership are raised, principals need a higher stake to make their voice heard.12

Regarding the composition of ownership, it was interesting to note that the retro-
spective sample of top performers (T60) throughout the period had a significantly
higher portion of state ownership than the random sample of industrial firms (S56).
The other general trend observed was that the role of private owners increased at
the expense of investment funds – however, this was a development which was
visible already before the transformation of the investment funds gained pace.

3.3. Competitiveness of methods for privatisation
The potential methods for conducting privatisation policies were discussed in a di-
chotomy of standard (e.g. direct sales) and non-standard methods (e.g. mass privati-
sation through vouchers). In Figure 9 (p. 98) the potential merits and drawbacks in
terms of economic as well as political goals of the various methods were summa-
rised. In comparison to the standard analysis of potential advantages and disadvan-
tages of the respective methods it was posited that yet a dimension might be of im-
portance, i.e. the relative competitiveness of the various methods. The study indeed
lends some support to this. During Slovak privatisation emphasis moved from the
use of non-standard methods to the standard method of direct sales, which became
predominant – at least in terms of the number of privatisation outputs (cf. Table 45)
and, to a much lesser extent, also with regard to the value of property privatised (cf.
Table 47). However, the really defining changes did not relate to the methods per
se, rather to the prices paid for the property – which could be taken as a good proxy
for the degree of competition for resources.

12 This is in congruence with La Porta et al. (1998), who survey rules, quality of enforcement of the
rights of corporate shareholders and creditors in 49 countries.
Before pursuing the argument, it should be stated that the degree of competition during privatisation in general was low, irrespective of the government. This fact can be explained by a number of factors, for example the relative lack of domestic investment capital and the negligible foreign involvement pointed to in Chapter VI (irrespective of its causes). In addition, competition was hampered by the strong position of incumbent managers. As was shown, those managers who really did not want to go ahead with, for example, voucher privatisation had many options; one of the better ones seemed to be to stall the process and instead negotiate with the proper government. With this in mind, we could nevertheless point to distinct differences between different phases with regard to competitiveness. During the first phase (1992) the property sold through direct sales was, on average, never sold at prices below its book value (see Figure 27). The sales actually carried out during the second Meciar-government (2nd phase) initially (1993) did not imply any significant change, although one can begin to notice something of a change in policy towards the end of that phase; purchase prices in 1994 were down to 84 per cent of book value, incorporating also the results of the third phase. However, as pointed out, the amount of assets actually sold during 1993 and 1994 was very low. The real change came with the third Meciar-government (1995-1998); once transparency had been minimised also purchase prices were significantly lowered in the 1995-1997 period – in 1996 equalling a mere 28 per cent of book value.

Our conclusion has to be that the method per se is not as interesting as the way it is enacted. The study has shown that the way the problems, disputes and policy changes concerning privatisation and ownership reform emerged and were played out in the Slovak case also had important distributional impacts. In the aftermath of

Figure 27. Purchase prices in direct sales (as % of book value), 1992-1997.

Source: Slovak Monthly Report, April 1998. Comment: Figures are not comparable to Table 47 as the former is based on data of sold assets, while this table is based on approved privatisation projects and there is a lag between the two and there can also be changes following the approval. For the underlying figures, see Appendix D, TABLE 22 (p. 335).
voucher privatisation, the lack of transparency in fund asset management and the
dismal protection of minority shareholders led the latter to be cheated in many
cases. During the process of direct sales, despite much talk about workers partici-
pation during all of the latter three phases identified, incumbent management and
industrial groups turned out as the main beneficiaries in the majority of cases. Fur-
thermore, the very low prices, especially during the fourth phase, implied that ordi-
inary citizens could not even count on any indirect effects ensuing from, for exa-
ample, an improved fiscal position of the state. A conclusion has to be that from a
distributional point of view, given the way these processes developed, the method
made no significant difference for individual citizens, who in the Slovak case were
disfavoured by both methods. This, of course, is not to deny that there were indi-
viduals who made profitable investments with their voucher booklets.

In this context it deserves to be mentioned that recent findings in Slovakia point
in the direction that net revenue of the sales conducted in 1995-1998 period were
even lower than expected; a reviewal by the new government (in office since No-
vember 1998) revealed that in the 1995-1998 period, assets with a value of Sk
109.2 billion ($3.4 bn) were sold by standard methods for a price of Sk 30.7 billion
($950 mn). Of this, the FNM had by end-1998 received Sk 19.7 billion ($610 mn),
out of which Sk 7.8 billion ($241 mn) had been paid by means of the FNM-bonds.13
Those bonds had been issued by the organisation as a compensation for the can-
celled second wave of privatisation. They were subsequently bought by debtors to
the FNM at a discount and used for paying off their debts. Thus, in total, real reve-
nue of the FNM at the time was a mere Sk 11.9 billion ($369 mn). In comparison, it
can be stated that even the small-scale privatisation made for Sk 14 billion ($485
mn) in gross revenue. The effective discount relative to book value during the third
Meciar-government had thus been close to 90 per cent. An implication of this is that
neither researchers nor policy-makers ought to focus on methods of privatisation
simply as a methodological problem. The method per se is to some extent unim-
portant, rather its enactment and the supportive regulatory and institutional frame-
work will be the factors that to a large extent define the results of policies, and thus
should be factors put in the centre of analysis.

3.4. Structures, institutions and mechanisms for corporate
governance

The implications for corporate governance of these policies, as well as the question
of “which type of owners” that ownership reform brought for Slovakia are among
the more important questions of the study, although ones that have required the
whole picture presented in Chapters IV-VI before being assessed in any meaningful
way. The discussion above about the distributional impact of privatisation could,
for example, have been pursued on the basis of the macro-level analysis coupled
with the insights into the surrounding institutional set-up (the meso-level). How-
ever, before approaching the implications of privatisation and ownership reform for

corporate governance, it was necessary to complement the analysis with the insights into and the responses from the micro-level.

In such a context the choice of method again becomes important, not least because the approach chosen for privatisation and ownership reform will foster a certain type of institutions – formal as well as informal – and thus the ensuing incentive structures that were posited to be at the core of economic transformation. For example, the method for privatisation (as shown) will most definitely affect the development and the role of the stock market. Voucher privatisation was in itself what led to the speedy establishment of such a market in Slovakia. The stock market, however, was shown to be of minimal importance as a disciplining mechanism in corporate governance. The conclusion was based on the many problems identified in Chapter V with the market, relating to its non-transparency, lack of liquidity and ensuing inability to provide a good evaluation of firm performance. It was a view that was reinforced by the case studies of industrial firms, where managers expressed very reserved attitudes towards market-evaluation and its potential impact. This, however, brings to the fore the importance of complementarity and consistency of reform. It points to the difficulties and problems connected to pursuing diverse paths of reform in one and the same country in that the emerging institutions, which take time to become established and effective, may be put at risk by overly frequent changes in policy.

Voucher privatisation was a path of reform which in terms of governance of firms relied on outside owners being able to make their voice heard, either through exit or voice. For such a system to become effective it would however, given what we know about governance and incentives during communism, require a change in attitude of managers. Such a change in attitude is not unreasonable to expect if it becomes the normal set-up that external owners make their priorities heard; under such circumstances managers may be expected to more easily adapt and accept this new state-of-affairs. However, the changes in policy and priorities of the government illustrated that many managers could empower and enrich themselves through leveraged management buy-outs (LMBOs), something that may be expected to have influenced the incentives of managers (those involved as well as others) and their readiness for co-operation with external owners. Such a conclusion is also supported by the findings in Chapter V to the effect that investment fund managers perceived that executives in firms part-privatised with vouchers indeed began losing respect for outside owners.

The problems of a market-oriented system with outside owners to take root was in the case of Slovakia further compounded by the problematic issue of market regulation. The formal rules imposed cannot be said to have been conducive for creating the proper long-term incentives for market actors. Rather, in our reading, a combination of lacking, misdirected and changing regulations – coupled with the general uncertainty surrounding the path of privatisation and reform – created the type of short-term incentives which led actors to take on an opportunistic behaviour. In terms of consistency of reform, this seeming inability of authorities to develop a purposeful and coherent institutional framework could be viewed in terms of an implicitly chosen neglect; initially as a result of an overbelief in the “self-regulating” market forces to sort things out, and later, as the need must have been
apparent, as a consequence of that the path of privatisation and reform had been changed and thus that such issues were no longer deemed important.

Either way it was a neglect that resulted in negative consequences for transparency. A worrisome finding of the case studies was, for example, that even major listed firms were reluctant to provide information to the market. This could in part be explained by a lack of regulation (dismal disclosure rules), but also in part by a warranted mistrust against the durability of a nominally market-oriented system – thus making it quite irrational to adapt to it in terms of making business more transparent. Regarding investment funds it was shown in Chapter V that, with short-term incentives, they did not either have any genuine interest in increasing transparency. They could make better money on insider trading, murky deals and collecting and selling larger blocks of shares to other private interests. Finally, the kind of crony direct sales that became the dominant method for privatisation implied that those new owners most certainly did not have an interest in increased transparency. Taken together this means that the institutional set-up and its application did not provide any of the influential groups of actors with an embedded interest in increasing transparency. And, as has been discussed, transparency is a *sine qua non* for a market-oriented system of governance to function. A conclusion from this is that the preconditions for such a system were largely lacking at the time of the study.

**The role of banks**

The methods for privatisation could also be expected to influence the role of the banking sector in corporate governance. For example, substantial foreign involvement in privatisation, if related to capital injections, may be expected to weaken the dependency on banks. As illustrated, however, such privatisation was of marginal importance during the period of study. Rather, both the methods applied served to enhance the influence of the banks. Voucher privatisation implied the establishment of owners with no direct access to capital, thus reinforcing the reliance on banks for financing. Likewise did direct sales through LMBOs increase the dependency of firms upon banks; without bank guarantees there often would not be any direct sale. Thus, either way, the importance of debt-control was enhanced as a consequence of privatisation.

In addition, as shown in Chapter V, the initially strong position of investment funds meant that the banking sector increased its importance also on the equity side, since they stood as the founders of many of the major investment funds. In consequence it was shown in the case studies of firms that many managers often viewed banks and their representatives as the most influential actors in governance – although in some cases it was not possible to determine whether a board-member was acting in the position as owner or creditor.

This rather peculiar set-up, with banks controlling funds (and their successors) which in turn control firms is not without risks. Problems with the strong position of the banks pointed to in Chapter VI, making it doubtful whether they can act as “good creditors” as well as “good owners”, include the following: *(i)* the financial position of the banks, with high levels of classified debt; *(ii)* the concentration level with the three major banks being in an oligopolistic position; and *(iii)* the owner-
ship structure – with the state having a dominant position in the major banks. Furthermore, from a policy-level, it would be desirable if the banks could create functioning barriers between their lending-activities and their investment-activities.

An implication of the role of banks both on the equity and debt side is that they may be more prone to support ailing enterprises since they – if pressing for bankruptcy – would lose what they have on the equity side. In comparison, with a “pure” bank-system, the exposure of the banks is covered by collateral and their loss will not be increased if pushing for bankruptcy. This mixed governance thus poses a risk in that neither the mechanisms related to bank-finance (arms-length finance) for governance, nor the mechanisms connected to equity-finance (control-oriented finance),\textsuperscript{14} may work properly.

**Implications of LMBOs**

Given that direct sales to incumbents proved to be the most common method for privatisation during the period of study it is also necessary to discuss their possible implications in some more detail. However, when analysing their potential effects one must try to differentiate between their effects on efficiency and wealth, respectively. As has been shown and discussed, low prices will indeed have a significant effect on the distribution of wealth and the direct sales can thus rightly be criticised for being “unfair”. Nevertheless, to analyse their impact on the efficiency of the use of the resources acquired in this unfair way one has to return to the analytical framework. There is, for example, nothing in the theory that stipulates that an owner-manager who acquired a resource in this way will use it less efficiently than an outside owner who would have acquired the same resource in a competitive process. Likewise, the strong and direct incentives ensuing from such concentrated ownership are obvious, and need no further discussion. Rather, the potential disadvantages are probably indirect and must be sought on other levels.

A first such problem concerns the access to capital. Direct sales as they were conducted in Slovakia indeed gave Slovakia a capitalist class – it was, however, to a large extent capitalists without capital. To become capitalists they have, instead of risking their own capital, been “banking on their connections”. Thus, the owner-manager will have less resources readily at hand for further investments than would an outside bidder – investments that are necessary to boost productivity. There is also a risk that insider-dominated firms will find it more difficult to get access to external capital markets – be it equity or debt. This stems from at least two reasons: (i) the lower valuation of and greater risk connected to investments in insider-controlled firms, in terms of less insight, confidence etc.; and (ii) one can assume that insider-owners will be more reluctant to search for external finance if it lessens their own potential for control. The longer-term effects of such LMBOs will thus to some extent hinge on the willingness of managers to weaken their own power by means of opening to outside investment (e.g., equity issues). The indications we got from the case studies were not too encouraging in that respect, since many managers indeed seemed reluctant to endanger their position. The risk then is that restructuring will either be limited to what can be achieved by retained earnings

(which, in general, is little) or that they will rely on what can be achieved by means of debt-financing (which may be both difficult and expensive). After the collapse of VSZ in 1998 a third alternative, i.e. to buy one’s own bank to finance risky investment, is perhaps ruled out. Another by-effect of the collapse of the VSZ-empire is that it may have proved a lesson for other manager-owners.

A second pitfall with LMBOs is that they may preclude the efficient functioning of an exit-mechanism, i.e. a mechanism whereby non-performing managers can be removed by outsiders (who are taken to be the better judges of the managers’ relative performance than the manager himself). Even though this argument points to one of the potential advantages of LMBOs, i.e. that they put to good use the human capital (managers, incl. their experience and knowledge acquired over the years) by providing managers with a strong self-interest in the performance of the firm, it is still not certain that this human capital was allocated in an optimal manner during communism. In fact, one can readily assume that this was not the case in absence of a competitive labour market and when political considerations were at least as important in appointments as were other skills. Thus, even though some firms where insiders gained control were “lucky” in that their managers were equally skilled in everyday work-life as in the political manoeuvring needed to gain control in the first place – there are still many firms who are not – a fact which reinforces the need for an exit-mechanism for managers. Further, even if it is assumed that all firms were provided with the best owner-managers available at the time of privatisation – the lack of transferability of property rights may still distort the incentives for management. If there is no well-functioning market for property rights (which there would not be if the firm is closely held by a group of managers), managers could not cash in the discounted net present value of their holdings, something which may reduce the long-term incentives of owner-managers.

A third implication of direct sales, as they were conducted in Slovakia, is that they may help to build and/or reinforce a potentially dangerous alliance between the political leadership and the industrial managers/owners – an alliance which may make both parties prone to rent-seeking: industry by a search for support, subsidies and protection from external and/or internal competition; politicians by the extraction of pure rents, for example in return for the subsidies and protection which reinforce their own influence. Such a danger is especially apparent if the alliances are built with the country’s industrial giants (e.g. VSZ) since it is much more politically difficult to let them go bankrupt, given the sizeable consequences in terms of regional unemployment, exports etc. Finally, and on a more marginal note, recent research indicates that not even the incentive effects may be that direct and obvious as one could expect; Djankov found managers to be reacting differently from what they perceived as “windfall gains”. Moreover, given the low prices that in many instances were paid in Slovakia for enterprises, they are not fundamentally different from “windfall gains”.

* * *

15 See Djankov (1999) who in a study of Georgian and Moldavian firms found restructuring to be faster where managers had bought their stakes, as compared to firms where incumbents had received stakes for free (in which case there were no significant differences in terms of restructuring from the SOEs).
In conclusion, and in terms of the typologies discussed and presented in the analytical framework, this study points in the direction of what by Pistor and Turkewitz (1996) was termed a “hybrid ownership” (with a continued role of the state through the banks and their equity holdings), and with a corporate governance system which is in essence a bank-oriented system – but with some notable traits of a market-oriented system. It was, for example, shown that the managers seemed more responsive to the wishes of their creditors than their owners – although they were in some cases represented by the same person on the board. An implication of this study concerning the corporate governance literature is that it points to some shortcomings – although it does not provide the answers. Nevertheless, the mainstream literature often presupposes the possibility of introducing new formal institutions and consequently focuses on the effects of these institutions. However, the models seldom formally incorporate the possibility of actors/agents to change these rules. Extensive work has been done on how agents avoid the rules that are set down – but there is precious little on how they actually manage to change the rules. Another implication, rather obvious as it may be, is that the study also (like many other studies) points to the limitations imposed by the dichotomous view of corporate governance systems.

4. General conclusions and implications

In the concluding section of the analytical framework the problems of economic transformation in general and especially the tendency to view the transformation process by way of two idealised and dichotomous regimes of property were raised. These ideal type systems of ownership were defined as either a situation where private property rights were vested solely in the hands of private persons with primarily economic responsibilities (“private ownership”), or with “state ownership” on the other hand, where these rights are executed entirely by centralised public agencies. However, it was argued that this view represented a misconception of both systems. Regarding the system of “private ownership”, it is often the case that the role of the state is overly played down – close to implying a minimalist state. It was also concluded on the basis of other research that in so-called state property regimes effective ownership and control was not organised solely in a hierarchical manner from the centre. Rather, a concept of “communal ownership” came closer to depict the situation in former communist economies. It will be remembered that this was not to suggest that communal ownership represented a situation that was identical to open access – rather, it was one where de facto property rights were divided among incumbent managers and their respective ministries according to a very blurred boundary. That is, property rights were communal but effective ownership distributed among a limited number of actors.

With such an approach the issue at stake is not whether there will be a role for the state (which of course there will be – as in any civilised society) – rather to which extent ownership reform and privatisation can bring about what, in congruence with Frydman and Rapaczynski, was termed a “private property regime”. Such a regime is about striking a balance between government and private activities, a
balance that puts emphasis on private initiatives and limits direct government intervention so as to change the behaviour of economic actors. The process (economic transformation and ownership reform) is thus about redefining the limits between public and private and changing the balance of power between state and non-state agents. The question then is whether such a “private property regime” developed in Slovakia during the period of study?

The answer, of course, can only be tentative and provisional. On the one hand, we have seen significant progress. Privatisation has resulted in a massive transformation of ownership. Small-scale privatisation led to private ownership of almost all shops, restaurants and minor workshops. Large-scale privatisation put in private hands a large part of industrial capacity. Furthermore, the case studies have pointed out that a market-oriented behaviour quickly took root and profit maximisation became rule rather than exception and that budget constraints were hardened. On the other hand, however, it has been shown that the process of privatisation was not as extensive and rapid as initially foreseen, partly as a consequence of the Strategic Enterprise Act, partly as a consequence of the delays that the frequent policy changes have caused. Thus, still in the summer of 1999 the book value of industries, utilities and banks in the hands of the state amounted to Sk 252 billion ($6.2 bn), with an estimated market value of some Sk 130 billion ($3.2 bn).\(^{16}\) In addition, the state has retained a large indirect influence through ownership of the dominant banks, which has indirect control over many industries. Furthermore, we have pointed to a tendency for direct political interference in privatisation and the regulation of for example investment funds and capital markets. However, politically organised and enacted regulation is not the issue. What is problematic is rather the biased results of this political regulation. During privatisation, especially post-1994, it seems that political connections were more important than ever.

Thus, the answer to the question of whether a “private property regime” had been established is not straightforward, and in an analytically confronting environment opinion is predictably divided. However, the results of this study at the very least raise some doubts as to whether such a “borderline” between the political and economic spheres of life was established. The state has clearly found the process of relinquishing control over the economy agonising. It may be appropriate to, again, recall Kyn’s assessment of the reforms in 1966-1967, stating that ‘it was not the obsolete price system but rather the obsolete political system which was the main obstacle to the development of market socialism.’\(^{17}\)

The relative lack of such a “borderline” – or, at the very least, its lack of durability, is underlined by recent events when the government elected late 1998 set out to “clean up” past deals and claimed to have found so many murky deals that some firms even have been re-nationalised. This points to what has been a recurring theme throughout the study, namely the issues related to the relative stability and durability of the institutional set-up – and the incentives that result. It has been shown that in many cases insecurity about the “rules of the game” has led to short-term incentives and opportunism on behalf of the economic and political agents.

\(^{16}\) Slovak News Agency-TASR, 4 September 1999; recalculated according to the average exchange rate in January-June 1999.

This is also what could be expected in the absence of a “private property regime”, i.e. rent-seeking is directed towards the political sphere. The insecurity has manifested itself on a number of levels. Perhaps the most obvious example concerns the regulation of markets and market actors, where the cases of PSIS and the Bratislava Options Exchange (Bratislavská Opcná Burza, BOB) stand out. Also regarding privatisation we have seen numerous changes in the policies, and above all, in their implementation. Finally, and perhaps most importantly, the general atmosphere during economic transformation and the period of study has been one of instability and insecurity. For example, the macro- and micro-economic environment have changed radically and the whole system of property rights has been in a state of flux – leading to uncertain relations in governance etc.

Although an explanation of this phenomenon of insecurity in itself lies out of reach of this study, it may nevertheless be speculated that security and long-term stability of institutional solutions can only be achieved where decisions and decision-makers have a certain level of legitimacy. This, in turn, is connected to the question of transparency – which in the Slovak case has definitely been lacking. Transparency and clear rules of the game are important not only for the functioning of markets, but also for strength and long-lastingness of reforms. The recent revokals of privatisation deals are thus part of the price paid for this lack of stability, transparency and legitimacy.

