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A FRAMEWORK FOR ANALYSIS OF CORPORATE CONTROL IN TRANSITION COUNTRIES

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Abstract: *Corporate control is integrative concept of corporate governance. This paper offers novel perspective on elaborating corporate control in transition countries. The research framework that we propose hold that most important feature of corporate governance is its stability in achieving two major functions of corporate governance: macro perspective which is represented with balance between shareholders and micro perspective which is represented by enterprise performance. We argue that nature of corporate control is not solely determinant of ownership concentration as most literature suggests but is also a matter of identity of shareholders and that the level of corporate control can be approximated by attributes of structure and work of board of directors. Framework for analysis is in this paper described from perspective of transition economy where corporate control mechanism are more unstable and fragile that they are in countries with longer tradition of market for corporate control.*
Key words: *corporate control, owership concentration, shareholder identity, transition*

1. INTRODUCTION

Corporate governance is primarily concerned with relationship between owner and manager of an enterprise. Way in which country regulates relation between shareholders and managers significantly differs, mostly on the level of different economic situations and national traditions. That is especially correct for countries of central and Eastern Europe that in the period of last twenty years went though fundamental political and economic changes (Mallin, Jelic, 2000).

Focus of the research framework we propose is on determinants and consequences of corporate governance systems of transitional economies. Transition countries of central and Eastern Europe can significantly differ according to historical context as well as according to present institutional framework but they still share some common characteristics. All countries have or they have had big number of corporations in state ownership which needed to go trough process of restructuring. Besides that, it is important to introduce changes in dysfunctional legal system as well as to build fundamental institutions from the beginning (Berglöf, von Thadden, 1999).

2. LOCUS OF CORPORATE CONTOL AS INTEGRATIVE CONCEPT OF CORPORATE GOVERNANCE

In this paper we propose framework for analysis of corporate governance which in the hearth of the issue puts concept of corporate control. Corporate control is defined as position in which one subject can enforce its goals as goals of the corporation.

Most important attribute of corporate control is its stability. If corporate control is not stable two most important elements of corporate control becomes questionable: balance in relations of stakeholders and corporate performance. If one of these two elements is not addressed there is a crisis of corporate governance system. Lack of stable corporate control affects these fundamental issues. Consequence of instability of corporate control is battle between coalitions of shareholders for the position of control which, if taking a long time, subsequently destroys competitiveness of the corporation.

Stability of corporate control is mostly determined by level of shareholder concentration as well as by identity of shareholders. Concentration and identity of shareholders forms patterns of corporate control and influence performance – distribution of rights between stakeholders.

Ownership concentration determines distribution of power and control between managers and shareholders. Empirical research in this area focuses on trends towards dispersion of ownership as well as on reasons and consequences of diminishing shareholders influence.

High level of ownership concentration is characteristic that mostly differentiates German form Anglo-Saxon system of corporate governance. (La Porta et al., 1999). Big number of small owners increases difference between ownership and control – major characteristic of modern business systems – corporations. Big dispersion of ownership – lack of single big principal, leads to higher influence of management what increases agency problem. Main research question of American system of corporate governance is question of collective action of dispersed shareholders in direction of management disciplinarian. While in American system of corporate governance ownership is highly dispersed in rest of the world corporate ownership is characterized by several large shareholders – *blockholders.* (La Porta et al., 1999).

Research about level of ownership concentration and its consequences have so far been much more often done in USA and UK than in transition countries. Literature recognizes many different measures for measuring ownership concentration. Big group of researches use framework developed by Demsetza and Lehna which measure ownership concentration in respect to group of shareholders, usually measured as total number of shares held by certain number of shareholders (for instance 5 or 20 biggest shareholders) (Demsetz, Lehn, 1985). In other studies Holderness and Sheehan as well as Wruck examine only blockholders ownership (more than 5% of equity) and managerial ownership (Holderness, Sheehan, 1988, Wruck, 1989). Prowse in his research considers five biggest shareholders as well as Hovey et al. (Prowse, 1992, Hovey et al., 2003). Claessens et al. as a measure of concentration ownership take level of ownership of highest shareholder (Claessen et al., 2000).

Ownership and control are rarely completely different within corporations, since ones who are in position of control usual have at least certain level of ownership in the company in which they perform that function. Typical problem of dispersed ownership is the fact that certain shareholders will not have significant motivation or influence to participate in decision making within corporation. Blockolders are in position to nominate majority of members of board of directors and they can influence management turnover as well as initiate and block important decisions. Board of directors is responsible for implementation of corporate governance system and shareholders are responsible for nominating qualified and efficient board members. Corporate boards are decisive element of corporate governance because they develop politics and strategies which determine future of the corporation and which are in closest connection with management. From all these reasons question of roll and structure of corporate boards represents crucial question in discussion of corporate control.

Besides ownership concentration framework for analysis of corporate control recognizes importance of shareholders identity. Identity of shareholders in literature depends on the main goal of research. For example Pajuste and Olsson as types of shareholder identity recognize private domestic shareholders, domestic corporations, foreign private investors, foreign corporations, banks and *other* (Pajuste, Olsson 2001). In their classification state ownership is under *other*. In different perspective state ownership is in the hearth of classification. Such is classification of owners in analysis of Russian corporations where Guriev and Rachinsky (2003) define as: state owned, municipal ownership, large private owners and other private owners.

By identifying usual approaches to analysis of shareholders concentration and identity we can argue that framework for analysis of corporate control can be used in analysis of position and possible change in corporate control.

3. CORPORATE CONTROL IN TRANSITION CONTEXT

According to Stieglitz lack of good corporate governance is one of most important reasons why in many transition countries new owners of privatized companies found it more profitable to tunell out valuable assets than to invest in development (Stieglitz, 1999). Main question of corporate governance in transition countries is how it is possible to enhance corporate performance trough corporate governance. Here we will focus on some of the influences on level of corporate control.

If we examine advantages which better practice of corporate governance can offer to countries in transition two main factors come in focus – transparency and responsibility. When flows of information are precise and dependable it is harder to hide illegal actions. Secondly, efficient institutions of corporate governance make insiders responsible. If we were to assure efficient allocation of resources investors have to have possibility of reaction, explicitly – by dismissing management or implicitly – by withdrawing of investment.

Ownership of transition countries of central and Eastern Europe is significantly higher than concentration in Anglo-Saxon countries. That is mostly effect of mass privatization and roll of investment funds in post-privatization period. As a result of high ownership concentration problem of protection of minority shareholders rights is emphasized. It has been showed how legal framework that protects minority shareholders is not sufficient. Big shareholders are in position to make decisions that are in their best interest with obvious expropriation if minority shareholders with almost no sanctions.

4. CONCLUSION

In this paper we argue how nature of corporate control is fundamental concept of corporate governance and that it is not solely determinant of ownership concentration as most literature suggests but is also a matter of identity of shareholders. Besides that we argue how level of corporate control can be approximated by attributes of structure and work of corporate boards. Major limitation of the research framework we present is that it does not combine both private and institutional sector. Although that assertion is true for most studies, it is evident that identification of the most important determinants and implications of good corporate governance is beneficial for companies and governments alike. Both sides of corporate governance systems have a common goal – protection of investor's rights and transparency of the system in which transactions take place. Framework for analysis is in this paper described from perspective of transition economy where corporate control mechanism are more unstable and fragile that they are in countries with longer tradition of market for corporate control. Further research on development of this framework have two approaches, one is investigation of the nature of battle for corporate control and its effect on corporate performance and other is further development of connections between concepts of shareholder concentration and identity in these processes.

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