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PROTECTION OF MINORITY SHAREHOLDER INTERESTS IN POST-PRIVATIZATION ECONOMIES

HRUSKA, D[omagoj]

Abstract: *Problems in corporate governance system take place where mechanisms of protection of certain shareholders in weakest. High ownership concentration in most European transition economies can prevent opportunistic managerial behavior in the sense of using corporate control for they own benefit. However, high ownership concentration has its price – blockholders are in position to follow their own interest on the cost of minority shareholders. In other words, from the position of control they have over corporation, blockholders in transition countries are in position to expropriate minority shareholders. This paper argues how agency problem of difference between cash flow control and property in the hands of one or several shareholders poses biggest threat on stability of corporate governance system in European transition economies.*
Key words: *minority shareholders, corporate control, corporate governance system, transition*

1. INTRODUCTION

Economic growth in transition countries was in last 20 years quite lower than expected at the beginning of transition period, mostly because privatization did not bring expected changes in efficiency of corporations (Gregorič, Prašnikar, Ribnikar 2000).

Mayor point of interest of researchers who attempt to enhance practice of corporate governance in transition economies is to develop understanding of most important determinants and consequences of underlying corporate and institutional processes. Common scenario for east and central European transition countries was that control over corporations ended up in hands of internal stakeholders (Berglöf, von Thadden, 1999). Within privatization context, which in most countries was not able to deliver results anticipated by policy maker's, managers of the state owned companies were able to suppress minority shareholders – usually employees and other protagonists of mass privatization. We argue that is such circumstances protection of interest of outside shareholders is of biggest importance for development of complementary and consistent system of corporate governance.

2. GENESIS OF GORPORATE GOVERNANCE SYSTEM IN CENTRAL AND EAST EUROPE TRANSITION COUNTRIES – DETERMINANTS AND CONSEQUENCES

Corporate governance systems of transition countries of east and central Europe share several common characteristics (Pučko, 2005). Firstly, supervisory and executive functions are rarely separated due to the fact that executive managers are often most influential shareholders. Secondly, even in case when managers do not have significant ownership of the company they try to establish significant level of control though concentration voting rights. Thirdly, there is significant influence of workers in corporate governance structures. And finally, supervisory boards of companies in transition European economies are rarely composed of experts. Such constellation of power within corporate governance system in European transition countries is result of privatization process that took place in early 1990's. Beside in several cases (German Democratic Republic (GDR), Hungary and Croatia) initial privatization has led to much dispersed ownership structures. However, soon after first privatization wave, in the middle of the 90s, fast ownership concentration occurred (Kočenda, 2002, Kozarzewski, 2001, Gregorič, Prašnikar, Ribnikar, 2000). Initial heterogeneity in ownership structures of corporations in central and east European countries was mostly such because of different approaches in privatization as showed in Table 1. (Bornstein, 1997, Djankov, Simeon, Pohl 1998, Pučko, 2005).

Country	Privatization method
The Czech Republic	Voucher privatization
GDR	Direct sale
Croatia	Direct sale with preferred buyers
Hungary	Sale to foreign buyers and MEBO in cases of smaller companies
Poland	Sale to private investors and MEBO
Slovakia	Voucher privatization and direct sale
Slovenia	Gradual mass privatization

Tab. 1. Prevalent privatization models for selected countries of central and east Europe

Most corporations are governed by internal shareholders while foreign owners have trouble in protection of their position and getting adequate return for their investment. Capital markets are still relatively underdeveloped and market transactions are often conducted with privileged, insider information (Gregorič, Prašnikar, Ribnikar 2000).

Weak protection of investors and high level of ownership concentration also lower liquidity of capital markets in transition countries (Berglöf, von Thadden, 1999). It seems that in most transition economies that fact was not been taken in account in the process of designing privatization schemes. Accent was on speed of privatization and it was common understanding that adequate infrastructure will be consequently created. However, that did not happeded. When market for corporate control is static so are structures of ownership and control which is most definitely one of the major contemporary issues in transition corporate governance. All that leads to most important consequence of described process of establishing transition system of corporate governance - high and relatively static level of shareholders concentration.

3. CONCENTRATION OF OWNERSHIP IN TRANSITION EUROPEAN COUNTRIES

Levels of ownership concentration give support to assertion that large shareholders can pose significant threat to stability of corporate governance system. In the Table 2 we compare the shares in ownership of two major shareholders in the countries of the Anglo-Saxon business circle with countries of the European Union and European transition countries (Barca, and Becht, 2001; Pajuste and Olsson, 2001; Gregoric, Prasnikar, and Ribnikar, 2000; Maury, and Pajuste, 2002).

Country	**Share in ownership %**	
	Largest shareholder	**Second largest shareholder**
Croatia	46,95	12,05
UK and USA		
UK	14,4	7,3
USA (NYSE)	5,4	3,7
Developed economies		
Austria	54,1	7,8
Belgium	55,9	10,3
Germany	49,6	2,9
Spain	40,1	10,5
France	29,4	6,4
Italy	52,3	7,7
Netherlands	42,8	11,4
Sweden	37,6	11,2
Transition countries		
The Czech Republic	77,6	11,19
Croatia	46,95	12,05
Estonia	61.09	21,57
Latvia	49,47	9,71
Lithuania	44,72	15,96
Poland	42,4	14,8
Finland	27,4	13,4
Slovenia	32,8	9,8
Hungary	45,02	13,74

Tab. 2. Shareholding levels of two major shareholders in selected countries

Significantly higher level of ownership concentration in transition countries in respect to ownership levels in developed economies points to the fact that higher level of managerial ownership is also required in pursuit of exercising significant level of corporate control. In such distribution of power it is likely that blockholders will seek personal benefits from the position of control that they have in the corporation. Right on cash flows is guaranteed to all shareholders in proportion to their ownership share, while ownership concentration is in hands of the few blockhodlers. In theory higher part of cash flow rights in the hands of shareholders the more are their interest aligned with interests of all shareholders and hence lower their drive to expropriate minority shareholder (Jensen, Michael 1976). However, blockholders can detach cash flow rights from control in several different ways. One way is to issue shares without vote rights, second is by controlling corporation through pyramidal structures – holdings and third is by developing cross ownership networks. All these evidence lead us to conclusion that concentration of ownership and context that facilitates control concentration has tremendous influence on corporate governance system of transition European countries.

4. CONCLUSION

This paper argues that major contemporary issue of transition corporate governance is not conflict between large number of dispersed shareholders at one side and professional management at another side as it is in countries of Anglo-Saxon business circle. Concentrated ownership in the hands of several or even one blockholder insures significant level of control to directly influence on nomination and efficiency control of managerial team while role of supervisory board is prevalently formal. Major limitations of the research can be found in the fact that systems of corporate governance in attempt to gain necessary level of harmonization and consistency rely heavily on contextual factors of specific economy. Although selected countries to some extend share history of their economic development, the results of the research indicate that today there are very different pressing issues in consequent systems of corporate governance. High ownership and control concentration significantly lowers crucial problem of Anglo-Saxon corporate governance system but opens another agency problem – expropriation of minority shareholders rights by controlling shareholders. We argue that this agency problem is fundamental for balance of powers within transitional system of corporate governance.

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