* * *

The existence of path dependence was also an issue brought to the fore in the concluding section of the analytical framework. The question implicitly raised was whether, and in that case how, path dependency would affect efforts of economic transformation. It was posited that “shock-therapists” and “gradualists”, while both acknowledging its existence, drew different inferences from it; and both were held to be slightly erroneous. Instead it was argued that a more proper implication of the concept would be that economic transformation is, in the words of Nielsen et al., a matter of ‘path-shaping in a path-dependent context.’\(^\text{18}\) This case study of Slovakia indeed lends some support to such a notion.

On the one hand, it has been shown quite clearly that changes in the path can be achieved. On the most obvious level, we find that centrally administered resource-allocation was replaced by a market co-ordination in a very short time, that property reform has been extensive etc. We can also see that external factors are clearly of importance – the starting point in itself, i.e. the Velvet Revolution, is a good example. Without the similar happenings in the neighbouring countries and, above all, the implicit acceptance by Moscow, the whole process would not have been set off (at least not when it did). Our analysis of the process of ownership reform also found the changes to be closely connected to the changes in the political setting – pointing to a role for policy. However, there were also common elements in the different phases, which policies seem to have been unable to change. One aspect of Slovak privatisation that could be analysed in terms of institutional legacies and path dependency is the limited role for foreign investors. Extensive sell-offs to foreign companies were further complicated by the newly achieved independence, the

lack of a clear and secure national identity and the existence of a party (Slovak National Party, SNS) which early articulated and popularised these attitudes, in part helped by the populist-nationalist rhetoric of HZDS. Also the continued great role for debt financing could be interpreted as a sign of path dependency. Lindgren, for example, has shown that there are indeed problems and costs connected to breaking an already established bank-influence in a firm.19

The role of path dependency is also well illustrated by the activities of the different interest groups and actors involved in the privatisation process. Politicians have often been acting in an opportunist manner – quite in accordance with the logic and traditions of the centrally administered system – of which traces have remained also in independent Slovakia. The lack of stability in the fragile political system has more served to increase than to repress this kind of opportunism, and thus contributed to the wish of many politicians to strengthen their position – in terms of power as well as in terms of wealth. It is, however, not only the behaviour of politicians that in this sense has been affected by path-dependency. Also in the behaviour of the new owners and managers one may find traces of the logic and traditions of the centrally administered economy, not least in that they by short-term behaviour and exploitation of the lack of transparency of the market were able to strengthen their position at the expense of the minor shareholders. The lack of formal rules and/or generally accepted norms pertaining to the behaviour of private owners has thus been a contributing factor to the opportunistic behaviour of enterprises and their managers, in ways resembling the use of non-transparency and lack of information so characteristic for the centrally administered economy.

The institutional heritage was also evident in a comparative perspective. While not representing the “strong all-encompassing state” at the outset of reform – the state in Czechoslovakia was still considerably stronger than for example in Poland or Hungary, something which could serve to explain why one initially could pull off such a relatively centralised reform of the property rights system as the voucher privatisation. In Poland, for example, decentralisation had gone much further and management’s position was much stronger – and in this view the much more frequent management buy-outs in Poland could be understood.

Finally, it was argued in the analytical framework that given the bounded rationality etc. of agents, there were no compelling reasons to expect that efficient/optimal institutional solutions would develop and take hold. Therefore it is not surprising to see numerous examples of institutions with severe bi-effects develop in the case of Slovakia. However, whether this should be taken as a sign of path dependency per se is a more difficult issue. It may just as well be thought of as an example of rent-seeking individuals, who themselves have managed to install/maintain such, from a societal perspective, inefficient institutional solutions in the light of the lack of an institutional set-up providing long-term incentives.

* * *

This study has examined the period prior to 1997. It surely does not attempt to provide the final word on the process of ownership reform and privatisation in Slovakia. The process is an ongoing one and there have indeed been important develop-

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ments since then. We can also expect that there will be further twists and turns in this unfolding drama. However, the present circumstances are comprehensible only with some understanding of the period under investigation. Paradoxically perhaps, just as individual companies and the state more generally are attempting to set history at a distance, they highlight the extent to which the past is in the present. The recent example of the state announcing its intention to drastically increase transparency to attract international investment well illustrates this point.20

The study has also shown that the analytical framework for studying the process of transformation is critical. Eyal et al. (1998) are surely correct in suggesting that developing the appropriate analytical categories for analysing transformation will have implications for studying wider societal processes. We may not agree with their formulation, but the task of analytical development remains urgent. In the meantime, researchers need to be clear about the strengths and limitations of evolving theoretical approaches and methodologies.

In view of the provisional nature of the process of ownership reform, and the analytical controversies surrounding the transformation process in general, the study developed its analysis on a number of levels of explanation (macro, meso and micro). These were not construed as separate levels of social organisation, rather as different explanatory lenses for creating the whole picture. Take the use of case studies, for instance. Just as we suggested that finding the right analytical categories was critical, so the study argued that researchers should be cautious about aggregating until the right units of aggregation are found. To paraphrase Offe, in absence of any prescriptive theoretical explanation for the transformation process, the task for all social scientists must be to understand in retrospect what has been happening. In this project, individual national stories and individual corporate case studies are essential. But, just as we cautioned against uncritical aggregation to contrive national stories, researchers also need to be wary of case study methodology. Finding the right balance between knowing what to look for and being sensitive to important differences and distinctions is a daunting task. This is, however, the very dilemma that has always confronted economic historians and thus should allow them to bring their own unique contribution to analysing the transformation process. It may not yet be possible to develop general and universal categories, but if theoretical and historical advances are going to emerge, it has to be done on the basis of sound analytical investigation – not just simply on the basis of hypothetical models. History will be the ultimate judge of the durability of theoretical constructs. And just as we can conclude that history as much as theoretical elegance and consistency will matter in sorting out the claims of the various analytical approaches emerging to explain transformation, so we can predict that the work of economic historians will be vital in that process.

20 Cf. Financial Times, 13 September 1999, p. 3.
Appendix A. Restructuring and economic performance

As has been emphasised in the study, the outcome of the process of economic transformation will, to a large part, depend on changing incentives and how, and to what extent, these changes induced industrial restructuring. This appendix aims to give an overview over to what extent such changes took place in the case study firms. The data for the firms will also be compared to national and sector aggregates. The appendix is divided into four sections, looking at, in order, the development of sales and output, employment and labour productivity, export and trade reorientation, and, finally, some indicators of economic and financial performance. Taken together, hopefully, these indicators and discussions will provide some insight into how firms have restructured in the 1990s.

Industrial restructuring, however, is a wide concept which could be taken to include any change in firm behaviour after 1989 albeit this would give no guide as to what the driving forces are behind the changes. A somewhat more refined, although still crude, view would divide restructuring into two types, reactive and strategic restructuring. Reactive restructuring would be the first type of change expected to materialise; such changes could include anything done to cut costs in response to declining market demand for produce, for example labour shedding. It could also include the efforts made to secure new markets for the produce, i.e. trade reorientation (then presumably away from the collapsed CMEA market). Changing the product mix is another example. The basic impetus behind this kind of change would be market competition in combination with the hardening of firms’ budget constraints. Reactive restructuring could, in short, be defined as the changes which management has been “forced” to undertake in response to factors outside the realm of their influence, for example hardening budgets, loss of markets, liberalisation of trade and increasing competition. Using the same dichotomy strategic, or deep, restructuring on the other hand is the type of changes undertaken as a response to changes in ownership structure and governance structure internal to the firm. In practice, however, it is very hard to differentiate between these latter changes where pressure for adjustment comes from privatisation and improvements with regard to corporate governance and changes induced by other factors.

Production cuts

At the aggregate level industrial production experienced a deep decline in the early 1990s. Between 1989 and 1993 total production fell by an aggregate of 32.3 per cent. Looking at production- and sales indicators for some of the case study firms the same pattern emerges, i.e. a sharp decline at the beginning of economic transformation with 1991 as the worst year for the majority of firms (see TABLE D 1).

1 The view that market pressure constitutes the main cause for this type of restructuring also finds support in recent research, cf. EBRD (1997), pp 69-70; Pinto and van Wijnbergen (1995) [a survey of managers in 75 Polish SOEs]; Heinrich (1995) [on the impact of competition on enterprise adjustment in Hungary and the Czech Republic].
Aggregate production bottomed out during 1993 and real growth resumed in 1994, although in 1996 there was still a long way before reaching the 1990 real levels of industrial production. A sharp drop in industrial production was however not unexpected at the outset of economic transformation, although its severity took some by surprise and was the result of many interrelated factors. To begin with, most firms experienced severe demand shocks as prices were liberalised, subsidies cut back and budget constraints hardened. In Slovakia budgetary subsidies in general were lowered from 7.8 per cent of GDP (CSFR) in 1989 to 3.3 per cent in 1996.

In the case study sample none of the firms has been receiving any direct state subsidies, although some indirect support has been forthcoming. Concurrently domestic demand plummeted after 1991 with the general industrial slowdown. Secondly, the collapse of CMEA trade dealt a hard blow for many producers. Thirdly, the market structures changed completely as trade monopolies, domestic wholesale as well as foreign trade monopolies, were broken down. For example, many firms experienced disruptions and problems as a consequence of the privatisation of wholesale organisations during the small-scale privatisation, which in many cases broke the existing chain between producer, wholesaler and retailer. As a consequence distribution channels were destroyed; firms who had been used to deal only with a handful of “customers” in the form of wholesale organisations were not seldom forced to totally reconstruct the channels for selling their produce. A Slovak television producer, for example, saw its number of customers rise from three to 840 in a matter of months in 1992. In short, these disruptions implied large investments and high transaction costs for establishing new sales networks. Finally, liberalisation of trade meant new and stiff competition for many domestic producers.

As can be seen in TABLE D 1, there were however large variations both with regard to the timing and severity of the downturn. Sector differences in general tend to be significant, and firms with either a direct or indirect connection to the oversize Slovak military production were hit particularly hard. Although precise figures are lacking it is estimated that military production in 1995 was at about 10 per...
## TABLE D 1. Output indicators 1990-1996 (Sk mn in sales and index 1991=100, unless otherwise noted)

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<td>536,749</td>
<td>450,231</td>
<td>488,892</td>
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<td>73</td>
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<td>86</td>
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<tr>
<td>Manufacturing total</td>
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<td>385,784</td>
<td>412,188</td>
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<tr>
<td>index</td>
<td>– 100</td>
<td>87</td>
<td>72</td>
<td>76</td>
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<td>60</td>
<td>65</td>
<td>165</td>
<td>180</td>
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<tr>
<td>index, 1993=100</td>
<td>. . 100</td>
<td>143</td>
<td>359</td>
<td>380</td>
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<tr>
<td>sector idx (DL)</td>
<td>– 132</td>
<td>115</td>
<td>100</td>
<td>103</td>
<td>114</td>
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<td>Cosmos</td>
<td>. 59</td>
<td>64</td>
<td>50</td>
<td>.</td>
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<tr>
<td>index</td>
<td>. 100</td>
<td>96</td>
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<tr>
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<td>87</td>
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<td>Hydronika</td>
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<td>124</td>
<td>109</td>
<td>152</td>
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<tr>
<td>index</td>
<td>. 100</td>
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<td>51</td>
<td>57</td>
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<td>Ozeta</td>
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<td>1,412</td>
<td>1,591</td>
<td>1,736</td>
<td>2,054</td>
<td>1,850</td>
<td>1,916</td>
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<tr>
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<td>77</td>
<td>78</td>
<td>68</td>
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<td>Slov. lodenice</td>
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<td>937</td>
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<td>1,614</td>
<td>2,315</td>
<td>2,942</td>
<td>2,687</td>
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<tr>
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<td>125</td>
<td>149</td>
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<td></td>
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<tr>
<td>sector idx (DM)</td>
<td>– 100</td>
<td>69</td>
<td>57</td>
<td>61</td>
<td>98</td>
<td>122</td>
<td></td>
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<tr>
<td>VSZ</td>
<td>– – 27,364</td>
<td>25,519</td>
<td>39,782</td>
<td>49,792</td>
<td>48,828</td>
<td></td>
<td></td>
</tr>
<tr>
<td>index, 1992=100</td>
<td>– – 100</td>
<td>89</td>
<td>128</td>
<td>140</td>
<td>131</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sector idx (DJ)</td>
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<td>100</td>
<td>98</td>
<td>105</td>
<td>114</td>
<td>102</td>
<td></td>
</tr>
<tr>
<td>ZVL Auto/Bearings</td>
<td>550</td>
<td>554</td>
<td>370</td>
<td>252</td>
<td>226</td>
<td>369</td>
<td>429</td>
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<tr>
<td>index</td>
<td>163</td>
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<td>61</td>
<td>37</td>
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<tr>
<td>sector idx (DJ)</td>
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<td>90</td>
<td>88</td>
<td>95</td>
<td>103</td>
<td>92</td>
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</table>

Sources: Statistická Rocenka SR (various issues); Annual Reports; The Factbook 1993; Moserová (1995) [interview]; Fabinský (1995) [interview]; Hospodarske Noviny, 29 March 1996 [reg. ABB Stotz]; Pekár (1995) [interview]; data communicated directly from firms; TREND Tyzdník o hospodářství a podnikání, Top-100 1996 (1997); TREND Tyzdník o hospodářství a podnikání, Top-100 1995 (1996); own computations.

Note: 
1 Recalculated to 1996 fixed prices. 2 Bratislava plant only. 3 Combined sales for ZVL Bearings (1990-1995) and ZVL Auto (1993-1996). 4 Figures and firm index reflect operating revenue/income. 5 Sources: Statistická Rocenka SR (various issues); Annual Reports; The Factbook 1993; Moserová (1995) [interview]; Fabinský (1995) [interview]; Hospodarske Noviny, 29 March 1996 [reg. ABB Stotz]; Pekár (1995) [interview]; data communicated directly from firms; TREND Tyzdník o hospodářství a podnikání, Top-100 1996 (1997); TREND Tyzdník o hospodářství a podnikání, Top-100 1995 (1996); own computations.

Comment: Sector averages are based on industrial sales in industrial enterprises with 25 or more employees in 1996 prices; for a discussion of problems in connection to the creation of the time series, see discussion in comment to TABLE 7 (p. 324) in Appendix D. The table is incomplete since some of the participating case study firms failed to provide coherent production data following changes in management (ZPA Krížik and ZTS Sabinov), while others later were reluctant to update firm level data due to similar reasons. Regarding VSZ, accounting changes make figures for 1990-1991 non-comparable with the 1992-1996 period.

Notes: 
1 Recalculated to 1996 fixed prices. 2 Bratislava plant only. 3 Combined sales for ZVL Bearings (1990-1995) and ZVL Auto (1993-1996). 4 Figures and firm index reflect operating revenue/income. 5 Sources: Statistická Rocenka SR (various issues); Annual Reports; The Factbook 1993; Moserová (1995) [interview]; Fabinský (1995) [interview]; Hospodarske Noviny, 29 March 1996 [reg. ABB Stotz]; Pekár (1995) [interview]; data communicated directly from firms; TREND Tyzdník o hospodářství a podnikání, Top-100 1996 (1997); TREND Tyzdník o hospodářství a podnikání, Top-100 1995 (1996); own computations.

Comment: Sector averages are based on industrial sales in industrial enterprises with 25 or more employees in 1996 prices; for a discussion of problems in connection to the creation of the time series, see discussion in comment to TABLE 7 (p. 324) in Appendix D. The table is incomplete since some of the participating case study firms failed to provide coherent production data following changes in management (ZPA Krížik and ZTS Sabinov), while others later were reluctant to update firm level data due to similar reasons. Regarding VSZ, accounting changes make figures for 1990-1991 non-comparable with the 1992-1996 period.

Notes: 
1 Recalculated to 1996 fixed prices. 2 Bratislava plant only. 3 Combined sales for ZVL Bearings (1990-1995) and ZVL Auto (1993-1996). 4 Figures and firm index reflect operating revenue/income.

6 TREND Tyzdník o hospodářství a podnikání, No. 1, 1996.
production had been more or less discontinued in all three, with or without the assistance of the state.\textsuperscript{7}

Another sector which was hard hit by economic transformation was consumer goods. For such producers, communism had provided an advantage in that general shortages in combination with a reluctance to spend the country’s hard currency earnings on imports of goods produced domestically, secured a demand for the products, were they at least functional. Liberalisation of trade therefore constituted a serious blow for a producer like Cosmos (toothbrushes) where the attractive imported alternatives, although often more expensive, were still affordable to the general consumer. With little experience in design and advertising,\textsuperscript{8} inflexible production facilities etc., Cosmos was forced to reduce its production of toothbrushes from 12 (1989) to two (1995) million pieces. Ozeta (men’s clothes) is a firm which faced a similar situation, but which due to rapid reorientation of trade managed better than Cosmos.

* * *

In conclusion, the largest drop in industrial sales and output came in 1991. Contributing factors were the severe disruptions in the trade regime of the CMEA countries, declining domestic demand, falling military production etc. However, at the root of it was the changes in the institutional set-up which implied that firms were all of a sudden faced with a dependence on the market rather than the state as the budget constraints were considerably hardened. It took until 1994 before the decline was halted. However, even if the downturn was a general phenomenon there were large variations between sectors and firms – both with regard to the severity and duration of the decline and regarding the capacity for catching up.

Labour shedding and productivity

A typical early reactive measure of firms to the above discussed changes and shocks, which reliance on the market rather than the state implied, was to cut employment. Firstly, labour shedding was a natural response since there traditionally was an overstaffing problem with socialist firms with their soft budget constraints;\textsuperscript{9}

\begin{flushright}
Labour shedding and productivity
\end{flushright}

In the region as a whole industrial employment had by 1995 been reduced to 28 per

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\textsuperscript{7} Slovenské lodenice had by early 1993 completely discontinued its military production following assistance through two state-subsidised conversion programmes; military equipment thus turned into containers and frames for earth-moving machinery. Container production is undertaken in the company Contexto a.s. in Komarno, co-owned with VSZ and Martinex. ZTS Sabinov, on the other hand, where a substantial part of revenues used to originate from deliveries of special gearboxes for the domestic armaments industry, applied for one of the conversion programmes but was granted no state-support at all for restructuring according to Mr. Jancík. Hydronika, finally, did indeed receive a government bail-out, but one which was not dedicated to covering the costs for discontinuing military production (see footnote 4).

\textsuperscript{8} When during a interview asked whether Cosmos has its own design department, the General Director, Ms. Moserová, laughs and explains that they do it the ‘Slovak way’, i.e. they take some bottles of wine and draw throughout the night; the toothbrushes are thus examples of “home-designed-products”.

\textsuperscript{9} A key characteristic of many Eastern European economies was exactly its excessive share of industrial employment relative market economies on a similar level of development, see EBRD (1997), pp. 62-64. Even though the whole of the difference cannot be attributed to labour hoarding (older and more labour intensive technology is also a factor of importance), there should clearly be room for reducing industrial employment.
cent, compared to an average of 36 per cent before economic transformation began (1989-1990).\textsuperscript{10} In Slovakia similar developments meant a reduction from 33.1 per cent (1990) to 29.1 per cent (1996) of total employment. Industrial employment experienced a cumulative decline of 21.5 per cent between 1990 and 1996 (see TABLE D 2) as opposed to a corresponding decline of 10.7 per cent in total employment. From the point of view of management, labour shedding was also a quick way to reduce operating costs and to adjust capacity to actual demand. However, just as was the case with production cuts, there were significant differences both between sectors and firms, and also between the type of cuts made within firms.

In our sample of firms there were three which cut employment by more than 50 per cent between 1990 and 1995; three which reduced it in the range of 25-50 per cent and one with between 1-25 per cent (see TABLE D 2). At the other end of the line is found two firms (VSZ and ABB Stotz) where employment actually increased. The trend is nevertheless clear, with major cuts taking place early on (1991-1992) when there were cuts across the line in all cases except VSZ. After that, developments were more diverse with the poorly performing firms continuing to lay-off people and others either reducing the pace of lay-offs or even increasing employment. Interesting is that the vast part of labour shedding thus took place before new owners had been established, leaving incumbent managers responsible for much of this action. This points to (i) that there was a general overstaffing problem well known by managers, and (ii) that changes in the market environment and hardening budget constraints was enough to set off some kind of restructuring.

Among the firms which made the greatest cuts was Hydronika, a case which deserves some mentioning since much of the changes resulted from organisational restructuring. Already in 1991 some units were broken out of this group, thus reducing registered employment by 328 employees. Then in September 1992, following corporatisation, a production unit located in Dunajska Streda was sold, further reducing employment. However, even when discounting the effects of these organisational changes it is clear that substantial cuts were made. The 1,100 employed in Bratislava in 1991 had by end-1992 been reduced to a mere 390 persons (-65%), although employment was later raised (see TABLE D 2). Another case of great employment reductions is the eastern-Slovak bearings producer (ZVL) which reduced its staff with some 89 (!) per cent between 1990 and 1996.\textsuperscript{11} Also Cosmos, hard hit by trade liberalisation, cut total employment by close to 60 per cent. Among firms with more “normal” cuts in employment is found the shipbuilder Slovenské lodenie, which laid off 1,369 persons between 1990 and 1995; also here, however, the majority of lay-offs was in the early period 1990-1992 when more than 85 per cent of total cuts took place.

