

Project Title:

The Analysis of the Ownership Dynamics in the Post-privatization period

Project Leader: Katarina Zajc, Assistant Professor, Faculty of Law, University of Ljubljana, Slovenia.

Aleksandra Gregoric, Assistant Professor, Department of International Economics and Management, Copenhagen Business School, Denmark.

Arjana Brezigar Masten, IMAD, Slovenia.

EXECUTIVE SUMMARY

1. Research objectives:

While there is a wide range of empirical studies addressing the impact of ownership concentration on firm performance, few empirical studies specifically analyse the factors driving the choice of a specific ownership structure. The general observation concerning transition countries is that, rather than reflecting firm characteristics, the ownership structure to some extent still reflects the initial distribution of shares, while the inefficiencies in the investors' protection and lack of alternative corporate governance mechanism have been largely determining the general trend towards higher concentration in most transition countries.

The aim of our analysis was to look beyond the existing explanations of the ownership dynamics, namely the economic factors (following Demsetz and Lehn, 1985) and the inefficiencies in the minority investors' protection (see for instance, Berglof and Pajuste, 2005) as the determinants of the level of ownership concentration in privatized firms. Following the conclusions of the existing theoretical literature on the division of control in a corporation (Zwiebel, 1995; Bennedsen and Wolfenzon, 2000, Gomes and Novaes, 2005 and Hansmann, 1996) we explore two main research questions and generate some relevant findings, as follows:

1- Given the inefficiencies in the minority investors' protection and the (expected) relevant presence of large blockholders in the privatized firms, **what is then that determines how the control will be shared/divided in a specific firm?** To put it differently, which are the factors that determine whether a firm (and its management) will be controlled and directed by one large blockholder or a coalition of more (relatively) large blockholders? This question is based on the theoretical predictions of Zwiebel (1995) and the existing empirical evidence from the Western countries. Most of the firms on the stock exchange in Continental Europe have one dominant or controlling owner, but no other or few other, significantly smaller blockholders (Becht and Barca, 2001). On the other hand, a large number of firms off the market have two or three significant but non-majority blockholders that co-exist to share monitoring and the benefits of control. In this

regard, our paper provides new evidence on the factors that influence the co-existence of multiple blocks. Following Hansmann (1996), and Gomes and Novaes (2005) we test whether the persistence of multiple blockholder structure and consequently, the incentive of the larger owner to drive out the other shareholders anyhow depend on the identity (type) and ownership share of the three main largest blockholders and whether these incentives differ between listed and non-listed firms.

Findings:

The detailed data on the ownership structure in the years 1998-2004 for the privatized Slovenian firm as well as the specifics of Slovenian privatization represent a perfect basis for addressing the question 1. First, the Slovenian Privatization Law (1992) introduced a mandatory distribution of a relatively large but still minority ownership share blocks (10%) to two-types of large blockholders: the privatization investment funds and state-controlled funds. Thus, all Slovenian privatized firms ended up with relatively dispersed ownership structure. However, 6 years after the conclusion of privatization, the ownership concentration and the distribution of ownership blocks across the main blockholders differs across firms (See Brezigar, Gregoric and Zajc, 2008). Our main finding is that the owners are more likely to share control when they are of the same type: when homogenous (i.e. two investment funds or two individuals or two non-financial companies, etc.), the two largest owners can join and form coalitions in monitoring and sharing the private benefits of control. This is more the case when these blockholders hold relatively similar shares; on the other hand, when small, the presence of 'additional' blockholders of the same type (identity) as the largest, facilitate the concentration of the largest blockholder by selling off their block. These results have been confirmed also in our latest estimations (see results for 2009, attached). In the first version of the paper (2006), we furthermore test the impact of the different control structures for firm performance: we find a generally positive effect of ownership concentration and a negative impact of the coalitions formed by privatization investment funds.

2- Assuming that the ownership structure introduced at the time of privatization is, at least to some extent, exogenous to the firm-specific variables (i.e. size, risk, assets' tangibility, etc.), the resulting level of ownership concentration did not reflect the economic factors specific to the firm and to them associated trade-offs between costs and benefits of concentrated ownership. Thus, the changes in the ownership concentration in the post-privatization period should introduce the adjustments to (more) optimal levels. **In this regard we test whether the level of inside¹ ownership or the presence of State-controlled investors in Slovenian firms prevent efficient changes to take place.**

Paper 1 and 2 address the issue of obstacles to ownership concentration. We only find a relation between the ownership concentration (the size of the ownership share held by the largest owner) and the level of minority ownership in the non-listed firms. In the latter, the minority owners actually include employees (and managers), former employees and their relatives. We find that, in general, the largest, outside owner

¹ Inside owners include employees, former employees and their relatives.

has been concentrating more in the firms with a larger share of the inside owners; this may imply that the outsiders feel challenged by insiders (managers and the employees supporting them) and thus, try to gain control rights to become more powerful. Also, at a given share of inside ownership, the increase in the size of the largest share is lower in the firms that have been reducing the employment. We argue that in such firms, the employees are less likely to support management against the outside owner. This reduces the need of the latter to concentrate/increase her ownership share.

In regards to the State-role in creating obstacles to efficient ownership dynamics, we performed some preliminary analysis of the determinants of the state-funds exit from the privatized firms. We wanted to see whether the presence of the State can be explained by some firm-specific determinants that could justify the remaining State ownership from the perspective of firm efficiency. Also, we were interested whether we can find some evidence on the persistency of State ownership in, for example, better performing firms or bigger firms, which could imply that the State is preserving the share for other (i.e. political) reasons and consequently, preventing the efficient ownership dynamics to take place. However, so far, we find no significant results. Thus, this question remains open for further research.