Although the structure of lay-offs differed among firms, it does indeed seem that the potential for lay-offs in general was greater among white- than blue-collar workers. In ZVL, for example, the reductions made between 1992 and 1995 were to two-thirds made up from white collar workers of whom 400 were laid off. The share of white-collar workers decreased also at ZTS Sabinov, falling from 35 to ap-

\textsuperscript{10} EBRD (1997), p. 63.
\textsuperscript{11} The figures given for ZVL refers to total employment in ZVL Bearings and the start-up company ZVL Auto, on the organisational changes within ZVL, see Chapter VI:3.1.
### TABLE D 2. Industrial employment 1990-1996 (average no. of employees & index, 1991=100 unless otherwise noted)

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<tbody>
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<td>Industry (total)</td>
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<td>111</td>
<td>100</td>
<td>93</td>
<td>88</td>
<td>86</td>
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<tr>
<td>Industry (&gt;24 empl)</td>
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<td>76</td>
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<tr>
<td>Manufacturing (&gt;24 empl)</td>
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<td>–</td>
<td>100</td>
<td>87</td>
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<td>74</td>
<td>75</td>
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<tr>
<td>ABB Stotz</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>60</td>
<td>75</td>
<td>83</td>
<td>100</td>
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<td>index, 1993=100</td>
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<td>125</td>
<td>138</td>
<td>167</td>
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<tr>
<td>sector idx (DL)</td>
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<td>152</td>
<td>122</td>
<td>100</td>
<td>89</td>
<td>93</td>
<td>93</td>
</tr>
<tr>
<td>Cosmos</td>
<td>-58%</td>
<td>240</td>
<td>182</td>
<td>.</td>
<td>.</td>
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<tr>
<td>index</td>
<td>-58%</td>
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</tr>
<tr>
<td>sector idx (DN)</td>
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<td>100</td>
<td>93</td>
<td>82</td>
<td>73</td>
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</tr>
<tr>
<td>Hydronika</td>
<td>-64%</td>
<td>1,350</td>
<td>1,099</td>
<td>390</td>
<td>468</td>
<td>420</td>
<td>480</td>
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</tr>
<tr>
<td>index</td>
<td>-64%</td>
<td>123</td>
<td>100</td>
<td>35</td>
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<td>59</td>
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<tr>
<td>Ozeta</td>
<td>-8%</td>
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<td>6,045</td>
<td>.</td>
<td>5,809</td>
<td>5,929</td>
<td>5,976</td>
<td>5,767</td>
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<tr>
<td>index</td>
<td>-8%</td>
<td>108</td>
<td>100</td>
<td>.</td>
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<td>98</td>
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<td>95</td>
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<tr>
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<td>91</td>
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<td>84</td>
<td>83</td>
<td>80</td>
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<td>Slovenske lodenice</td>
<td>-32%</td>
<td>4,319</td>
<td>3,704</td>
<td>3,135</td>
<td>2,813</td>
<td>2,750</td>
<td>2,950</td>
<td>2,773</td>
</tr>
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<td>-32%</td>
<td>117</td>
<td>100</td>
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<td>84</td>
<td>71</td>
<td>66</td>
<td>67</td>
<td>70</td>
</tr>
<tr>
<td>VSZ</td>
<td>-3%</td>
<td>26,057</td>
<td>24,601</td>
<td>27,290</td>
<td>25,624</td>
<td>25,242</td>
<td>25,283</td>
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</tr>
<tr>
<td>index</td>
<td>-3%</td>
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<td>100</td>
<td>111</td>
<td>104</td>
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<td>93</td>
<td>94</td>
<td>98</td>
<td>102</td>
</tr>
<tr>
<td>ZPA Križik</td>
<td>-38%</td>
<td>4,000</td>
<td>.</td>
<td>.</td>
<td>.</td>
<td>2,500</td>
<td>.</td>
<td></td>
</tr>
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<td>-38%</td>
<td>.</td>
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<td>63</td>
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<tr>
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<td>–</td>
<td>100</td>
<td>80</td>
<td>66</td>
<td>58</td>
<td>61</td>
<td>61</td>
</tr>
<tr>
<td>ZTS Sabínov</td>
<td>-43%</td>
<td>800</td>
<td>787</td>
<td>.</td>
<td>.</td>
<td>.</td>
<td>460</td>
<td>.</td>
</tr>
<tr>
<td>index</td>
<td>-43%</td>
<td>102</td>
<td>100</td>
<td>.</td>
<td>.</td>
<td>.</td>
<td>58</td>
<td>.</td>
</tr>
<tr>
<td>sector idx (DK)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>82</td>
<td>65</td>
<td>59</td>
<td>58</td>
<td>56</td>
</tr>
<tr>
<td>ZVL Auto/Bearings</td>
<td>-80%</td>
<td>2,141</td>
<td>1,970</td>
<td>1,373</td>
<td>855</td>
<td>799</td>
<td>424</td>
<td>242</td>
</tr>
<tr>
<td>index</td>
<td>-80%</td>
<td>109</td>
<td>100</td>
<td>70</td>
<td>43</td>
<td>41</td>
<td>22</td>
<td>12</td>
</tr>
<tr>
<td>sector idx (DJ)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>90</td>
<td>93</td>
<td>94</td>
<td>98</td>
<td>102</td>
</tr>
<tr>
<td>Average case-sample</td>
<td>-43%</td>
<td>114</td>
<td>100</td>
<td>75</td>
<td>72</td>
<td>71</td>
<td>65</td>
<td>54</td>
</tr>
</tbody>
</table>

**Sources:** Statistická Rocenka SR (1992-1997); Annual Reports; interviews; Plánovsky (1993), p. 10 [on VSZ in 1990]; own computations.

**Comment:** The reason for using 1991 as a base-year is that NACE categorised figures for industrial employment have only been calculated since 1991. Regarding VSZ, organisational changes make figures for 1996 non-comparable with the 1990-1995 period.

**Notes:** 1 Including estimates for small enterprises and private firms. 2 Industrial enterprises w. 25 or more employees. 3 In the absence of reported employment for 1990 the figure used is the one given for 1989. 4 Bratislava plant only; 1990 figure is approximation. 5 Combined employment for ZVL Bearings (1990-1995) and ZVL Auto (1993-1996). 6 Refers to 1991/1995 – and firm is not included in the average.

Approximately 25-30 per cent. Also at Ozeta, where lay-offs in general were minimised due to its relatively positive development, the cuts done have mainly affected white collar workers with the number of blue-collar workers remaining about the same between 1990 and 1995, i.e. slightly more than 4,000. The only case where lay-offs among blue-collar workers dominated was VSZ, in the rest of the firms cuts were made pretty equally across the line.13

---

13 However, it should be noted that total employment at VSZ actually increased between 1990 and 1995, and the minor reductions which took place were referred to technological improvements in the produc-
In some cases, the reductions in employment were accompanied by some interesting, more progressive policies, such as further education and re-training. At ZPA Krizik, for example, the general reductions led to a higher level of competence as the number of trained engineers increased while lower positions in production were cut back. Also, after 1991/1992 many engineers received further training in sales and foreign languages in order to fill the gap with respect to salesmen. Similarly, at Slovenské lodenice the harsh cuts in 1990-1992 were accompanied by a significant increase in R&D-staff, which went up 17 per cent in the corresponding period. This urge to increase the competence of remaining employees actually made staffing somewhat of a problem at for example Ozeta which had problems finding qualified staff, forcing them at times to take on unqualified staff. Thus, the high unemployment in the country as a whole is not simply problem of a shortage of demand for labour, but also one of mismatches as restructuring is moving on.

* * *

The implications of changes for labour productivity are illustrated in TABLE D 3. Although there was a general increase in industrial labour productivity there are noticeable differences which deserve some commenting. As can be seen in the table the major increase has been with minor firms, i.e. those with less than 25 employees. Interesting is also that of the case study firms for which data is available it was only one (Hydronika) that underperformed its sector. Noticeable is also the drastic increase in productivity at the joint-venture ABB Stotz. A caveat with the statistics is that the figures to some extent reflect the organisational restructuring in that firms have sold off auxiliary plants and other “extraordinary” activities. Nevertheless it stands clear that some improvements were made during the period of study, although the large cuts in employment have not resulted in the large gains in labour productivity that could have been hoped for – with labour productivity in 1995 at approximately the same level as in 1990. However, as illustrated, there were major differences between firms and sectors also in this respect.

---

13 Firms where this was the case included Slovenské lodenice, ZPA Krizik and Cosmos, although in the latter case there was even a slight dominance of cuts among blue-collar workers (-60% versus -52%).

14 The problems at Ozeta are related to the changes in the system of apprentice schools. Until 1992 the apprentice schools, from which the company primarily recruited, were part of the company which then organised and provided the practice for the students. After 1992 the whole curriculum and practice-period was made the responsibility of the state. The change meant an increase in the theoretical subjects, to the detriment of the amount of practice provided; a situation which management was not too happy about. A second problem regarding staffing at Ozeta, was the high frequency of maternity leaves. The CFO, Mr. Briestensky, said that 84 per cent (1995) of the workers were woman, and each year some 1,300 (!) were on maternity leave.
Trade reorientation

Another aspect of what was defined as reactive restructuring is the re-orientation of trade. The term “reactive” should, however, not be taken as negative. The forced trade reorientation may bring with it many long-term beneficial effects as it contributes new influences, learning by imitation and contacts. Contacts which in turn may provide access to new technologies through licensing etc. Rather, the implication of “reactive” is only to point to the causes of the changes. Trade liberalisation in 1991, in conjunction with the collapse of CMEA trade and the formerly so dominant Soviet market, meant that firms were forced to find new markets for their pro-

### TABLE D 3. Industrial labour productivity 1990-1996 (Sk & index, 1991=100, unless otherwise noted)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry (+24 empl)</td>
<td>0.1%</td>
<td>111</td>
<td>100</td>
<td>98</td>
<td>100</td>
<td>107</td>
<td>111</td>
<td>114</td>
</tr>
<tr>
<td>Manufacturing (+24 empl)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>98</td>
<td>89</td>
<td>92</td>
<td>103</td>
<td>106</td>
</tr>
<tr>
<td>ABB Stotz</td>
<td>159%</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>65,838</td>
<td>75,386</td>
<td>170,660</td>
</tr>
<tr>
<td>index, 1993=100</td>
<td>159%</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>115</td>
<td>259</td>
<td>228</td>
</tr>
<tr>
<td>sector idx (DL)</td>
<td>–</td>
<td>–</td>
<td>96</td>
<td>92</td>
<td>100</td>
<td>109</td>
<td>116</td>
<td>134</td>
</tr>
<tr>
<td>Cosmos</td>
<td>–</td>
<td>35,198</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>index</td>
<td>–</td>
<td>100</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>sector idx (DN)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>102</td>
<td>98</td>
<td>102</td>
<td>121</td>
<td>137</td>
</tr>
<tr>
<td>Hydronika</td>
<td>-45%</td>
<td>67,733</td>
<td>98,079</td>
<td>59,950</td>
<td>28,544</td>
<td>37,588</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>index</td>
<td>-45%</td>
<td>69</td>
<td>100</td>
<td>61</td>
<td>29</td>
<td>38</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>sector idx (DK)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>80</td>
<td>76</td>
<td>71</td>
<td>87</td>
<td>96</td>
</tr>
<tr>
<td>Ozeta</td>
<td>-34%</td>
<td>41,853</td>
<td>32,701</td>
<td>–</td>
<td>36,636</td>
<td>35,958</td>
<td>27,710</td>
<td>27,686</td>
</tr>
<tr>
<td>index</td>
<td>-34%</td>
<td>128</td>
<td>100</td>
<td>–</td>
<td>112</td>
<td>110</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td>sector idx (DB)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>100</td>
<td>88</td>
<td>82</td>
<td>77</td>
<td>77</td>
</tr>
<tr>
<td>Slovenske lodenice</td>
<td>134%</td>
<td>34,841</td>
<td>38,566</td>
<td>51,287</td>
<td>63,244</td>
<td>77,631</td>
<td>81,400</td>
<td>80,749</td>
</tr>
<tr>
<td>index</td>
<td>134%</td>
<td>90</td>
<td>100</td>
<td>133</td>
<td>164</td>
<td>201</td>
<td>211</td>
<td>209</td>
</tr>
<tr>
<td>sector idx (DM)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>84</td>
<td>82</td>
<td>97</td>
<td>142</td>
<td>176</td>
</tr>
<tr>
<td>VSZ</td>
<td>51%</td>
<td>–</td>
<td>–</td>
<td>113,842</td>
<td>108,421</td>
<td>157,085</td>
<td>171,718</td>
<td>–</td>
</tr>
<tr>
<td>index, 1992=100</td>
<td>51%</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>95</td>
<td>138</td>
<td>151</td>
<td>–</td>
</tr>
<tr>
<td>sector idx (DJ)</td>
<td>–</td>
<td>–</td>
<td>96</td>
<td>100</td>
<td>92</td>
<td>97</td>
<td>101</td>
<td>89</td>
</tr>
<tr>
<td>ZVL Auto/Bearings</td>
<td>140%</td>
<td>48,541</td>
<td>40,159</td>
<td>30,567</td>
<td>31,424</td>
<td>46,414</td>
<td>116,616</td>
<td>234,160</td>
</tr>
<tr>
<td>index</td>
<td>140%</td>
<td>121</td>
<td>100</td>
<td>76</td>
<td>78</td>
<td>116</td>
<td>290</td>
<td>583</td>
</tr>
<tr>
<td>sector idx (DJ)</td>
<td>–</td>
<td>–</td>
<td>100</td>
<td>105</td>
<td>97</td>
<td>101</td>
<td>105</td>
<td>93</td>
</tr>
</tbody>
</table>

Sources: Statisticka Rocenka SR (1992-1997); Annual Reports; interviews; own computations.
Notes: 1 Including estimates for small enterprises and private firms. 2 Industrial enterprises w. 25 or more employees. 3 Refers to 1993/1995 period. 4 Bratislava plant only. 5 Refers to 1990/1994 period. 6 Refers to 1992/1995 period. 7 Productivity measure based on combined operating income for ZVL Bearings (1990-1995) and ZVL Auto (1993-1996).
Comment: Labour productivity is calculated as monthly production/output per employee in 1996 prices; for ABB Stotz and Hydronika turnover has been used, for Cosmos total revenue, for Ozeta and Slovenske lodenice operating income, and for VSZ, finally, sales has been used. Sector averages refer to industrial enterprises with 25 or more employees. The table is incomplete since ZPA Krizik and ZTS Sabinov failed to provide coherent production data following changes in management. Regarding VSZ, organisational and accounting changes make figures for 1990-1991 and 1996 non-comparable with the 1992-1995 period.
duce were they to survive. This holds especially true since Slovakia indeed can be characterised as a small open economy (see TABLE D 4). The EBRD in their 1997 Transition Report concluded that:

‘[w]hile available evidence suggests that openness to trade is significantly and positively related to enterprise performance, indicators of openness reveal that, despite significant increases in trade, transition economies remain less open than industrialised market economies’.15

While there is nothing in this study that defies the first part of the above conclusion, i.e. that liberalisation of foreign trade has contributed greatly to industrial restructuring, the latter part does not hold in the case of Slovakia. In fact, Slovakia developed into one of the most open economies in the whole of the region with foreign trade turnover equalling 106 per cent of GDP in 1996. In comparison with the other Visegrad countries this is a remarkable figure and also much higher than, for example, Sweden.

At the outset of reform the majority of exports were targeted at the CMEA market, and then primarily to the Soviet Union. Foreign trade was, in the majority of cases, conducted through centralised sales organisations, not seldom with their headquarters in Prague; leaving the producing firms with little direct contacts and/or experience with their customers. For Ozeta, for example, the situation until 1991 was that all foreign trade in textiles to and from CSFR was organised by the foreign trade monopoly Centrotex in Prague.16 The abolishment of this institutional set-up took many firms by surprise. The shock, however, was not only limited to finding and establishing new channels for foreign trade. At approximately the same time, much of the CMEA market collapsed and especially the Soviet customers

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Slovak Republic</td>
<td>41</td>
<td>67</td>
<td>66</td>
<td>101</td>
<td>97</td>
<td>101</td>
<td>106</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>58</td>
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<td>64</td>
<td>76</td>
<td>73</td>
<td>99</td>
<td>87</td>
</tr>
<tr>
<td>Hungary</td>
<td>55</td>
<td>54</td>
<td>50</td>
<td>45</td>
<td>64</td>
<td>65</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>31</td>
<td>33</td>
<td>33</td>
<td>34</td>
<td>38</td>
<td>40</td>
<td>42</td>
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<td>Sweden</td>
<td>48</td>
<td>44</td>
<td>43</td>
<td>50</td>
<td>56</td>
<td>63</td>
<td>61</td>
</tr>
</tbody>
</table>


Comment: Note that foreign trade turnover before 1993 is excluding trade in CSFR.

Notes: 1 Data on a customs basis since 1991. 2 From 1995 new methodology with new reporting system; for the above figures implying an increase of 24.7 and 23 percentage points for turnover in 1995 including and excluding SR, respectively. 3 Balance of payments data (includes trade to and from free-export zones); customs data show considerably higher trade growth in 1994, but lower growth in 1995-1996. 4 Balance of payments data on a settlement basis, show slight (app. 20%) underrepresentation of imports in 1994-1996 compared to customs questionnaires.

16 The majority of firms were as of 1991 forced to handle their own sales and setting up sales departments etc., although some chose to continue to use what was left of the old channels. ZVL, for example, continued to use their old centralised sales organisation in the 1990-1993 period.
were to a large extent unable to pay for deliveries planned or done. The hydraulic-cylinders producer Hydronika, where exports to the Soviet Union made up some 60 per cent of total production prior to 1989, was badly struck and had as of 1992 terminated all exports to the region, thus reducing total exports from Sk 315 million ($10.7 mn) in 1991 to a mere Sk 20 million ($0.7 mn) in 1992. As if these two major changes in the business environment were not enough, the split of Czechoslovakia put new burdens on firms as it soon meant that also this trade had to be conducted in foreign currency.

Given these problems, it is remarkable how fast many of the firms adapted to the new rules of the game. As can be seen in TABLE D 5, many had quickly regained quite respectable levels of exports; and, in some cases, even surpassed their old levels. In a few cases the high relative share of exports is of course connected to a general decline in production; and in others, like for the shipbuilder Slovenské lodnice, it is a consequence of the fact that there existed no domestic market at all. Of the total revenue of Slovenské lodnice only some 0.5-1 per cent originated from

---

TABLE D 5. Exports as a per cent of total sales, 1990-1996

<table>
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<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing, total</td>
<td>-</td>
<td>31</td>
<td>37</td>
<td>43</td>
<td>47</td>
<td>49</td>
<td>44</td>
</tr>
<tr>
<td>Hydronika (incl. CR-exports)</td>
<td>-</td>
<td>.</td>
<td>.</td>
<td>42</td>
<td>44</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Hydronika (exc. CR-exports)</td>
<td>-</td>
<td>40</td>
<td>17</td>
<td>12</td>
<td>11</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Ozeta (incl. CR-exports)</td>
<td>-</td>
<td>41</td>
<td>33</td>
<td>49</td>
<td>44</td>
<td>43</td>
<td>41</td>
</tr>
<tr>
<td>Ozeta (exc. CR-exports)</td>
<td>-</td>
<td>47</td>
<td>53</td>
<td>55</td>
<td>54</td>
<td>57</td>
<td>56</td>
</tr>
<tr>
<td>Slovenske lodnice (incl. CR-exports)</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Slovenske lodnice (excel. CR-exports)</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>VSZ (incl. CR-exports)</td>
<td>-</td>
<td>84</td>
<td>79</td>
<td>55</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VSZ (exc. CR-exports)</td>
<td>-</td>
<td>86</td>
<td>63</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZTS Sabinov (incl. CR-exports)</td>
<td>-</td>
<td>59</td>
<td>67</td>
<td>69</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZTS Sabinov (excel. CR-exports)</td>
<td>-</td>
<td>12</td>
<td>18</td>
<td>43</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZVL Auto/Bearings (incl. CR-exports)</td>
<td>-</td>
<td>61</td>
<td>83</td>
<td>92</td>
<td>86</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZVL Auto/Bearings (exc. CR-exports)</td>
<td>-</td>
<td>20</td>
<td>21</td>
<td>33</td>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sector average (DK)</td>
<td>-</td>
<td>49</td>
<td>60</td>
<td>68</td>
<td>67</td>
<td>65</td>
<td>40</td>
</tr>
</tbody>
</table>


Notes: 
1 Figures 1990-1992 excludes exports to the Czech Republic, 1993-1996 includes exports to the Czech Republic; data based on industrial firms with 25 and more employees. 
2 Per cent of ship production exported. 
3 Estimate based on physical volume sold.

Comment: Only in 1992 did the Slovak Statistical Office adopt NACE classification for reporting industrial sales (later retroactively calculated to include also 1991) – thus 1990 figures are missing.

---

17 For Hydronika, matters worsened in 1993 and 1994 with total exports of only Sk 13 and 16 million ($423,200 and $499,200), respectively. This meant that the export share of total sales was reduced from
the Slovak market. In many cases, however, the quick recoupement of markets is a consequence of ambitious and well thought through sales offensives. It however deserves to be mentioned that the case study sample may not be considered representative in this sense, having four firms among the top-80 exporters (as per cent of total sales) in 1996; VSZ (1), Slovenske lodenice (16), Ozeta (21), and ZVL as number 80.18

As the old export-customers in many cases suffered from the “disadvantage” of not being able to pay their bills, increasing exports meant that one had to find new markets (TABLE D 6). Two success stories in this respect is Slovenske lodenice and Ozeta. At the shipbuilder in Komarno, which traditionally sold approximately 90 per cent of its output to the former Soviet Union, and thus was in dire straits, a re-orientation of production with new ships and improved quality, combined with a successful sales offensive actually brought life back to the company. The one market which rose to prominence was the German market which, following a cooperation with the German firm Wessels, grew to account for 74 per cent of exports by as early as 1992.19 The German market later slightly decreased in importance as a consequence of the somewhat improved payments situation on the eastern markets in combination with a determination of keeping the connections to these potentially lucrative markets.20 Also the men’s-clothes producer Ozeta made a re-

### TABLE D 6. “Western” trade reorientation (per cent of total sales/exports)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovakia</td>
<td>52.8</td>
<td>52.5</td>
<td>65.9</td>
<td>66.2</td>
<td>70.9</td>
<td>69.9</td>
<td>71.5</td>
</tr>
<tr>
<td>Hydronika</td>
<td>0.9</td>
<td>16</td>
<td>7</td>
<td>9</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Ozeta</td>
<td>21.0</td>
<td>62.2</td>
<td>66.5</td>
<td>75.1</td>
<td>78.5</td>
<td>82.6</td>
<td>80.1</td>
</tr>
<tr>
<td>Slovenske lodenice</td>
<td>0</td>
<td>74</td>
<td>65</td>
<td>79.3</td>
<td>70</td>
<td>75.1</td>
<td></td>
</tr>
<tr>
<td>ZVL</td>
<td>2</td>
<td>17</td>
<td>19</td>
<td>31</td>
<td>47</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>ZTS Sabinov</td>
<td>.</td>
<td>.</td>
<td>3</td>
<td>10.3</td>
<td>17.1</td>
<td>38.9</td>
<td>.</td>
</tr>
<tr>
<td>VSZ</td>
<td>.</td>
<td>.</td>
<td>.</td>
<td>55</td>
<td>49</td>
<td>.</td>
<td>.</td>
</tr>
</tbody>
</table>

**Sources:** Statistická Rocenka SR (1992-1997); Zahranicny obchod Slovenskej (1993-1997); Annual Reports; data communicated directly from firms; Slovak News Agency-TASR, 12 June 1996 [reg. Slovenske lodenice in 1996]; own computations.

**Notes:** 1 Figure is estimate. 2 Total figures for ZVL Bearings and ZVL Auto. 3 Estimate based on the number of ships sold. 4 Estimates based on physical volumes sold. 5 Calculated as per cent of total exports (excluding Czech Republic) destined to non-CMEA (former) countries (in statistical publications thus excluding “planned and transition economies”).

**Comment:** “Western” exports have been defined as to include all exports to non-CMEA (former) countries, i.e. to include also sales to the American continent, Asia etc. Detailed data has generally been difficult to access, not least because some firms did not manage their own exports in the early 1990s.
markable reorientation of trade compared to 1990 when only one-fifth of total production was destined to western Europe; by 1995 this share had been raised to 82.6 per cent. Other good exporters includes ZVL, ZPA Krzik and VSZ. Among those that have not done too well we find Cosmos, Hydronika and ZTS Sabinov. The former had virtually no direct trade contacts prior to 1990 and did not manage to improve the situation after that. Hydronika did not manage to find new markets either, and exports continued to dwindle both in 1993 and 1994. ZTS Sabinov mainly produced for the Czech Republic and Slovakia, with minor shares sold to Germany and Poland. In all three cases, much of the explanation for the faltering export performance rests with an inability to modernise production.

For most companies, the western European markets were the natural target for their export drives. However, some of them, like ZPA Krzik, ZVL Auto and Slovenské lodenice, made attempts to penetrate markets further away from home than that. ZPA Krzik did as part of their offensive create a number of ventures abroad (Russia, Equador and Malaysia) and also managed to break in on South American markets like the Argentine. The bearings-producer ZVL complemented their main customers VW/Skoda (Czech Republic), John Deer (Germany), SAMI (Italy) and Mlada Boleslav (Slovakia) with strong offensives in South America where Argentine and Brazil emerged as important markets. Also, Slovenské lodenice attempted to break out of Europe, contemplating a joint-venture project in Vietnam for the production of cargo ships.

* * *

In conclusion, this section pointed to the area where Slovak industry perhaps was the most successful in terms of restructuring, i.e. in the reorientation of trade. It was shown that Slovakia is a very open economy, and that industry as whole managed to quickly find (new) export markets for their produce as domestic demand plummeted. Exports as a per cent of total sales also increased during the period of study, although with 1996 showing a decline (as was discussed in Chapter III). An important point is that Slovakia was a very export dependent economy already at the outset of reforms, making the firms very vulnerable to the collapse of the CMEA trade and putting a lot of pressure on them to quickly find new (western) markets. It also seems that the firms which managed to do this are the ones that fared the best in general, ZVL and Slovenské lodenice are prominent examples.

21 Although declaring to target the western markets, the general impression is that the offensive is somewhat half-heartedly done; in a long-run perspective management questioned their ability to make western Europe a stronghold and would rather prefer to re-establish themselves on the Russian market.
22 Krzik-MZEP Moskva was set up in mid-1995 in Moscow for the production of electricity meters. In Equador an assembly plant for electricity meters was established, and in Malaysia water-meter production was to begin. Plans were also (1995) to establish co-operation with firms in Turkey and Germany (AEG). Further, the company was involved in a big Syrian project with technical support. All of the mentioned companies were created by ZPA Krzik Holding a.s. (see Chapter VI:3.1).
Economic and financial indicators

To assess firm performance three different measures were used, all of which deserve some mentioning. Firstly, firm profitability was measured as return on capital (ROC). This was calculated as pre-tax profit divided by the registered capital.\(^{23}\) A reasonable standard of comparison for ROC could be the consumer price index or the nominal interest rate, for example on state-bonds. Secondly, to get an idea of the ability for self-financing, and thus their possible long-term vulnerability, their solidity (SOL) was calculated as their registered capital divided by total assets. A very rough benchmark for assessing the solidity could be to say that indicators in excess of 50 per cent are good. Thirdly, short-run payment ability was assessed by the firms liquidity (LIQ), calculated as short-term receivables and financial assets divided by their respective short-term liabilities. A similar rough benchmark for this measure could be 100 per cent; figures above indicate that short-term assets are greater than short-term liabilities.

Before discussing these indicators as shown in TABLE D 7 there are a number of caveats regarding the data which need mentioning. First of all, the data used is that reported by firms to the RM-S and included in their database, not the figures derived during the case studies and from annual reports. Reporting standards in Slovakia have generally been poor, leaving room for potential errors in the database. In addition, profit and loss for firms are generally calculated using historical cost accounting, thus making for example ROC an uncertain measure.\(^{24}\) Furthermore, there are in general great difficulties in giving a proper evaluation of the assets of firms in transforming economies; secondary markets are in many cases lacking and/or underdeveloped. It should also be remembered that the database only includes firms traded on the RM-S, a fact which introduces a selection bias making it improper to use the results as an indicator of the situation among firms in general in Slovakia as many successful firms are start-ups and/or non-publicly traded companies. Moreover, given changes in reporting standards only figures for the 1993-1996 are comparable and thus reported, thus reducing the time-period of the study and making it difficult to speak about trends. Finally, it should be remembered that both solidity and liquidity are figures which may be quite individual to firms. The reason for using these figures, despite their problems, is that they allow for comparison with the two larger samples of firms used throughout (Sample-of-56 and Top-60) as well as with sector averages.\(^{25}\) However, the results should nevertheless be treated with caution.

Even though caution is needed when interpreting the results in TABLE D 7 there are some inferences to be made. Regarding profitability (ROC), the case study firms can be divided into two groups, one with a clearly negative trend (e.g. Cosm-

\(^{23}\) Pre-tax profit is calculated by adding operating profit, income from securities sales and deposits, dividends and interest earned from deposits, and financial operations profit. The reason for omitting the result from extraordinary activities is that they say little about the firm as an on-going venture, as such profits/losses could be the result of either asset stripping or divestiture of unwanted assets.


\(^{25}\) Sector averages are computed on the basis of the same data, and thus the discussed caveats apply also to these figures.
### TABLE D 7. Key financial indicators of firms, 1993-1996 (all figures in per cent, exc. standard deviation)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ROC</td>
<td>SOL</td>
<td>LIQ</td>
<td>ROC</td>
<td>SOL</td>
</tr>
<tr>
<td>Cosmos</td>
<td>6</td>
<td>74</td>
<td>105</td>
<td>-5</td>
<td>72</td>
</tr>
<tr>
<td>DN avg.</td>
<td>-1</td>
<td>63</td>
<td>131</td>
<td>-11</td>
<td>57</td>
</tr>
<tr>
<td>Std dev</td>
<td>0.10</td>
<td>0.12</td>
<td>1.00</td>
<td>0.21</td>
<td>0.13</td>
</tr>
<tr>
<td>N</td>
<td>8</td>
<td>8</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Hydronika</td>
<td>-13</td>
<td>49</td>
<td>13</td>
<td>-2</td>
<td>55</td>
</tr>
<tr>
<td>Std dev</td>
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<td>6.14</td>
<td>0.23</td>
<td>0.19</td>
</tr>
<tr>
<td>N</td>
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<td>34</td>
<td>40</td>
<td>40</td>
<td>41</td>
</tr>
<tr>
<td>DN avg.</td>
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<td>57</td>
<td>202</td>
<td>-13</td>
<td>55</td>
</tr>
<tr>
<td>Std dev</td>
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<td>0.15</td>
<td>0.47</td>
<td>0.68</td>
<td>0.22</td>
</tr>
<tr>
<td>N</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Slov. lod.</td>
<td>-28</td>
<td>26</td>
<td>27</td>
<td>32</td>
<td>77</td>
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<tr>
<td>Std dev</td>
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<td>0.64</td>
<td>0.11</td>
<td>0.13</td>
</tr>
<tr>
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<td>13</td>
<td>16</td>
<td>16</td>
<td>16</td>
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<tr>
<td>VSZ</td>
<td>12</td>
<td>73</td>
<td>284</td>
<td>13</td>
<td>76</td>
</tr>
<tr>
<td>Std dev</td>
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<td>0.14</td>
<td>1.90</td>
<td>1.02</td>
<td>0.20</td>
</tr>
<tr>
<td>N</td>
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<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>DJ avg.</td>
<td>-5</td>
<td>56</td>
<td>148</td>
<td>-30</td>
<td>54</td>
</tr>
<tr>
<td>Std dev</td>
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<td>0.16</td>
<td>6.14</td>
<td>0.23</td>
<td>0.19</td>
</tr>
<tr>
<td>N</td>
<td>34</td>
<td>34</td>
<td>40</td>
<td>40</td>
<td>41</td>
</tr>
<tr>
<td>ZVS Sabin.</td>
<td>-2</td>
<td>74</td>
<td>138</td>
<td>-3</td>
<td>75</td>
</tr>
<tr>
<td>Std dev</td>
<td>0.17</td>
<td>0.14</td>
<td>1.90</td>
<td>1.02</td>
<td>0.20</td>
</tr>
<tr>
<td>N</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>ZVL Bear.</td>
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<td>36</td>
<td>73</td>
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</tr>
<tr>
<td>Std dev</td>
<td>0.25</td>
<td>0.20</td>
<td>0.92</td>
<td>0.11</td>
<td>0.18</td>
</tr>
<tr>
<td>N</td>
<td>7</td>
<td>7</td>
<td>7</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Avg. C9</td>
<td>6</td>
<td>74</td>
<td>105</td>
<td>-5</td>
<td>72</td>
</tr>
<tr>
<td>Std dev</td>
<td>0.16</td>
<td>0.17</td>
<td>0.86</td>
<td>0.17</td>
<td>0.72</td>
</tr>
<tr>
<td>N</td>
<td>44</td>
<td>44</td>
<td>48</td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td>Avg. T60</td>
<td>14</td>
<td>58</td>
<td>241</td>
<td>24</td>
<td>54</td>
</tr>
<tr>
<td>Std dev</td>
<td>0.19</td>
<td>0.23</td>
<td>5.36</td>
<td>0.80</td>
<td>1.00</td>
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<tr>
<td>N</td>
<td>45</td>
<td>45</td>
<td>49</td>
<td>49</td>
<td>49</td>
</tr>
</tbody>
</table>

Sources: RM-S Database; own calculations

Comment: ZPA Krizik and ABB Stotz are limited liability companies (s.r.o.’s) and has thus not reported to RM-S and are as a consequence not included in the table; sector averages are based on two-digit NACE classification, the number of observations are given within parenthesis; the overall average (1993-1996) is calculated only from firms having reported throughout the period.

Abbreviations: ROC = Return on capital; SOL = Solidity; LIQ = Liquidity

os and Hydronika) which were major loss-makers almost throughout the period. Somewhat more surprisingly also Ozeta showed a negative trend, despite their remarkable liquidity.26 On the other hand there are two firms which managed to make

26 In their Annual Report we can see that financial losses rose to 94 per cent of the operating profit in 1995; this could either be a sign of mismanagement of its financial means – or, as a sign of restructuring
a turnaround during the period of study, ZTS Sabinov and above all Slovenské lodenice which in 1996 was the most profitable firm in the sample and way above the average for the Sample-of-56. The steel-mill VSZ remained in the middle-ground with mediocre and declining profitability, but at the time still in the black. As regards the statistical analysis it quite naturally showed a significantly higher profitability on average (ROC avg.) for the T60 sample than for the two other samples; although for none of the groups were there any significant change over time.27

Looking at the solidity, it must be stated that firms across the board are showing surprisingly good numbers, with only Slovenské lodenice significantly below the benchmark of 50 per cent. In addition, the spread is very low. Somewhat more surprisingly the solidity of the top-performers (T60) was in both 1994 and 1996 significantly lower than for the random Sample-of-56; in addition, both of these samples showed a significant deterioration of solidity in 1993-1996.28 However, as pointed to, a great deal of caution is needed when interpreting these figures, not least given the problems connected to evaluation of assets.

Liquidity, finally, remains on an acceptable level in the majority of firms, albeit with a high spread in all three samples. Once again the loss-making Hydronika stands out with extremely low figures in connection with the above discussed government bail-out. Somewhat more surprisingly also Slovenské lodenice suffers from low liquidity, which in their case partly may be explained by the fact that production of the costly ships is done on trade-credit and payment forthcoming only on delivery. However, again, without full access to company files it is difficult to make an assessment. VSZ on the other hand stands out as a firm with initially extremely high liquidity (1993-1994), money later invested in both firms and other ventures.29 On average (LIQ avg.) there were no significant differences between samples.30

Concluding remarks

To sum up, it seems that almost all firms experienced the same pattern of declining demand and production in the early years of economic transformation – likewise almost all firms responded with the type of reactive restructuring which we would expect if budget constraints had been hardened, i.e. cuts in production and consecutive lay-offs. In addition, all firms tried to reorient themselves towards the western markets, albeit with varying degrees of success.

The signs of more strategic restructuring however were not equally present in the case studies. Four of the firms however seemed to be on the right track, i.e. Ozeta, Slovenske lodenice, ZVL Auto/Bearings and the joint-venture of ABB Stotz. In all these cases management gave the impression of early on having adopted a “market-

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27 See Appendix D, TABLE 64 (average) and TABLE 65 (over time). Looking at differences in individual years, T60 had significantly higher ROC than both S56 and C9 in 1993, 1995 and 1996, see Appendix D, TABLE 60-TABLE 63.
28 See Appendix D, TABLE 60-TABLE 63 and TABLE 65.
29 VSZ has become an extremely diversified company, with interests in foreign steel-mills, soccer teams as well as the domestic banking sector.
30 See Appendix D, TABLE 60-TABLE 65.
oriented” way of thinking. In connection to this we may recall what was said in Chapter III about the responses to the reforms in 1966-1967, where Kyn for example concluded that ‘firms with well-educated and flexible managers did very well, attracted large demand, and substantially improved their income situation.’\textsuperscript{31} To some extent, these case studies indeed point in the same direction. The direct role of external owners in restructuring was however largely absent – with the exception of ZVL where the bank had a significant impact in the turnaround and restructuring of the whole company.

\textsuperscript{31} Kyn (1975), p. 119.
Appendix B. The strategic enterprises act

Below are listed those firms which in 1995, in accordance with the Act on safeguarding the state interests in the privatisation of strategically important state-owned companies and joint-stock companies (Act no. 175/1995), were completely exempted from privatisation (important enterprises) and those where the state planned to retain a say (strategic enterprises) through a “golden share”. In the tables are provided the name/sector of the enterprises, the number of enterprises and the estimated book value of enterprises.

### Important enterprises

<table>
<thead>
<tr>
<th>Enterprise/sector</th>
<th>Number</th>
<th>Book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas and energy</td>
<td>4</td>
<td>40,298</td>
</tr>
<tr>
<td>SPP, s.p.</td>
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<td>27,191</td>
</tr>
<tr>
<td>ZEZ, s.p.</td>
<td></td>
<td>5,961</td>
</tr>
<tr>
<td>SEZ, s.p.</td>
<td></td>
<td>5,074</td>
</tr>
<tr>
<td>VEZ, s.p.</td>
<td></td>
<td>2,072</td>
</tr>
<tr>
<td>Post and telecommunications</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>SP, s.p.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ST, s.p.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Armaments and general machinery</td>
<td>6</td>
<td>8,957</td>
</tr>
<tr>
<td>ZTS DV, s.p.</td>
<td></td>
<td>3,424</td>
</tr>
<tr>
<td>ZTS TEEES, s.p.</td>
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<td>3,455</td>
</tr>
<tr>
<td>ZVS, s.p.</td>
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</tr>
<tr>
<td>Konstrukta Defence, s.p.</td>
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<td>206</td>
</tr>
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<td>Konstrukta Industry, s.p.</td>
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<td>565</td>
</tr>
<tr>
<td>SM Kremnica, s.p.</td>
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</tr>
<tr>
<td>Pharmaceutical</td>
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<td>664</td>
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<tr>
<td>Medika, s.p.</td>
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<td>431</td>
</tr>
<tr>
<td>Imuna, s.p.</td>
<td></td>
<td>233</td>
</tr>
<tr>
<td>Agriculture, forest and water</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>12 enterprises</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Railway transport routes</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>42,726</td>
</tr>
<tr>
<td>Transpetrolu, a.s.</td>
<td></td>
<td>2,437</td>
</tr>
<tr>
<td>Slovenských elektrárni, s.p.</td>
<td></td>
<td>40,289</td>
</tr>
<tr>
<td>Total reported</td>
<td>29</td>
<td>92,645</td>
</tr>
<tr>
<td>Total estimate</td>
<td>29</td>
<td>105,000</td>
</tr>
</tbody>
</table>

**Source:** IMF (1995), Table V.2. (p. 60); own calculations

1 Data not readily available; estimates held that the book value of post- and telecom, agricultural enterprises, SM Kremnica and the railway transport routes was in excess of Sk 10 billion.

2 Including the estimate (Sk 10 bn) for enterprises with non-disclosed values (see note 1)
### Strategic enterprises

<table>
<thead>
<tr>
<th>Enterprise/sector</th>
<th>Number</th>
<th>Book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil processing, mining and metallurgy</td>
<td>5</td>
<td>26,979</td>
</tr>
<tr>
<td>Nafta Gbely, a.s.</td>
<td>3</td>
<td>3,231</td>
</tr>
<tr>
<td>Hormon, bane, s.p.</td>
<td></td>
<td>3,338</td>
</tr>
<tr>
<td>Bana Dolina, a.s.</td>
<td></td>
<td>536</td>
</tr>
<tr>
<td>VSZ, a.s.</td>
<td></td>
<td>16,448</td>
</tr>
<tr>
<td>ZSNP, a.s.</td>
<td></td>
<td>3,426</td>
</tr>
<tr>
<td>Processing of other raw materials</td>
<td>1</td>
<td>93</td>
</tr>
<tr>
<td>Solivary, a.s.</td>
<td></td>
<td>93</td>
</tr>
<tr>
<td>Machinery</td>
<td>4</td>
<td>6,942</td>
</tr>
<tr>
<td>Povazske strojcarne, a.s.</td>
<td></td>
<td>3,994</td>
</tr>
<tr>
<td>Calex Zlaté, a.s.</td>
<td></td>
<td>1,169</td>
</tr>
<tr>
<td>Podpolianske strojárne Delva, s.p.</td>
<td></td>
<td>1,368</td>
</tr>
<tr>
<td>ZTS Hrinovské, s.p.</td>
<td></td>
<td>411</td>
</tr>
<tr>
<td>Chemical and consumer industries</td>
<td>9</td>
<td>37,069</td>
</tr>
<tr>
<td>Slovnaft, a.s.</td>
<td></td>
<td>13,169</td>
</tr>
<tr>
<td>Benzinol, a.s.</td>
<td></td>
<td>2,547</td>
</tr>
<tr>
<td>Duslo, a.s.</td>
<td></td>
<td>4,307</td>
</tr>
<tr>
<td>Chemlon, a.s.</td>
<td></td>
<td>1,975</td>
</tr>
<tr>
<td>Istrochem, s.p.</td>
<td></td>
<td>6,043</td>
</tr>
<tr>
<td>NCHZ, a.s.</td>
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<td>1,595</td>
</tr>
<tr>
<td>Izornat, a.s.</td>
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<td>561</td>
</tr>
<tr>
<td>Severoslov. celulózky a papierne, s.p. (SCP)</td>
<td></td>
<td>5,424</td>
</tr>
<tr>
<td>Juhoslov. celulózky a papierne, a.s. (JCP)</td>
<td></td>
<td>1,448</td>
</tr>
<tr>
<td>Transport</td>
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<td>2,713</td>
</tr>
<tr>
<td>Slov. plavba dunajská, s.p.</td>
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<td>2,713</td>
</tr>
<tr>
<td>Agriculture and water industry</td>
<td>18</td>
<td>36,948</td>
</tr>
<tr>
<td>Zrebcín Motesice, s.p.</td>
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<td>63</td>
</tr>
<tr>
<td>Zrebcínec Velky Saris, s.p.</td>
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<td>7</td>
</tr>
<tr>
<td>Slacht. stanica Horná Štreda, s.p.</td>
<td></td>
<td>43</td>
</tr>
<tr>
<td>Istropol, s.p.</td>
<td></td>
<td>27</td>
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<tr>
<td>Slacht. stanica Levocské Lúky, s.p.</td>
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<td>7</td>
</tr>
<tr>
<td>V.u.o.o.d., Bojnice, s.p.</td>
<td></td>
<td>35</td>
</tr>
<tr>
<td>V.a.s.u., Velká Lomnica, s.p.</td>
<td></td>
<td>73</td>
</tr>
<tr>
<td>Polnonáykup Agropros, s.p.</td>
<td></td>
<td>508</td>
</tr>
<tr>
<td>Polnonáykup Navys, s.p.</td>
<td></td>
<td>344</td>
</tr>
<tr>
<td>Polnonáykup Tekov, s.p.</td>
<td></td>
<td>377</td>
</tr>
<tr>
<td>Polnonáykup Tatry, s.p.</td>
<td></td>
<td>182</td>
</tr>
<tr>
<td>Polnonáykup Trnavan, s.p.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tokaj, s.p.</td>
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<td></td>
</tr>
<tr>
<td>Vodárne a kanalizácie, s.p.</td>
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<td>6,374</td>
</tr>
<tr>
<td>Zápodoslov. vodárne a kanalizácie, s.p.</td>
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<td>9,507</td>
</tr>
<tr>
<td>Štredoslov. vodárne a kanalizácie, s.p.</td>
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<td>4,482</td>
</tr>
<tr>
<td>Severoslov. vodárne a kanalizácie, s.p.</td>
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<td>5,356</td>
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<tr>
<td>Východoslov. vodárne a kanalizácie, s.p.</td>
<td></td>
<td>9,563</td>
</tr>
<tr>
<td>Pharmaceutical industry</td>
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<td>191</td>
</tr>
<tr>
<td>MEVAK, a.s.</td>
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<td>191</td>
</tr>
<tr>
<td>Construction industry</td>
<td>6</td>
<td>1,140</td>
</tr>
<tr>
<td>Povazská cementáren, a.s.</td>
<td></td>
<td>314</td>
</tr>
<tr>
<td>Cementáren Turna, a.s.</td>
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<td>331</td>
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<tr>
<td>Kamenolomy a strkopieskovne, a.s.</td>
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<td>132</td>
</tr>
<tr>
<td>Paneláren Zilina, s.p.</td>
<td></td>
<td>98</td>
</tr>
<tr>
<td>Paneláren Kosice, s.p.</td>
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<td>147</td>
</tr>
<tr>
<td>NIBACO, s.p.</td>
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<td>118</td>
</tr>
<tr>
<td>Property administered by the Slovak railways</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>112,075</td>
</tr>
</tbody>
</table>

Source: IMF (1995), Table V.3. (p. 61); own calculations
Appendix C. Controversial direct sales

Below are listed a few of the more spectacular direct sales which have taken place in 1995-1996. Common for them is that the buyer have been traditional insiders with good connections to the ruling party. The list, which makes no claim whatsoever to be fully representative of all the sales in the period 1995-1996, may nevertheless serve as examples and thus provide the reader with an understanding of the controversy which privatisation de facto stirred in Slovakia.

• *Skloobal Nemsova.* In February 1995 the disputed 67 per cent stake in glassmaker Skloobal is sold on the same soft terms as during the so-called midnight-privatisations.¹

• *Nafta Gbely.* The FNM on 1 August 1996 sold a 45.9 per cent stake in the very profitable Slovak oil and gas storage firm, Nafta Gbely, a.s. to a private firm Druha Obchodna, for Sk 500 million ($16 mn) while the shares were valued at Sk 3.2 billion ($104 mn) at the stock market. Net profits in 1996 were in fact higher than the purchase price. Noticeable is also that the company was still on the list of “strategic enterprises”; and the buyer was a small company established only days before the sell-off and gave as it headquarters a deserted building.²

• *Biotika.* A 40.6 per cent share of pharmaceutikal company Bitoika was on 1 March 1996 sold to a company, GV Pharma in Presov, for Sk 486.5 million ($16.2 mn); a group of employees had offered close to triple that amount (Sk 1.38 bn, $45.8 mn) as well as pledged investments of Sk 1 billion ($33 mn) over the coming 8 years (GV Pharma pledged Sk 246.5 mn), see Fisher (1996).

• *Benzinol.* FNM in February 1995 sold a 51 per cent stake in Benzinol (fuel distributor with 202 filling stations) to Slovnaft (in which FNM at the time held 80.3%). Such a merger had previously been prevented by the anti-monopoly office, see Schmögnerová 1995, p. 244. This direct sale was decided in spite of a prior tender-procedure which attracted six different bidders. No details about the purchase were disclosed.³

• *Slovnaft.* Among the more spectacular sales was the 10 August 1995 decision to sell a 39 per cent stake of profitable Slovnaft to Slovintegra, a firm established by a group of Slovnaft managers. The shares, with a nominal value of Sk 6.42 billion ($215 mn), were sold for a total of Sk 1.3 billion ($43.5 mn), with a mere Sk 100 million ($3.3 mn) up-front. This caused an outrage from the EBRD which, following a failed GDR-placement, in July had picked up a 10.5 per cent stake of the firm for their full face value.⁴ The deal resulted in a 30 per cent drop in share prices – thus helping to pull down the market in general as Slovnaft was the most highly capitalised equity issue at the BCPB.

¹ Cf. TREND Týždeník o hospodárstve a podnikaní, No. 12, 1995; Box 3 (p. 122).
² Cf. TREND Týždeník o hospodárstve a podnikaní, Nos. 23 and 32, 1997.
³ Cf. TREND Týždeník o hospodárstve a podnikaní, No. 12, 1995.
• *Piestany Spa.* In May 1996 51 per cent of the very profitable spa – with a book value of Sk 1.6 billion – and an estimated market value in excess of that – was sold for Sk 302 million to a company controlled by four of its top managers.
Appendix D. Tables and statistical analysis

Below are included those tables which have not justified their presence in the actual text, but which nevertheless are of significant importance for the study.

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### TABLE 1. May 1946 General Elections, Czechoslovak Republic

<table>
<thead>
<tr>
<th>Party</th>
<th>Per cent of votes cast</th>
<th>Slovakia</th>
<th>Czech Lands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communist Party</td>
<td>30.37</td>
<td>40.17</td>
<td></td>
</tr>
<tr>
<td>Democratic Party</td>
<td>62.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour Party</td>
<td>3.11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Freedom Party</td>
<td>3.73</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Socialist Party</td>
<td>–</td>
<td></td>
<td>23.6</td>
</tr>
<tr>
<td>Social Democratic Party</td>
<td>–</td>
<td></td>
<td>15.58</td>
</tr>
</tbody>
</table>


*Comment*: Although common in most respects the communists in the Czech Lands and Slovakia were nominally two different parties.

### TABLE 2. General Elections, June 1990 (Slovak Republic only)

<table>
<thead>
<tr>
<th>Party</th>
<th>National council</th>
<th>House of people</th>
<th>House of Nations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>per cent</td>
<td>seats</td>
<td>per cent</td>
</tr>
<tr>
<td>VPN</td>
<td>29.34</td>
<td>48</td>
<td>32.54</td>
</tr>
<tr>
<td>KSC</td>
<td>13.34</td>
<td>22</td>
<td>13.81</td>
</tr>
<tr>
<td>KDH</td>
<td>19.20</td>
<td>31</td>
<td>18.98</td>
</tr>
<tr>
<td>SNS</td>
<td>13.94</td>
<td>22</td>
<td>10.96</td>
</tr>
<tr>
<td>DS</td>
<td>4.39</td>
<td>7</td>
<td>–</td>
</tr>
<tr>
<td>SDSS</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Hungarian coalition</td>
<td>8.66</td>
<td>14</td>
<td>8.58</td>
</tr>
<tr>
<td>Party of the Greens (SZ, Strana Zelenych)</td>
<td>3.48</td>
<td>6</td>
<td>–</td>
</tr>
</tbody>
</table>


*Comment*: Listed are only those parties/coalitions who gained parliamentary representation.

1 The Hungarian coalition in the national elections consisted of the Hungarian Christian Democratic Movement (MKDH) and Coexistence; in the federal elections the small Hungarian People’s Party was also part in the coalition.
**TABLE 3. General Elections, June 1992 (Slovak Republic only)**

<table>
<thead>
<tr>
<th>Party</th>
<th>National council</th>
<th>House of people</th>
<th>House of Nations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>per cent</td>
<td>seats</td>
<td>per cent</td>
</tr>
<tr>
<td>HZDS</td>
<td>37.26</td>
<td>74</td>
<td>33.53</td>
</tr>
<tr>
<td>SDL</td>
<td>14.70</td>
<td>29</td>
<td>14.44</td>
</tr>
<tr>
<td>KDH</td>
<td>8.89</td>
<td>18</td>
<td>8.96</td>
</tr>
<tr>
<td>SNS</td>
<td>7.93</td>
<td>15</td>
<td>9.39</td>
</tr>
<tr>
<td>Hungarian coalition¹</td>
<td>7.42</td>
<td>14</td>
<td>7.37</td>
</tr>
<tr>
<td>SDSS</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total SR</strong></td>
<td><strong>150</strong></td>
<td><strong>51</strong></td>
<td><strong>75</strong></td>
</tr>
</tbody>
</table>


Note: Listed are only those parties/coalitions who gained parliamentary representation, a total of 23 parties, movements and coalitions participated in the elections for the National Council of Slovakia and the House of Nations (22 for the House of People). Voter turnout in the Slovak national elections was 84.2 per cent.

¹ The Hungarian coalition in the national elections consisted of the Hungarian Christian Democratic Movement (MKDH) and Coexistence; in the federal elections the small Hungarian People’s Party was also part in the coalition.

**TABLE 4. 1994 elections to the National Council of the Slovak Republic**

<table>
<thead>
<tr>
<th>Party</th>
<th>Per cent of votes cast</th>
<th>Seats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movement for a Democratic Slovakia (HZDS) –</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Party of Slovakia (RSS) (coalition)</td>
<td>34.96</td>
<td>61</td>
</tr>
<tr>
<td>Party of Democratic Left/Common Choice (coalition)¹</td>
<td>10.41</td>
<td>18</td>
</tr>
<tr>
<td>Hungarian Coalition (MK) (coalition)²</td>
<td>10.18</td>
<td>17</td>
</tr>
<tr>
<td>Christian Democratic Movement (KDH)</td>
<td>10.08</td>
<td>17</td>
</tr>
<tr>
<td>Democratic Union (DU)</td>
<td>8.57</td>
<td>15</td>
</tr>
<tr>
<td>Association of Workers of Slovakia (ZRS)</td>
<td>7.34</td>
<td>13</td>
</tr>
<tr>
<td>Slovak National Party (SNS)</td>
<td>5.40</td>
<td>9</td>
</tr>
</tbody>
</table>

**Total**                                           | **150**               |       |


Comment: Listed are only those parties/coalitions who gained parliamentary representation, a total of 17 parties, movements and coalitions participated. Voter turnout was 75.65 per cent.

Notes: ¹ Common Choice = coalition of SDL, which is the most significant party in the coalition, and the minor Social Democratic Party of Slovakia (SDSS), Green Party of Slovakia (SZS) and the Movement of Peasants (HP). ² MK = A coalition of the two important Hungarian parties, Hungarian Catholic Democratic Movement (MKDH) and Coexistence, and the smaller Hungarian Civic Party (MOS).
### TABLE 5. Sectoral employment and population in Slovakia, the Czech Republic and Czechoslovakia, 1948-1989 (million and per cent)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Population CSFR (mn)</td>
<td>12.3</td>
<td>12.8</td>
<td>13.7</td>
<td>14.4</td>
<td>14.8</td>
<td>15.3</td>
<td>15.5</td>
<td>15.6</td>
<td></td>
</tr>
<tr>
<td>Slovakia (mn)</td>
<td>3.4</td>
<td>3.6</td>
<td>4.0</td>
<td>4.5</td>
<td>4.5</td>
<td>4.7</td>
<td>5.0</td>
<td>5.2</td>
<td>5.3</td>
</tr>
<tr>
<td>Slovakia (%)</td>
<td>27.9</td>
<td>28.1</td>
<td>29.3</td>
<td>31.2</td>
<td>31.6</td>
<td>32.0</td>
<td>32.6</td>
<td>33.3</td>
<td>33.7</td>
</tr>
<tr>
<td>Total employment CSFR (mn)</td>
<td>5.5</td>
<td>5.6</td>
<td>6.0</td>
<td>6.7</td>
<td>6.9</td>
<td>7.1</td>
<td>7.4</td>
<td>7.6</td>
<td>7.8</td>
</tr>
<tr>
<td>Slovakia (mn)</td>
<td>1.5</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
<td>1.9</td>
<td>2.1</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Slovakia (%)</td>
<td>27.5</td>
<td>27.4</td>
<td>25.9</td>
<td>27.5</td>
<td>28.4</td>
<td>29.7</td>
<td>30.8</td>
<td>31.5</td>
<td>31.8</td>
</tr>
<tr>
<td>Industrial empl. CSFR (mn)</td>
<td>1.6</td>
<td>1.8</td>
<td>2.2</td>
<td>2.6</td>
<td>2.6</td>
<td>2.6</td>
<td>2.8</td>
<td>2.8</td>
<td>2.9</td>
</tr>
<tr>
<td>Slovakia (mn)</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>Slovakia (% of CSFR)</td>
<td>13.9</td>
<td>16.2</td>
<td>17.8</td>
<td>21.9</td>
<td>23.1</td>
<td>23.1</td>
<td>27.4</td>
<td>28.5</td>
<td>28.6</td>
</tr>
<tr>
<td>Slovakia (% of SR)</td>
<td>14.9</td>
<td>19.0</td>
<td>25.5</td>
<td>30.4</td>
<td>30.8</td>
<td>28.7</td>
<td>33.4</td>
<td>33.8</td>
<td>33.5</td>
</tr>
<tr>
<td>Czech Lands (mn)</td>
<td>1.4</td>
<td>1.5</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Czech Lands (% of CR)</td>
<td>34.9</td>
<td>37.2</td>
<td>41.2</td>
<td>41.2</td>
<td>40.6</td>
<td>40.3</td>
<td>39.4</td>
<td>39.0</td>
<td>38.9</td>
</tr>
<tr>
<td>Agricultural empl. CSFR (mn)</td>
<td>2.2</td>
<td>1.9</td>
<td>1.5</td>
<td>1.2</td>
<td>1.2</td>
<td>1.0</td>
<td>0.9</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Slovakia (mn)</td>
<td>0.9</td>
<td>0.8</td>
<td>0.6</td>
<td>0.5</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Slovakia (% of CSFR)</td>
<td>41.0</td>
<td>40.7</td>
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<td>37.5</td>
<td>37.9</td>
<td>37.5</td>
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<td>36.1</td>
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<td>12.2</td>
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<tr>
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<td>1.3</td>
<td>1.1</td>
<td>0.9</td>
<td>0.8</td>
<td>0.7</td>
<td>0.6</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
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<tr>
<td>Czech Lands (% of CR)</td>
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<td>14.6</td>
<td>12.3</td>
<td>11.0</td>
<td>10.3</td>
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*Source: Statistická Rocenka CSFR 1990 [Tables 1.1-1.3]; own computations.*

### TABLE 6. Gross industrial production in Slovakia, the Czech Republic and Czechoslovakia, 1948-1989 (index)

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<td>193</td>
<td>372</td>
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<td>666</td>
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<td>1438</td>
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<td>516</td>
<td>584</td>
<td>779</td>
<td>955</td>
<td>1,072</td>
<td>1,167</td>
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<tr>
<td>CSFR 1937=100</td>
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<td>526</td>
<td>596</td>
<td>794</td>
<td>974</td>
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*Source: Statistická Rocenka CSFR 1990 [Tables 1.1-1.3].*
### TABLE 7. Industrial production 1989-1996 (Sk mn, 1996 prices & index)

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</thead>
<tbody>
<tr>
<td>Industry total, incl. estimates for small enterprises and private sector</td>
<td>Sk mn, 1996 prices</td>
<td>675,804</td>
<td>648,475</td>
<td>522,863</td>
<td>474,986</td>
<td>457,153</td>
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<td>519,118</td>
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<td>77</td>
<td>70</td>
<td>68</td>
<td>77</td>
<td>77</td>
<td>79</td>
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<tr>
<td>Manufacturing sectors, only firms with 25 and more employees</td>
<td>DA</td>
<td>100</td>
<td>101</td>
<td>84</td>
<td>59</td>
<td>52</td>
<td>48</td>
<td>47</td>
</tr>
<tr>
<td>DB</td>
<td>100</td>
<td>101</td>
<td>63</td>
<td>57</td>
<td>47</td>
<td>47</td>
<td>46</td>
<td>41</td>
</tr>
<tr>
<td>DC</td>
<td>100</td>
<td>101</td>
<td>59</td>
<td>47</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>37</td>
</tr>
<tr>
<td>DD</td>
<td>100</td>
<td>94</td>
<td>70</td>
<td>70</td>
<td>46</td>
<td>48</td>
<td>55</td>
<td>54</td>
</tr>
<tr>
<td>DE</td>
<td>100</td>
<td>102</td>
<td>88</td>
<td>77</td>
<td>75</td>
<td>85</td>
<td>90</td>
<td>95</td>
</tr>
<tr>
<td>DF</td>
<td>100</td>
<td>81</td>
<td>75</td>
<td>39</td>
<td>38</td>
<td>47</td>
<td>50</td>
<td>48</td>
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<tr>
<td>DG</td>
<td>100</td>
<td>95</td>
<td>62</td>
<td>66</td>
<td>59</td>
<td>62</td>
<td>69</td>
<td>71</td>
</tr>
<tr>
<td>DH</td>
<td>100</td>
<td>100</td>
<td>74</td>
<td>70</td>
<td>64</td>
<td>72</td>
<td>84</td>
<td>87</td>
</tr>
<tr>
<td>DI</td>
<td>100</td>
<td>94</td>
<td>65</td>
<td>61</td>
<td>55</td>
<td>52</td>
<td>52</td>
<td>51</td>
</tr>
<tr>
<td>DJ</td>
<td>100</td>
<td>100</td>
<td>80</td>
<td>73</td>
<td>72</td>
<td>76</td>
<td>83</td>
<td>76</td>
</tr>
<tr>
<td>DK</td>
<td>100</td>
<td>96</td>
<td>60</td>
<td>41</td>
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<td>36</td>
<td>45</td>
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</tr>
<tr>
<td>DL</td>
<td>100</td>
<td>95</td>
<td>61</td>
<td>48</td>
<td>42</td>
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</tr>
<tr>
<td>DM</td>
<td>100</td>
<td>93</td>
<td>61</td>
<td>45</td>
<td>36</td>
<td>38</td>
<td>62</td>
<td>76</td>
</tr>
<tr>
<td>DN</td>
<td>100</td>
<td>99</td>
<td>69</td>
<td>65</td>
<td>56</td>
<td>52</td>
<td>57</td>
<td>63</td>
</tr>
</tbody>
</table>

**Source:** Statistická Rocenka SR (1992-1997); own computations.

**Comment:** The indices have been calculated by converting sectorial data according to two-digit NACE-based PPI to 1996 prices. In converting industrial production from 1993 prices (data for 1989-1993) to 1996 prices (data for 1992-1996) minor discrepancies were detected for the two overlapping years. However, on a sectorial level the discrepancies are not deemed as grave as not to warrant the publication of the above figures. On average the 1993 production was 0.38% higher in the original 1996 prices than when converting them from 1993 prices. Also, counting only the sectors of concern for comparison with the case studies, see TABLE D 1 (p. 301), the accumulated discrepancy for 1993 was only Sk 7 million (0.004%). The above mentioned conversion has been applied only for 1989-1991. On a more aggregate level the discrepancies are however more problematic; therefore only the time-series for industrial production including estimates for small enterprises and private sector are reported above.

### TABLE 8. Size structure of Slovak industry, 1989-1996

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Number of firms</td>
<td>158</td>
<td>390</td>
<td>600</td>
<td>1,059</td>
<td>1,327</td>
<td>1,515</td>
<td>1,723</td>
<td>1,823</td>
</tr>
<tr>
<td>Number of firms with less than 500 manual workers</td>
<td>6</td>
<td>152</td>
<td>394</td>
<td>870</td>
<td>1,162</td>
<td>1,356</td>
<td>1,571</td>
<td>1,673</td>
</tr>
<tr>
<td>Avg. size (no. of manual workers)</td>
<td>2,487</td>
<td>1,283</td>
<td>751</td>
<td>512</td>
<td>417</td>
<td>392</td>
<td>300†</td>
<td>261†</td>
</tr>
</tbody>
</table>

**Sources:** Statistická Rocenka SR (1992-1997); own computations.

**Comment:** Figures for 1991 refers to firms w. 100 or more employees; from 1992 onwards w. 25 or more employees.

1 Estimate based on the average number of employees divided by the number of enterprises; figures reported in statistical yearbook may be faulty – the series has also been discontinued as of 1998.

| Year | Industry in total | Manufacturing in total | DA. Manufacture of food products; beverages and tobacco | % of manufacturing empl. | DB. Manufacture of textiles and textile products | % of manufacturing empl. | DC. Manufacture of leather and leather products | % of manufacturing empl. | DD. Manufacture of wood and wood products | % of manufacturing empl. | DE. Manufacture of pulp, paper and paper products; publishing and printing | % of manufacturing empl. | DF. Manufacture of coke, refined petroleum products and nuclear fuel | % of manufacturing empl. | DG. Manufacture of chemicals, chemical products and man-made fibres | % of manufacturing empl. | DH. Manufacture of rubber and plastic products | % of manufacturing empl. | DI. Manufacture of other non-metallic mineral products | % of manufacturing empl. | DJ. Manufacture of basic metals and fabricated metal products | % of manufacturing empl. | DK. Manufacture of machinery and equipment N.E.C. | % of manufacturing empl. | DL. Manufacture of electrical and optical equipment | % of manufacturing empl. | DM. Manufacture of transport equipment | % of manufacturing empl. | DN. Manufacturing N.E.C. | % of manufacturing empl. |
|------|------------------|----------------------|--------------------------------------------------|-----------------------|-----------------------------------------------|-----------------------|---------------------------------------------|-----------------------|-----------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|-----------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|
| 1991 | 675,479          | 595,197              | 539,711                                          | 513,494              | 516,938                                       | 512,378              | 57,724                                      | 9.6                   | 66,377                                        | 11.0                  | 26,865                                          | 4.5                   | 20,314                                         | 3.4                   | 8,549                                          | 1.4                   | 15,036                                        | 2.5                   | 37,928                                        | 6.4                   | 10,036                                        | 3.2                   | 58,037                                        | 9.6                   | 123,218                                       | 20.5                  | 61,275                                        | 10.2                  | 40,200                                        | 6.7                   | 25,485                                        | 4.2                   | 325                                           |
TABLE 10. State budget balances in Slovakia, the Czech Republic and Czechoslovakia, 1989-1996 (local currency, million, current prices)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
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<td><strong>Revenue</strong></td>
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<td></td>
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<td></td>
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<td>71,461</td>
<td>76,378</td>
<td>108,902</td>
<td>115,190</td>
<td>150,342</td>
<td>139,148</td>
<td>163,138</td>
<td>166,330</td>
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<tr>
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<td>117,134</td>
<td>127,800</td>
<td>156,412</td>
<td>217,693</td>
<td>358,000</td>
<td>390,508</td>
<td>440,000</td>
<td>482,817</td>
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<tr>
<td>Federal</td>
<td>69,412</td>
<td>92,017</td>
<td>124,034</td>
<td>119,015</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total CSFR</strong></td>
<td>258,007</td>
<td>296,195</td>
<td>389,348</td>
<td>451,898</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>SR</td>
<td>74,483</td>
<td>76,846</td>
<td>119,130</td>
<td>123,123</td>
<td>173,353</td>
<td>162,002</td>
<td>171,437</td>
<td>191,889</td>
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<td>118,381</td>
<td>127,568</td>
<td>170,029</td>
<td>219,390</td>
<td>356,919</td>
<td>380,059</td>
<td>432,800</td>
<td>484,379</td>
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<tr>
<td>Federal</td>
<td>70,243</td>
<td>88,002</td>
<td>117,645</td>
<td>126,015</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total CSFR</strong></td>
<td>263,107</td>
<td>292,416</td>
<td>406,804</td>
<td>468,528</td>
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<td>–</td>
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<tr>
<td><strong>Balance</strong></td>
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<tr>
<td>SR</td>
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<td><strong>Total CSFR</strong></td>
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**Comment:** The figures exclude local government budgets

TABLE 11. Consumer prices in Slovakia and the Czech Republic, 1990-1996 (%)

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<tr>
<td>December-December</td>
<td>18.4</td>
<td>58.3</td>
<td>9.1</td>
<td>25.1</td>
<td>11.7</td>
<td>7.2</td>
<td>5.4</td>
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<tr>
<td>Annual average</td>
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<td>61.2</td>
<td>10</td>
<td>23.2</td>
<td>13.4</td>
<td>9.9</td>
<td>5.8</td>
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<td><strong>Czech Republic</strong></td>
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<td>December-December</td>
<td>17.5</td>
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<td>18.8</td>
<td>9.7</td>
<td>7.9</td>
<td>8.6</td>
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<tr>
<td>Annual average</td>
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<td>56.6</td>
<td>11.1</td>
<td>20.8</td>
<td>10</td>
<td>9.1</td>
<td>8.8</td>
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**Sources:** Slovak Statistical Office, Czech Statistical Office, Czechoslovak Statistical Office, various publications.
TABLE 12. Voucher privatisation: the market process in figures

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<th>Indicator</th>
<th>Total</th>
<th>Round 1</th>
<th>Round 2</th>
<th>Round 3</th>
<th>Round 4</th>
<th>Round 5</th>
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<td><strong>Cumulative no of shares bought in Slovakia</strong></td>
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<td>8.1</td>
<td>17.44</td>
<td>22.75</td>
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<td>37.76</td>
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<td>18.10</td>
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<td>40.85</td>
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<td>57.61</td>
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<td>Total</td>
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<td>26.2</td>
<td>49.94</td>
<td>63.6</td>
<td>77.47</td>
<td>95.37</td>
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<tr>
<td>Shares offered from firms located in</td>
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<tr>
<td>SR</td>
<td>86.9</td>
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<td>132.13</td>
<td>99.60</td>
<td>62.50</td>
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<td>CR</td>
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<td>299.39</td>
<td>209.95</td>
<td>132.13</td>
<td>99.60</td>
<td>62.50</td>
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<td><strong>Average share price (points/share)</strong></td>
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<td>33.33</td>
<td>33.33</td>
<td>33.33</td>
<td>33.33</td>
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<td>31.45</td>
<td>31.45</td>
<td>31.45</td>
<td>31.45</td>
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<tr>
<td><strong>Per cent of shares requested by DIKs that were allocated</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SR</td>
<td>43.19</td>
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<td>9.6</td>
<td>34.58</td>
<td>8.04</td>
<td>12.37</td>
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<td>47.2</td>
<td>7.9</td>
<td>39.6</td>
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<td>43.86</td>
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<td>31.45</td>
<td>31.45</td>
<td>31.45</td>
</tr>
<tr>
<td><strong>Per cent of shares requested by IFs that were allocated</strong></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>SR</td>
<td>36.86</td>
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<td>27.9</td>
<td>89.9</td>
<td>89.9</td>
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<td>33.99</td>
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<td>16.6</td>
<td>35.6</td>
<td>91.8</td>
<td>91.8</td>
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<td>MH IF</td>
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<td>Tatra kupon IF</td>
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<td>IF polnohnosopadov</td>
<td>Tatransky IF</td>
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<td>SPIF</td>
<td>IF PRO POPULO</td>
<td>TILA</td>
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<td>Trenčiansky IF</td>
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<td>IF REGIONFOND SP</td>
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<td>Zemplinsky IF</td>
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<td>APSF FOND IF v likvidacii</td>
<td>IF slovenských družstevníkov</td>
<td>ZIARAL IF</td>
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<td>Zilinsky basketbalovy IF</td>
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<td>Harvard Growth Investment Fund</td>
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<td>HIGH TECH IF</td>
<td>IF KRIVAN TATRA IF v likvidacii</td>
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<td>Humanita IF</td>
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<td>Source: RM-S Database</td>
<td>IF Makyta IF</td>
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### TABLE 14. Three samples of Slovak industrial firms

<table>
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<tr>
<th>Case study firms (Case-9, C9)</th>
<th>Sample-of-56 (continued)</th>
<th>Top-60 (continued)</th>
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</thead>
<tbody>
<tr>
<td>ABB Stotz, s.r.o.</td>
<td>SLOVAKOFARMA</td>
<td>Mlyn. - pekarensky kombinat</td>
</tr>
<tr>
<td>COSMOS</td>
<td>Slovenske lodenice</td>
<td>Nafta</td>
</tr>
<tr>
<td>Hydronika</td>
<td>SMRECINA</td>
<td>NOVONA</td>
</tr>
<tr>
<td>OZETA, odevne zavody</td>
<td>Specializacije Bratislava</td>
<td>OBAL-VOGEL &amp; NOOT</td>
</tr>
<tr>
<td>Slovenske lodenice</td>
<td>Staveco Galanta</td>
<td>PLASTIKA</td>
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<tr>
<td>VSZ</td>
<td>STAYMART</td>
<td>Podvihorlats, pekarne a cukrane</td>
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<tr>
<td>ZPA Krizik, s.r.o.</td>
<td>STAVOUDRZBA</td>
<td>Pozemstav Presov</td>
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<td>ZTS Sabinov</td>
<td>STAVOUNIA</td>
<td>Pefabeton</td>
</tr>
<tr>
<td>ZVL BEARINGS</td>
<td>Stavris</td>
<td>Prievidsza mliekaren</td>
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<td>Strojarne Prsvidza</td>
<td>Prievidszke pekarne a cukr.</td>
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<tr>
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<td>Strojstav Nove Mesto n/V</td>
<td>PRIOUDA</td>
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</table>

**Random sample of firms,** Sample-of-56 (S56)

| AGRÖHUM                                           | Topolciansky hydinarsky podnik             | Puchov. masovy priemysel     |
|AGRÓNNOVAZ                                        | TORUS, stavebny podnik                    | REGULA Kosice                |
|AVC                                              | Trebisovske pekarne a cukrane              | REVING                      |
|BONA                                             | VOD - EKO                                  | SLOVAKIA INDUSTRIES          |
|BUCINA                                           | VODSTAV                                    | SLOVAKOFARMA                 |
|DANUBIA                                          | VUNAR                                      | Slovenska Grafia             |
|Drevestol                                        | ZAVOD SNP                                  | Slovenske elektrarne         |
|DUNAKO                                           | ZMV                                        | SLOVNAFT                     |
|EURO SIPOX holding                               | TATRASVIT                                  | SLOVPUMP                     |
|Gemerske pekarne a cukrarne                       | Retrospective sample of top performers, Top-60 (T60) | SOLIVARY                    |
|Gold Limo                                        |                                           |                             |
|GRAFOBAL                                         |                                           |                             |
|Krupinsky mliekaren                               |                                           |                             |
|Levoceke strojarne                                |                                           |                             |
|LIPTOSTAV                                        |                                           |                             |
|LR CRYSTAL                                       |                                           |                             |
|LUKO                                             |                                           |                             |
|Martańska mliekaren                               |                                           |                             |
|MAYTEX                                           |                                           |                             |
|Míchalovské pekarne a cukrane                     |                                           |                             |
|MLIEKOSERVIS                                     |                                           |                             |
|Mlyn Pohronsky Ruskov                            |                                           |                             |
|Myjavsky masopriemysel                           |                                           |                             |
|Novohradské pekarne                              |                                           |                             |
|NOVOKER                                          |                                           |                             |
|Pekaren a cestovinare Petržalka                   |                                           |                             |
|Polonakup NOVOHRAD                                |                                           |                             |
|Potravinarsky kombinat                           |                                           |                             |
|PREFA Sucany                                     |                                           |                             |
|Prefabeton                                       |                                           |                             |
|Prefa-Konzulta                                    |                                           |                             |
|PREFATEMPO                                       |                                           |                             |
|REMKOMPLEX                                       |                                           |                             |
|REMUS                                            |                                           |                             |
|Roznava mliekaren                                 |                                           |                             |

**Source:** RM-S Database

**Comment:** All firms are incorporated as joint-stock (a.s.) companies unless otherwise noted.
### TABLE 15. Direct trades at the BCPB and the RM-S, 1993-1996

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<td>BCPB (direct trade, % of total equity)</td>
<td>79.5</td>
<td>85.6</td>
<td>98.4</td>
<td>91.1</td>
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<td>–</td>
<td>79.1</td>
<td>81.4</td>
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*Source*: Computations on data from the BCPB and the RM-S (see Table 12 and Table 13 above for exact sources).

*Comment*: Registered direct trades only began in 1995.

### TABLE 16. NAV of a selection of investment funds (sorted according to 1994 NAV), December 1993- June 1996

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*Source*: Data communicated directly from ASIF/Ministry of Finance; own computations.
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**Sources:** RM-S Database; Data communicated directly from ASIF/Ministry of Finance; own computations.

**Comment:** Note that asset values in 1996 refers to mid-year, thus the average price is the most suitable – the figures are nevertheless included for purpose of comparison.
<table>
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<th>1996 Owner</th>
<th>% cum.</th>
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<td>VSZ, a.s., Kosice</td>
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*Source: RM-S Database; own computations.*
### TABLE 19. Changes in ownership composition 1993-1996 (three types, end-year figures in per cent)

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<th>Firm</th>
<th>1993</th>
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Source: RM-S Database; own calculations

Comment: All figures refer to reported holdings among the top-5 owners in each of the enterprises; generally only holdings in excess of 5 per cent are reported.

### TABLE 20. P/E Ratios on the RM-S (annual average prices), 1993-1996

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<td>Avg. Sample-of-56</td>
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Source: RM-S Database; own computations
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<tr>
<td>Max/Min r. p. price, DT</td>
<td>–</td>
<td>150/32</td>
<td>–</td>
<td>107/50</td>
<td>150/30</td>
</tr>
<tr>
<td><strong>Ozeta</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>1,347</td>
<td>5,155</td>
<td>3,796</td>
<td>47,688</td>
<td>57,986</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>0</td>
<td>1,675</td>
<td>238,774</td>
<td>432,762</td>
<td>673,211</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>600,741</td>
<td>7,233,912</td>
<td>2,810,732</td>
<td>18,690,552</td>
<td>29,325,937</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>0</td>
<td>2,742,808</td>
<td>144,625,717</td>
<td>226,153,247</td>
<td>373,521,772</td>
</tr>
<tr>
<td>Max/min price (floor)</td>
<td>500/550</td>
<td>1,910/500</td>
<td>1,010/440</td>
<td>570/305</td>
<td>1,910/305</td>
</tr>
<tr>
<td>Max/Min r. p. price, DT</td>
<td>–</td>
<td>1,900/828</td>
<td>1,027/369</td>
<td>1,000/345</td>
<td>1,900/345</td>
</tr>
<tr>
<td><strong>Slovenske lodenice</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>57</td>
<td>2,642</td>
<td>14,859</td>
<td>98,737</td>
<td>116,295</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>0</td>
<td>16,034</td>
<td>236,796</td>
<td>1,426,636</td>
<td>1,679,466</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>20,830</td>
<td>2,276,729</td>
<td>22,535,660</td>
<td>131,886,055</td>
<td>156,719,274</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>0</td>
<td>17,565,983</td>
<td>339,182,810</td>
<td>2,638,490,612</td>
<td>2,995,239,405</td>
</tr>
<tr>
<td>Max/min price (floor)</td>
<td>500/300</td>
<td>1,350/370</td>
<td>1,700/1,055</td>
<td>2,107/724</td>
<td>2,107/300</td>
</tr>
<tr>
<td>Max/Min r. p. price, DT</td>
<td>–</td>
<td>1,222,400</td>
<td>1,750/6</td>
<td>2,345/830</td>
<td>2,345/6</td>
</tr>
<tr>
<td><strong>VSZ</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>8,499</td>
<td>52,226</td>
<td>188,033</td>
<td>784,622</td>
<td>1,033,380</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>9,000</td>
<td>1,669,339</td>
<td>8,018,142</td>
<td>12,082,944</td>
<td>21,779,425</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>1,578,741</td>
<td>23,539,470</td>
<td>82,673,043</td>
<td>451,743,572</td>
<td>559,534,826</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>1,755,000</td>
<td>357,162,857</td>
<td>2,526,395,511</td>
<td>6,207,925,878</td>
<td>9,093,238,964</td>
</tr>
<tr>
<td>Max/min price (floor)</td>
<td>200/137</td>
<td>740/195</td>
<td>490/550</td>
<td>748,126</td>
<td>745,137</td>
</tr>
<tr>
<td>Max/Min r. p. price, DT</td>
<td>195/195</td>
<td>800/200</td>
<td>760/200</td>
<td>1,486,397</td>
<td>1,486/195</td>
</tr>
<tr>
<td><strong>ZTS Sabinov</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>0</td>
<td>0</td>
<td>24</td>
<td>17,367</td>
<td>17,391</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>0</td>
<td>0</td>
<td>37,442</td>
<td>92,908</td>
<td>130,350</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>0</td>
<td>0</td>
<td>2,400</td>
<td>1,692,399</td>
<td>1,694,799</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>0</td>
<td>0</td>
<td>3,746,978</td>
<td>11,638,917</td>
<td>15,699,927</td>
</tr>
<tr>
<td>Max/min price (floor)</td>
<td>–</td>
<td>100/100</td>
<td>115/47</td>
<td>115/47</td>
<td></td>
</tr>
<tr>
<td>Max/Min r. p. price, DT</td>
<td>–</td>
<td>134/70</td>
<td>297/86</td>
<td>297/70</td>
<td></td>
</tr>
<tr>
<td><strong>ZVL Bearings</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>0</td>
<td>10</td>
<td>317</td>
<td>13,498</td>
<td>13,825</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>0</td>
<td>0</td>
<td>5,124</td>
<td>20,479</td>
<td>25,603</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>0</td>
<td>400</td>
<td>15,187</td>
<td>532,542</td>
<td>548,129</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>0</td>
<td>2,642,078</td>
<td>2,910,917</td>
<td>5,552,995</td>
<td></td>
</tr>
<tr>
<td>Max/min price (floor)</td>
<td>–</td>
<td>40/40</td>
<td>50/40</td>
<td>602/22</td>
<td>602/22</td>
</tr>
<tr>
<td>Max/Min r. p. price, DT</td>
<td>–</td>
<td>1,000/20</td>
<td>143/10</td>
<td>1,000/10</td>
<td></td>
</tr>
<tr>
<td><strong>Case firms total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floor trade pcs</td>
<td>9,903</td>
<td>64,155</td>
<td>207,050</td>
<td>964,749</td>
<td>1,245,857</td>
</tr>
<tr>
<td>Direct trade pcs</td>
<td>9,000</td>
<td>1,687,048</td>
<td>8,608,119</td>
<td>14,095,979</td>
<td>24,400,146</td>
</tr>
<tr>
<td>Floor trade Sk</td>
<td>2,200,312</td>
<td>37,160,266</td>
<td>108,038,723</td>
<td>605,165,431</td>
<td>752,564,732</td>
</tr>
<tr>
<td>Direct trade Sk</td>
<td>1,755,000</td>
<td>377,471,366</td>
<td>3,023,453,181</td>
<td>9,091,415,632</td>
<td>12,494,095,179</td>
</tr>
<tr>
<td>Direct trade (of pcs)</td>
<td>48</td>
<td>96</td>
<td>98</td>
<td>94</td>
<td>95</td>
</tr>
<tr>
<td>Direct trade (of Sk)</td>
<td>44</td>
<td>91</td>
<td>97</td>
<td>94</td>
<td>94</td>
</tr>
</tbody>
</table>

Source: Daily data communicated directly from the BCPB; own computations.
### TABLE 22. Terms of payments in standard methods, 1992-1997 (Sk mn and %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Book value</td>
<td>11,973</td>
<td>4,510</td>
<td>21,183</td>
<td>44,257</td>
<td>50,819</td>
<td>7,972</td>
<td>140,712</td>
</tr>
<tr>
<td>Purchase price</td>
<td>12,675</td>
<td>4,812</td>
<td>17,775</td>
<td>33,046</td>
<td>14,314</td>
<td>1,436</td>
<td>74,058</td>
</tr>
<tr>
<td>1st payment (% of book value)</td>
<td>14.1</td>
<td>8.3</td>
<td>8.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase price/book value (%)</td>
<td>105.9</td>
<td>106.7</td>
<td>83.9</td>
<td>74.7</td>
<td>28.2</td>
<td>18.0</td>
<td>52.6</td>
</tr>
</tbody>
</table>

Note: Figures are not comparable to Table 47 (p. 285) as the former is based on data of sold assets, while this table is based on approved privatisation project and there is a lag between the two and there can also be changes following the approval.

### TABLE 23. Initial ownership structure (end-1993) with regard to investment funds (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 81)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest fund</td>
<td>T60 (n=32)</td>
<td>S56 (n=45)</td>
<td>C9 (n=7)</td>
</tr>
<tr>
<td></td>
<td>10.5 (11.1)</td>
<td>14.5 (9.0)</td>
<td>15.6 (4.7)</td>
</tr>
<tr>
<td>Two largest funds</td>
<td>16.8 (16.6)</td>
<td>24.4 (13.6)</td>
<td>26.4 (8.3)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Multivariate analysis of variance (MANOVA), using the per cent of shares held by the largest and two largest investment funds as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.925; df = 4, 160; p = ns). Follow-up univariate analysis of variance (ANOVA) and pairwise Welch-tests yielded the above results.
Comment: Only firms included in the voucher programme are included in the sub-samples.
* p < 0.10; ** p < 0.05

### TABLE 24. Initial ownership structure (end-1993) with regard to the state, investment funds and individual investors (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 69)</th>
<th>Fisher’s PLSD, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>FNM</td>
<td>T60 (n=26)</td>
<td>S56 (n=39)</td>
<td>C9 (n=7)</td>
</tr>
<tr>
<td></td>
<td>31.9 (27.8)</td>
<td>21.1 (20.8)</td>
<td>21.6 (23.4)</td>
</tr>
<tr>
<td>IFs</td>
<td>34.0 (23.3)</td>
<td>46.1 (20.9)</td>
<td>43.5 (17.8)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DIK</td>
<td>33.8 (20.0)</td>
<td>31.0 (17.5)</td>
<td>34.9 (17.2)</td>
</tr>
</tbody>
</table>

Note: MANOVA, using the per cent of shares held in total by the state (FNM), investment funds (IFs) and individual investors (DIKs) as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.925; df = 4, 160; p = ns). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above results.
Comment: Only firms included in the voucher programme are included in the sub-samples. Also, only firms reporting all three variables have been included.
* p < 0.10; ** p < 0.05
TABLE 25. Ownership concentration 1993; per cent of shares held by the largest non-state owners (NSO) (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>S56 (n=47)</th>
<th>C9 (n=9)</th>
<th>F (2, 86)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest NSO</td>
<td>T60 (n=33)</td>
<td>15.0 (9.5)</td>
<td>17.8 (14.1)</td>
<td>2.8*</td>
<td>T60 vs C9 *</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td>Two largest NSO</td>
<td>T60 (n=33)</td>
<td>25.3 (14.6)</td>
<td>31.6 (28.0)</td>
<td>4.1**</td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td>Five largest NSO</td>
<td>T60 (n=33)</td>
<td>34.1 (20.5)</td>
<td>35.2 (28.5)</td>
<td>4.5***</td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 ****</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
</tbody>
</table>

Note: MANOVA, using the one-, two-, and five largest non-state owners in 1993 as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.824; df = 6, 168; p = 0.0116). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above results.

* p < 0.10; ** p < 0.05; *** p < 0.01; **** p < 0.005

TABLE 26. Ownership concentration 1995; per cent of shares held by the largest non-state owners (NSO) (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>S56 (n=56)</th>
<th>C9 (n=9)</th>
<th>F (2, 121)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest NSO</td>
<td>T60 (n=59)</td>
<td>34.8 (25.6)</td>
<td>29.9 (28.8)</td>
<td>0.8 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>29.4 (21.0)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>29.9 (28.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Two largest NSO</td>
<td>T60 (n=59)</td>
<td>43.7 (26.5)</td>
<td>44.9 (32.0)</td>
<td>0.3 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>40.8 (19.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>44.9 (32.0)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Five largest NSO</td>
<td>T60 (n=59)</td>
<td>50.2 (26.0)</td>
<td>53.8 (28.0)</td>
<td>0.3 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>53.7 (20.2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>53.8 (28.0)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: MANOVA, using the one-, two-, and five largest non-state owners in 1995 as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.877; df = 6, 238; p = 0.0150).

TABLE 27. Ownership concentration 1996; per cent of shares held by the largest non-state owners (NSO) (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>S56 (n=56)</th>
<th>C9 (n=9)</th>
<th>F (2, 122)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest NSO</td>
<td>T60 (n=60)</td>
<td>40.6 (25.6)</td>
<td>37.3 (27.4)</td>
<td>1.2 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>34.0 (18.9)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>37.3 (27.4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Two largest NSO</td>
<td>T60 (n=60)</td>
<td>49.8 (25.0)</td>
<td>53.4 (29.4)</td>
<td>0.3 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>47.4 (17.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>53.4 (29.4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Five largest NSO</td>
<td>T60 (n=60)</td>
<td>59.6 (23.2)</td>
<td>63.1 (26.0)</td>
<td>0.4 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=56)</td>
<td>62.7 (16.0)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=9)</td>
<td>63.1 (26.0)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: MANOVA, using the largest-, two-, and five largest non-state owners in 1996 as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.878; df = 6, 240; p = 0.0152).
TABLE 28. Ownership concentration 1993-1996: per cent of shares held by the one largest non-state owner (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>10.2 (11.1)</td>
<td>32.2 (22.1)</td>
<td>36.4 (22.1)</td>
<td>32.2 **</td>
<td>1993 vs 1995 **</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 **</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>15.0 (9.5)</td>
<td>30.9 (21.6)</td>
<td>34.7 (19.4)</td>
<td>1993 vs 1995 **</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 **</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>17.8 (14.1)</td>
<td>29.9 (28.8)</td>
<td>37.3 (27.4)</td>
<td>1993 vs 1995 ns</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 *</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA yielded no significant main effect for group (F = 0.08; df = 2; p = ns), nor any significant interaction effect (group vs time) (F = 0.8; df = 4; p = ns).

* p < 0.10; ** p < 0.0001

TABLE 29. Ownership concentration 1993-1996: per cent of shares held by the two largest non-state owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>16.3 (16.6)</td>
<td>41.8 (22.3)</td>
<td>45.6 (21.3)</td>
<td>36.7 *</td>
<td>1993 vs 1995 *</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 *</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>25.3 (14.6)</td>
<td>42.4 (19.2)</td>
<td>48.1 (18.0)</td>
<td>1993 vs 1995 *</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 *</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>31.6 (28.0)</td>
<td>44.9 (32.0)</td>
<td>53.4 (29.4)</td>
<td>1993 vs 1995 ns</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1993 vs 1996 ns</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA yielded no significant main effect for group (F = 1.4; df = 2; p = ns), nor any significant interaction effect (group vs time) (F = 1.0; df = 4; p = ns).

* p < 0.0001

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### TABLE 30. Ownership concentration 1993-1996; per cent of shares held by the five largest non-state owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>1993</td>
<td>20.1 (20.8)</td>
<td>49.3 (21.1)</td>
<td>57.1 (19.5)</td>
<td>57.3 **</td>
<td>1993 vs 1995 **</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td>1993 vs 1996 **</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>1993</td>
<td>34.1 (20.5)</td>
<td>55.5 (18.6)</td>
<td>63.8 (16.3)</td>
<td>1993 vs 1995 **</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td>1993 vs 1996 **</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>1995 vs 1996 *</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>1993</td>
<td>35.2 (28.5)</td>
<td>53.8 (28.0)</td>
<td>63.1 (26.0)</td>
<td>1993 vs 1995 ns</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td>1993 vs 1996 *</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>1995 vs 1996 ns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA also yielded a significant main effect for group (F=3.5; df; 2; p = 0.0357; for pairwise comparisons in individual years, see TABLE 25-TABLE 27); however, no significant interaction effect (group vs time) (F = 0.9; df = 4; p = ns) was found.  
* p < 0.05; ** p < 0.01

### TABLE 31. Ownership composition 1993; per cent of shares held by different types of owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=33)</th>
<th>S56 (n=47)</th>
<th>C9 (n=9)</th>
<th>F (2, 86)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
</table>
| “Private” | 1993 | 0.4 (1.5) | 2.1 (6.9) | 11.1 (33.3) | 3.2 ** | T60 vs C9 ns  
|          | 1995 | T60 vs S56 *  
|          | 1996 | C9 vs S56 ns |
| “Funds”  | 1993 | 19.8 (20.4) | 32.0 (19.4) | 24.1 (17.5) | 3.9 ** | T60 vs C9 ns  
|          | 1995 | T60 vs S56 ***  
|          | 1996 | C9 vs S56 ns |
| “State”  | 1993 | 35.6 (28.5) | 20.2 (21.3) | 27.3 (35.0) | 3.5 ** | T60 vs C9 ns  
|          | 1995 | T60 vs S56 ***  
|          | 1996 | C9 vs S56 ns |

Note: MANOVA, using the three different types of owners as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.840; df = 6, 168; p = 0.0219). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.  
* p < 0.10; ** p < 0.05; *** p < 0.01
TABLE 32. Ownership composition 1995: per cent of shares held by different types of owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=59)</th>
<th>S56 (n=56)</th>
<th>C9 (n=9)</th>
<th>F (2, 121)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Private”</td>
<td>(2, 121)</td>
<td>39.1 (28.9)</td>
<td>33.4 (25.4)</td>
<td>35.3 (39.4)</td>
<td>0.6 ns</td>
<td>–</td>
</tr>
<tr>
<td>“Funds”</td>
<td>(2, 121)</td>
<td>11.1 (16.1)</td>
<td>20.2 (17.7)</td>
<td>18.5 (14.7)</td>
<td>4.4 **</td>
<td>T60 vs S56 ###</td>
</tr>
<tr>
<td>“State”</td>
<td>(2, 121)</td>
<td>16.5 (29.0)</td>
<td>6.5 (13.6)</td>
<td>8.8 (16.8)</td>
<td>2.9 *</td>
<td>T60 vs S56 **</td>
</tr>
</tbody>
</table>

Note: MANOVA, using the three different types of owners as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.898; df = 6, 238; p = 0.0440). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.
* p < 0.05; ** p < 0.01; *** p < 0.005

TABLE 33. Ownership composition 1996: per cent of shares held by different types of owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=60)</th>
<th>S56 (n=56)</th>
<th>C9 (n=9)</th>
<th>F (2, 122)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Private”</td>
<td>(2, 122)</td>
<td>54.3 (24.2)</td>
<td>52.4 (19.7)</td>
<td>56.5 (27.3)</td>
<td>0.2 ns</td>
<td>–</td>
</tr>
<tr>
<td>“Funds”</td>
<td>(2, 122)</td>
<td>5.3 (8.2)</td>
<td>10.3 (10.4)</td>
<td>6.6 (10.0)</td>
<td>4.2 **</td>
<td>T60 vs S56 ###</td>
</tr>
<tr>
<td>“State”</td>
<td>(2, 122)</td>
<td>9.3 (22.5)</td>
<td>1.5 (9.5)</td>
<td>1.1 (3.3)</td>
<td>3.3 *</td>
<td>T60 vs S56 **</td>
</tr>
</tbody>
</table>

Note: MANOVA, using the three different types of owners as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.896; df = 6, 240; p = 0.0396). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.
* p < 0.05; ** p < 0.01; *** p < 0.005

TABLE 34. Ownership composition 1993-1996: per cent of shares held by “private” owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>1993</td>
<td>0.4 (1.5)</td>
<td>37.0 (25.6)</td>
<td>50.7 (18.2)</td>
<td>134.5 **</td>
<td>1993 vs 1995 ***</td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>1993</td>
<td>2.1 (6.9)</td>
<td>35.1 (25.7)</td>
<td>54.0 (19.5)</td>
<td>1993 vs 1996 **</td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>1993</td>
<td>11.1 (33.3)</td>
<td>35.3 (39.4)</td>
<td>56.5 (27.3)</td>
<td>1993 vs 1995 ns</td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA yielded no significant main effect for group (F = 0.3; df = 2; p = ns), nor any significant interaction effect (group vs time) (F = 0.7; df = 4; p = ns).
* p < 0.01; ** p < 0.0001
### TABLE 35. Ownership composition 1993-1996; per cent of shares held by “fund” owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>1993</td>
<td>19.8 (20.4)</td>
<td>12.3 (15.0)</td>
<td>6.3 (8.7)</td>
<td>33.5 *****</td>
<td>1993 vs 1995 * 1993 vs 1996 **** 1995 vs 1996 **</td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>1993</td>
<td>32.0 (19.4)</td>
<td>20.4 (18.1)</td>
<td>9.9 (9.7)</td>
<td>1993 vs 1995 *** 1993 vs 1996 **** 1995 vs 1996 ****</td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>1993</td>
<td>24.1 (17.5)</td>
<td>18.5 (14.7)</td>
<td>6.6 (10.0)</td>
<td>1993 vs 1995 ns 1993 vs 1996 ** 1995 vs 1996 ns</td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA also yielded a significant main effect for group (F=3.8; df: 2; p = 0.0266; for pairwise comparisons in individual years, see TABLE 31-TABLE 33); however, no significant interaction effect (group vs time) was found (F = 1.6; df: 4; p = ns).

* p < 0.10; ** p < 0.05; *** p < 0.005; **** p < 0.001; ***** p < 0.0001

### TABLE 36. Ownership composition 1993-1996; per cent of shares held by “state” owners (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=33)</td>
<td>1993</td>
<td>35.6 (28.5)</td>
<td>9.4 (20.0)</td>
<td>5.4 (16.4)</td>
<td>42.1 ****</td>
<td>1993 vs 1995 **** 1993 vs 1996 **** 1995 vs 1996 ns</td>
</tr>
<tr>
<td>S56 (n=47)</td>
<td>1993</td>
<td>20.2 (21.3)</td>
<td>6.8 (13.9)</td>
<td>1.8 (10.3)</td>
<td>1993 vs 1995 *** 1993 vs 1996 **** 1995 vs 1996 **</td>
<td></td>
</tr>
<tr>
<td>C9 (n=9)</td>
<td>1993</td>
<td>27.3 (35.0)</td>
<td>8.8 (16.8)</td>
<td>1.1 (3.3)</td>
<td>1993 vs 1995 ns 1993 vs 1996 ** 1995 vs 1996 ns</td>
<td></td>
</tr>
</tbody>
</table>

Note: Repeated measures ANOVA also yielded a tendency to a significant main effect for group (F=2.3; df: 2; p = 0.1048; for pairwise comparisons in individual years, see TABLE 31-TABLE 33); also, a tendency to a significant interaction effect (group vs time) was found (F=2.3; df: 4; p = 0.0649).

* p < 0.10; ** p < 0.05; *** p < 0.001; **** p < 0.0001

### TABLE 37. Structure of Supervisory Board 1993

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=38)</th>
<th>S56 (n=55)</th>
<th>C9 (n=7)</th>
<th>F (2, 97)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>4.9 (1.9)</td>
<td>4.6 (2.0)</td>
<td>6.6 (1.8)</td>
<td>3.0 *</td>
<td>T60 vs C9 * T60 vs S56 ns C9 vs S56 *</td>
<td></td>
</tr>
<tr>
<td>Insiders (%)</td>
<td>13.6 (15.8)</td>
<td>13.8 (18.6)</td>
<td>11.9 (15.1)</td>
<td>0.6 ns</td>
<td>–</td>
<td></td>
</tr>
</tbody>
</table>

Note: MANOVA, using the number of members and the percentage of insiders as dependent variables, yielded no significant differences between groups (Wilks Lambda = 0.919; df = 6, 190; p = ns). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.05
**TABLE 38. Structure of Supervisory Board 1995**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=34)</th>
<th>S56 (n=50)</th>
<th>C9 (n=7)</th>
<th>F (2, 88)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Members (no.)</td>
<td>4.6 (1.8)</td>
<td>4.6 (1.8)</td>
<td>6.3 (2.4)</td>
<td>2.7 *</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insiders (%)</td>
<td>16.5 (18.4)</td>
<td>12.5 (15.5)</td>
<td>8.3 (14.4)</td>
<td>1.0 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New members (%)</td>
<td>54.2 (32.8)</td>
<td>54.5 (30.5)</td>
<td>39.5 (30.5)</td>
<td>0.7 ns</td>
</tr>
</tbody>
</table>

*Note: MANOVA, using the number of members, the percentage of insiders, and the percentage of new members as compared to 1993 as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.856; df = 10, 168; p = ns). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.10; ** p < 0.05

**TABLE 39. Structure of Supervisory Board 1996**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=56)</th>
<th>S56 (n=54)</th>
<th>C9 (n=6)</th>
<th>F (2, 112)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Members (no.)</td>
<td>4.8 (2.0)</td>
<td>4.2 (1.7)</td>
<td>5.8 (3.1)</td>
<td>2.6*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insiders (%)</td>
<td>15.4 (21.3)</td>
<td>11.9 (17.6)</td>
<td>9.3 (14.8)</td>
<td>0.6 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New members (%)</td>
<td>32.0 (35.9)</td>
<td>31.2 (30.5)</td>
<td>37.7 (25.9)</td>
<td>0.1 ns</td>
</tr>
</tbody>
</table>

*Note: MANOVA, using the number of members, the percentage of insiders, and the percentage of new members as compared to 1995 as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.928; df = 10, 216; p = ns). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.10; ** p < 0.05; 1 weak tendency to significance (p = 0.1167)

**TABLE 40. Members (number) at the Supervisory Board 1993-1996**

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comparisons between years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>1993</td>
<td>5.0 (1.9)</td>
<td>4.6 (1.8)</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td>4.6 (1.8)</td>
<td>4.5 (1.8)</td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>6.5 (2.0)</td>
<td>6.2 (2.6)</td>
</tr>
<tr>
<td>S56 (n=52)</td>
<td>1993</td>
<td>4.6 (2.1)</td>
<td>4.5 (1.8)</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>1993</td>
<td>6.5 (2.0)</td>
<td>6.2 (2.6)</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Repeated measures ANOVA yielded a significant main effect for group (F = 2.8; df = 2; p = 0.0657); for pairwise comparisons in individual years, see TABLE 37-TABLE 39. However, no significant interaction effect (group vs time) (F=0.3; df = 4; p = ns) was found.

* p < 0.10; ** p < 0.05
### TABLE 41. Insiders at the Supervisory Board 1993-1996 (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>14.0 (15.5)</td>
<td>16.5 (18.4)</td>
<td>16.6 (22.9)</td>
<td></td>
</tr>
<tr>
<td>S56 (n=50)</td>
<td>14.1 (19.0)</td>
<td>12.5 (15.5)</td>
<td>12.0 (17.7)</td>
<td></td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>13.9 (15.5)</td>
<td>9.7 (15.3)</td>
<td>9.3 (14.8)</td>
<td></td>
</tr>
</tbody>
</table>

*Note:* Repeated measures ANOVA yielded neither a significant main effect for group (F=0.5; df: 2; p = ns), for time (F = 0.1; df = 2; p = ns) nor a significant interaction effect (group vs time) (F=0.5; df: 4; p = ns).

### TABLE 42. New part of the Supervisory Board 1993-1996 (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>Main effect for time Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>54.2 (32.8)</td>
<td>29.8 (33.9)</td>
</tr>
<tr>
<td>S56 (n=52)</td>
<td>54.6 (30.3)</td>
<td>29.2 (28.0)</td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>46.1 (27.5)</td>
<td>37.7 (25.9)</td>
</tr>
</tbody>
</table>

*Note:* Repeated measures ANOVA yielded neither a significant main effect for group (F < 0.1; df: 2; p = ns) nor a significant interaction effect (group vs time) (F = 0.4; df: 2; p = ns).

*Comment:* The significant changes between periods are partly explainable by the longer duration between measurements in the first time-span.

* p < 0.01; ** p < 0.005; *** p < 0.0001

### TABLE 43. Structure of Board of Directors 1993

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=38)</th>
<th>S56 (n=55)</th>
<th>C9 (n=7)</th>
<th>F (2, 97)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>T60 (n=34)</td>
<td>5.1 (1.6)</td>
<td>5.0 (1.2)</td>
<td>5.3 (1.4)</td>
<td>0.2 ns</td>
</tr>
<tr>
<td>Insiders (%)</td>
<td>S56 (n=52)</td>
<td>64.8 (34.5)</td>
<td>58.5 (34.5)</td>
<td>51.8 (30.0)</td>
<td>0.6 ns</td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using the number of members and the percentage of insiders as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.979; df = 6, 190; p = ns). Follow-up univariate ANOVAs likewise yielded no significant differences.

### TABLE 44. Structure of Board of Directors 1995

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>T60 (n=34)</th>
<th>S56 (n=52)</th>
<th>C9 (n=7)</th>
<th>F (2, 90)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>T60 (n=34)</td>
<td>4.5 (1.8)</td>
<td>4.5 (1.1)</td>
<td>5.1 (1.2)</td>
<td>0.6 ns</td>
</tr>
<tr>
<td>Insiders (%)</td>
<td>S56 (n=52)</td>
<td>65.3 (28.6)</td>
<td>48.4 (27.8)</td>
<td>60.7 (25.2)</td>
<td>3.9*</td>
</tr>
<tr>
<td>New members (%)</td>
<td>C9 (n=7)</td>
<td>41.5 (35.8)</td>
<td>45.6 (30.5)</td>
<td>41.9 (51.5)</td>
<td>0.2 ns</td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using the number of members, the percentage of insiders, and the percentage of new members as compared to 1993 as dependent variables, yielded no significant differences between the three groups (Wilks Lambda = 0.849; df = 10, 172; p = ns). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.05; ** p < 0.01
### TABLE 45. Structure of Board of Directors 1996

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 113)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>T60 (n=56)</td>
<td>4.8 (1.8)</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>S56 (n=54)</td>
<td>4.4 (1.3)</td>
<td>T60 vs C9 ns</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>5.5 (1.0)</td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td>Insiders (%)</td>
<td>T60 (n=56)</td>
<td>60.3 (26.2)</td>
<td>T60 vs C9 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=54)</td>
<td>43.4 (26.5)</td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>49.0 (26.4)</td>
<td>C9 vs S56 **</td>
</tr>
<tr>
<td>New members (%)</td>
<td>T60 (n=56)</td>
<td>26.5 (33.7)</td>
<td>1.6 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=54)</td>
<td>31.8 (33.8)</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>51.7 (33.2)</td>
<td>–</td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using the number of members, the percentage of insiders, and the percentage of new members as compared to 1995 as dependent variables, yielded that there were significant differences between the three groups (Wilks Lambda = 0.851; df = 10, 218; p = 0.0560). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.005; ** p < 0.001

### TABLE 46. Members (number) at the Board of Directors 1993-1996

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>1993</td>
<td>5.1 (1.6)</td>
<td>4.5 (1.8)</td>
<td>4.7 (1.9)</td>
<td>2.9*</td>
<td>1993 vs 1995 ns 1993 vs 1996 ns 1995 vs 1996 ns</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S56 (n=52)</td>
<td>1993</td>
<td>5.1 (1.1)</td>
<td>4.5 (1.1)</td>
<td>4.5 (1.3)</td>
<td>1993 vs 1995 ** 1993 vs 1996 ***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>1993</td>
<td>5.3 (1.5)</td>
<td>5.2 (1.3)</td>
<td>5.5 (1.0)</td>
<td>1993 vs 1995 ns 1993 vs 1996 ns 1995 vs 1996 ns</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* Repeated measures ANOVA yielded neither a significant main effect for group (F=0.7; df: 2; p = ns) nor a significant interaction effect (group vs time) (F=0.8; df: 4; p-value=0.ns). Using Welch-test for pairwise comparisons within groups between years yielded the above reported results.

* p < 0.10; ** p < 0.05 *** p < 0.01

### TABLE 47. Insiders (per cent) at the Board of Directors 1993-1996

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (2)</th>
<th>Welch test, pairwise comparisons between years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>1993</td>
<td>63.4 (34.6)</td>
<td>65.3 (28.6)</td>
<td>59.4 (26.3)</td>
<td>2.5 *</td>
<td>1993 vs 1995 ns 1993 vs 1996 ns 1995 vs 1996 ns</td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S56 (n=52)</td>
<td>1993</td>
<td>56.2 (33.9)</td>
<td>48.4 (27.8)</td>
<td>44.0 (26.8)</td>
<td>1993 vs 1995 ns 1993 vs 1996 ** 1995 vs 1996 ns</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>1993</td>
<td>57.1 (29.0)</td>
<td>64.1 (25.8)</td>
<td>49.0 (26.4)</td>
<td>1993 vs 1995 ns 1993 vs 1996 ns 1995 vs 1996 ns</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* Repeated measures ANOVA yielded a significant main effect for group (F = 2.9; df = 2; p = 0.0627); for pairwise comparisons in individual years, see TABLE 43-TABLE 45. However, no significant interaction effect (group vs time) (F=1.0; df: 4; p = ns) was found.

* p < 0.10; ** p < 0.05 *** p < 0.01
### Table 48. New Part of the Board of Directors (per cent) 1993-1996

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>Main effect for time years</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=34)</td>
<td>41.5 (35.8)</td>
<td>21.3 (28.0)</td>
<td>2.2 * 1993/95 vs 1995/96 *</td>
</tr>
<tr>
<td>S56 (n=52)</td>
<td>45.6 (30.5)</td>
<td>29.2 (31.5)</td>
<td>1993/95 vs 1995/96 *</td>
</tr>
<tr>
<td>C9 (n=6)</td>
<td>45.6 (55.4)</td>
<td>51.7 (33.2)</td>
<td>1993/95 vs 1995/96 ns</td>
</tr>
</tbody>
</table>

**Note:** Repeated measures ANOVA yielded no significant interaction effect (group vs time) (F=0.9; df: 2; p = ns); regarding main effect for group, see Table 49.

**Comment:** The significant changes between periods are partly explainable by the longer duration between measurements in the first time-span.

* p < 0.01; 1 A weak tendency to significance was noted (p = 0.1383)

### Table 49. New Part of the Board of Directors (per cent) 1993-1996

<table>
<thead>
<tr>
<th>Period</th>
<th>Group</th>
<th>Main effect for group</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>T60 (n=34)</td>
<td>S56 (n=52)</td>
<td>C9 (n=6)</td>
</tr>
<tr>
<td>1993/1995</td>
<td>41.5 (35.8)</td>
<td>45.6 (30.5)</td>
<td>45.6 (55.4)</td>
</tr>
<tr>
<td>1995/1996</td>
<td>21.3 (28.0)</td>
<td>29.2 (31.5)</td>
<td>51.7 (33.2)</td>
</tr>
</tbody>
</table>

**Note:** Repeated measures ANOVA yielded no significant interaction effect (group vs time) (F=0.9; df: 2; p = ns); regarding main effect for time, see Table 48.

* p < 0.10

### Table 50. Members of the Management Board, 1993

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>Main effect</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members</td>
<td>T60 (n=35)</td>
<td>S56 (n=55)</td>
<td>C9 (n=6)</td>
</tr>
<tr>
<td></td>
<td>5.4 (2.7)</td>
<td>4.6 (1.7)</td>
<td>6.7 (3.6)</td>
</tr>
</tbody>
</table>

**Note:** Univariate ANOVA, using the number of members of the management board as dependent variable yielded a significant difference between groups.

* p < 0.10

### Table 51. Structure of Management Board 1995

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>Main effect</th>
<th>Fisher’s PLSD, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>T60 (n=30)</td>
<td>S56 (n=51)</td>
<td>C9 (n=6)</td>
</tr>
<tr>
<td>New members (%)</td>
<td>43.5 (31.7)</td>
<td>43.4 (33.6)</td>
<td>13.9 (26.7)</td>
</tr>
</tbody>
</table>

**Note:** MANOVA, using the number of members and the percentage of new members as compared to 1993 as dependent variables, yielded a significant difference between groups (Wilks Lambda = 0.856; df = 6, 164; p = 0.0446). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.10; ** p < 0.05

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### TABLE 52. Structure of Management Board 1996

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 106)</th>
<th>Fisher’s PLSD, pairw. comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members (no.)</td>
<td>T60 (n=51)</td>
<td>4.9 ***</td>
<td>T60 vs C9 ns</td>
</tr>
<tr>
<td></td>
<td>S56 (n=52)</td>
<td></td>
<td>T60 vs S56 ***</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td>C9 vs S56 **</td>
</tr>
<tr>
<td>New members (%)</td>
<td>16.2 (25.3)</td>
<td>2.8 *</td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td>18.4 (24.7)</td>
<td></td>
<td>T60 vs S56 ns</td>
</tr>
<tr>
<td></td>
<td>42.2 (30.0)</td>
<td></td>
<td>C9 vs S56 **</td>
</tr>
</tbody>
</table>

**Note:** MANOVA, using the number of members and the percentage of new members as compared to 1995 as dependent variables, yielded a significant difference between groups (Wilks Lambda = 0.814; df = 6, 208; p = 0.0014). Follow-up univariate ANOVAs and pairwise Fisher’s PLSD tests yielded the above reported results.

* p < 0.10; ** p < 0.05; *** p < 0.01

### TABLE 53. Members (number) at the Management Board 1993-1996

<table>
<thead>
<tr>
<th>Period</th>
<th>Group</th>
<th>T60 (n=30)</th>
<th>S56 (n=51)</th>
<th>C9 (n=5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>5.0 (2.2)</td>
<td>4.6 (1.7)</td>
<td>6.4 (4.0)</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>5.2 (1.9)</td>
<td>4.5 (1.8)</td>
<td>5.4 (1.5)</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>5.3 (2.1)</td>
<td>4.3 (1.6)</td>
<td>6.0 (2.5)</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Repeated measures ANOVA yielded a significant main effect for group (F = 2.8; df = 2; p = 0.0453); for pairwise comparisons in individual years, see TABLE 50-TABLE 52. However, neither a significant main effect for time (F=0.6; df; 2; p = ns) nor a significant interaction effect (group vs time) (F=1.1; df; 4; p = ns) was found.

### TABLE 54. New part of the Management Board (per cent) 1993-1996

<table>
<thead>
<tr>
<th>Period</th>
<th>Group</th>
<th>T60 (n=30)</th>
<th>S56 (n=51)</th>
<th>C9 (n=5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993/1995</td>
<td>43.5 (31.7)</td>
<td>10.7 (15.8)</td>
<td>3.0 *</td>
<td>1993/95 vs 1995/96 **</td>
</tr>
<tr>
<td>1995/1996</td>
<td>43.4 (33.6)</td>
<td>18.8 (24.9)</td>
<td></td>
<td>1993/95 vs 1995/96 ns</td>
</tr>
<tr>
<td>1993/95</td>
<td>13.3 (29.8)</td>
<td>39.2 (32.5)</td>
<td></td>
<td>1993/95 vs 1995/96 **</td>
</tr>
</tbody>
</table>

**Note:** Repeated measures ANOVA did yield a significant interaction effect (group vs time) (F=5.6; df; 2; p = 0.0054) but no significant main effect for group (F=0.4; df; 2; p = ns).

*Comment:* The significant changes between periods are partly explainable by the longer duration between measurements in the first time-span.

* p < 0.10; ** p < 0.0001

### TABLE 55. Bank debt as a per cent of total assets 1993 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 90)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank debt</td>
<td>T60 (n=43)</td>
<td>14.0 (10.6)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=43)</td>
<td>14.5 (9.8)</td>
</tr>
<tr>
<td></td>
<td>C9 (n=7)</td>
<td>18.8 (9.5)</td>
</tr>
</tbody>
</table>

**Note:** Univariate ANOVA, using Bank debt as dependent variable, revealed the above results.
### TABLE 56. Bank debt as a per cent of total assets 1994 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Group</th>
<th>Variable</th>
<th>T60 (n=46)</th>
<th>S56 (n=47)</th>
<th>C9 (n=6)</th>
<th>F (2, 96)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank debt</td>
<td>13.2 (10.2)</td>
<td>14.1 (10.1)</td>
<td>13.1 (4.2)</td>
<td>0.1 ns</td>
<td></td>
</tr>
</tbody>
</table>

*Note: Univariate ANOVA, using Bank debt as dependent variable, revealed the above results.*

### TABLE 57. Bank debt as a per cent of total assets 1995 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Group</th>
<th>Variable</th>
<th>T60 (n=53)</th>
<th>S56 (n=51)</th>
<th>C9 (n=6)</th>
<th>F (2, 107)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank debt</td>
<td>16.3 (12.9)</td>
<td>16.0 (11.0)</td>
<td>13.3 (5.7)</td>
<td>0.2 ns</td>
<td></td>
</tr>
</tbody>
</table>

*Note: Univariate ANOVA, using Bank debt as dependent variable, revealed the above results.*

### TABLE 58. Bank debt as a per cent of total assets 1996 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Group</th>
<th>Variable</th>
<th>T60 (n=53)</th>
<th>S56 (n=49)</th>
<th>C9 (n=6)</th>
<th>F (2, 105)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank debt</td>
<td>19.4 (16.5)</td>
<td>16.4 (10.8)</td>
<td>18.7 (8.1)</td>
<td>0.6 ns</td>
<td></td>
</tr>
</tbody>
</table>

*Note: Univariate ANOVA, using Bank debt as dependent variable, revealed the above results.*

### TABLE 59. Bank debt as a per cent of total assets 1993-1996 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (3)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>T60 (n=37)</td>
<td>15.4 (10.6)</td>
<td>14.5 (10.6)</td>
<td>16.9 (12.2)</td>
<td>18.6 (15.9)</td>
<td>5.4 **</td>
<td>93 vs 94 ns</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (3)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>S56 (n=37)</td>
<td>13.6 (9.4)</td>
<td>12.8 (9.0)</td>
<td>15.2 (9.6)</td>
<td>16.7 (11.1)</td>
<td>93 vs 94 ns</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Group</th>
<th>Period</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>Main effect for time F (3)</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>C9 (n=6)</td>
<td>15.7 (5.6)</td>
<td>13.1 (4.2)</td>
<td>13.3 (5.7)</td>
<td>18.7 (8.1)</td>
<td>93 vs 94 ns</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Repeted measures ANOVA yielded no significant main effect for group (F=0.3; df: 2; p = ns) nor any significant interaction effect (group vs time) (F=0.4; df: 6; p = ns).*

* p < 0.10; ** p < 0.001
TABLE 60. *Financial indicators 1993 (means and std. dev. in per cent)*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 93)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROC</td>
<td>T60 (n=45)</td>
<td>14.0 (19.0)</td>
<td>0.5 (15.1)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=44)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=7)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOL</td>
<td>T60 (n=45)</td>
<td>57.7 (22.8)</td>
<td>63.3 (16.8)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=44)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=7)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIQ</td>
<td>T60 (n=45)</td>
<td>240.5 (535.6)</td>
<td>130.8 (86.4)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=44)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=7)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using ROC, SOL and LIQ as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.791; df = 6, 182; p = 0.0014). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.

*Comment:* Outliers with ROC in excess of 250 per cent on average for the period 1993-1996 have been excluded from the samples.

* p < 0.005; ** p < 0.001; *** p < 0.0005

TABLE 61. *Financial indicators 1994 (means and std. dev. in per cent)*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 100)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROC</td>
<td>T60 (n=49)</td>
<td>24.1 (80.3)</td>
<td>-2.2 (17.4)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=48)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOL</td>
<td>T60 (n=49)</td>
<td>53.8 (24.2)</td>
<td>62.6 (16.7)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=48)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIQ</td>
<td>T60 (n=49)</td>
<td>160.7 (99.9)</td>
<td>122.7 (72.5)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=48)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using ROC, SOL and LIQ as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.826; df = 6, 196; p = 0.0044). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.

*Comment:* Outliers with ROC in excess of 250 per cent on average for the period 1993-1996 have been excluded from the samples.

* p < 0.10; ** p < 0.05; 1 A weak tendency to significance was noted (p = 0.1136); 2 A weak tendency to significance was noted (p = 0.1100)

TABLE 62. *Financial indicators 1995 (means and std. dev. in per cent)*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th>F (2, 113)</th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROC</td>
<td>T60 (n=58)</td>
<td>26.21 (46.4)</td>
<td>-5.1 (26.1)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=52)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOL</td>
<td>T60 (n=58)</td>
<td>47.2 (31.8)</td>
<td>56.8 (22.9)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=52)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIQ</td>
<td>T60 (n=58)</td>
<td>172.0 (139.0)</td>
<td>182.2 (215.3)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=52)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* MANOVA, using ROC, SOL and LIQ as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.843; df = 6, 222; p = 0.0041). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.

*Comment:* Outliers with ROC in excess of 250 per cent on average for the period 1993-1996 have been excluded from the samples.

* p < 0.0005; ** p < 0.0001
TABLE 63. Financial indicators 1996 (means and std. dev. in per cent)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>T60 (n=57)</td>
<td>S56 (n=49)</td>
<td>C9 (n=6)</td>
<td>(2, 109)</td>
<td></td>
<td>T60 vs C9 ****</td>
</tr>
<tr>
<td>ROC</td>
<td>40.4 (91.1)</td>
<td>7.2 (38.1)</td>
<td>0.3 (11.3)</td>
<td></td>
<td></td>
<td>T60 vs S56 ****</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td>SOL</td>
<td>38.5 (41.4)</td>
<td>53.5 (30.2)</td>
<td>51.4 (17.6)</td>
<td></td>
<td></td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td>LIQ</td>
<td>172.0 (139.0)</td>
<td>182.2 (215.3)</td>
<td>134.8 (71.7)</td>
<td></td>
<td></td>
<td>0.8 ns –</td>
</tr>
</tbody>
</table>

Note: MANOVA, using ROC, SOL and LIQ as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.900; DF = 6, 214; p = 0.0781). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.

Comment: Outliers with ROC in excess of 250 per cent on average for the period 1993-1996 have been excluded from the samples.

* p < 0.10; ** p < 0.05; ***; p < 0.01; **** p < 0.005

TABLE 64. Financial indicators average 1993-1996 (means & std. dev. in %)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Group</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Welch test, pairwise comp. betw. groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>T60 (n=43)</td>
<td>S56 (n=39)</td>
<td>C9 (n=6)</td>
<td>(2, 85)</td>
<td></td>
<td>T60 vs C9 **</td>
</tr>
<tr>
<td>ROC avg.</td>
<td>23.2 (28.2)</td>
<td>2.5 (16.2)</td>
<td>1.4 (6.8)</td>
<td></td>
<td></td>
<td>T60 vs S56 **</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>C9 vs S56 ns</td>
</tr>
<tr>
<td>SOL avg.</td>
<td>52.2 (23.3)</td>
<td>60.5 (15.9)</td>
<td>56.7 (19.1)</td>
<td></td>
<td></td>
<td>1.8 ns –</td>
</tr>
<tr>
<td>LIQ avg.</td>
<td>186.2 (122.5)</td>
<td>155.4 (84.1)</td>
<td>127.1 (77.5)</td>
<td></td>
<td></td>
<td>1.4 ns –</td>
</tr>
</tbody>
</table>

Note: MANOVA, using ROC, SOL and LIQ as dependent variables, yielded significant differences between the three groups (Wilks Lambda = 0.772; DF = 6, 166; p = 0.0013). Follow-up univariate ANOVAs and pairwise Welch-tests yielded the above results.

Comment: Outliers with ROC in excess of 250 per cent on average for the period 1993-1996 have been excluded from the samples. Also, only firms reporting all four years in question have been included.

* p < 0.0005; ** p < 0.0001

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### TABLE 65. Financial indicators 1993-1996 (means & std. dev. in per cent)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Group</th>
<th>Period</th>
<th>Main effect for time</th>
<th>Welch test, pairwise comp. betw. years</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROC</td>
<td>T60 (n=43)</td>
<td>15.6 (16.9)</td>
<td>24.9 (83.7)</td>
<td>16.9 (33.4)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=40)</td>
<td>1.8 (14.8)</td>
<td>-0.9 (17.3)</td>
<td>-1.8 (15.9)</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>-1.3 (16.8)</td>
<td>6.4 (11.3)</td>
<td>0.4 (7.4)</td>
</tr>
<tr>
<td></td>
<td>SOL</td>
<td>T60 (n=43)</td>
<td>56.6 (22.4)</td>
<td>54.5 (24.3)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=40)</td>
<td>63.6 (16.8)</td>
<td>63.4 (16.3)</td>
<td>59.3 (17.6)</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>57.2 (19.7)</td>
<td>59.2 (18.1)</td>
<td>59.1 (22.0)</td>
</tr>
<tr>
<td>LIQ</td>
<td>T60 (n=43)</td>
<td>163.6 (132.1)</td>
<td>165.9 (105.3)</td>
<td>190.1 (147.5)</td>
</tr>
<tr>
<td></td>
<td>S56 (n=39)</td>
<td>135.9 (87.6)</td>
<td>117.6 (65.1)</td>
<td>201.1 (241.0)</td>
</tr>
<tr>
<td></td>
<td>C9 (n=6)</td>
<td>121.6 (99.2)</td>
<td>139.4 (101.2)</td>
<td>134.8 (71.7)</td>
</tr>
</tbody>
</table>

Note regarding ROC: Repeated measures ANOVA revealed a significant main effect for group (F=10.0; df: 2; p = 0.0001; for pairwise comparisons in individual years, see TABLE 60-TABLE 63. However, no significant interaction effect (group vs time) was found (F=0.3; df: 6; p = ns).

Note regarding SOL: Repeated measures ANOVA revealed no significant main effect for group (F=1.5; df: 2; p = ns), nor any significant interaction effect (group vs time) (F=0.2; df: 6; p = ns).

Note regarding LIQ: Repeated measures ANOVA yielded no significant main effect for group (F=1.4; df: 2; p = ns), nor any significant interaction effect (group vs time) (F=0.7; df: 6; p = ns).

* p < 0.10; ** p < 0.05; *** p < 0.005
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