ETLA
ELINKEINOELÄMÄN TUTKIMUSLAITOS
THE RESEARCH INSTITUTE OF THE FINNISH ECONOMY
Lönnrotinkatu 4 B 00120 Helsinki Finland Tel. 609 900 Telefax 601 753
World Wide Web: http://www.etla.fi/

Keskusteluaiheita - Discussion papers

No. 557

Jari Hyvärinen

A SURVEY OF CORPORATE GOVERNANCE - WHICH MODEL FOR TRANSITION COUNTRIES ?

ISSN 0781-6847

13.05.1996

HYVÄRINEN, Jari[1], **A SURVEY OF CORPORATE GOVERNANCE - WHICH MODEL FOR TRANSITION COUNTRIES?,** Helsinki: ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy, 1996, 32 p. (Keskusteluaiheita, Discussion papers, ISSN 0781-6847; no. 557).

ABSTRACT: This discussion paper raises the question of privatization in transition countries, when necessary financial framework is absent. In CEE-counties, banking sector is weak, stock markets are fragile and other institutional investors are still in learning process. Furthermore, different privatization methods will need rather different financial basis. Paper is comparative study of two main financial systems e.g. stock market-based and bank-based systems and their solvency in Eastern European circumstances. This research field is essential while firms are privatized without necessary control mechanisms of capital allocation.

KEY WORDS: corporate governance, enterprise control, stock market-based and bank-based system, privatization, Eastern European transition countries

HYVÄRINEN, Jari, **A SURVEY OF CORPORATE GOVERNANCE - WHICH MODEL FOR TRANSITION COUNTRIES?,** Helsinki: ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy, 1996, 32 s. (Keskusteluaiheita, Discussion papers, ISSN 0781-6847; no. 557).

TIIVISTELMÄ: Tämä tutkimus selvittää yksityistämisen onnistumista Itä-Euroopassa, kun tarvittava rahoitusjärjestelmä on vielä kehittymätön. Tämä tarkoittaa sitä, että pankkien toimintakyky on heikko, osakemarkkinat epävakaat ja muut rahoitusinstituutiot hakevat edelleen muotoaan. Tämän lisäksi eri yksityistämismenetelmät tarvitsevat erilaisia rahoitusmuotoja. Tutkimusmetodi on vertaileva, ja raportissa tarkastellaan kahden erityyppisen rahoitusjärjestelmän (osakemarkkinakeskeinen ja pankkikeskeinen järjestelmä) soveltuvuutta Itä-Euroopan olosuhteisiin. Tutkimusalue on keskeinen, koska yrityksiä on yksityistetty ilman vaadittavia pääomien allokoinnin valvontamekanismeja.

AVAINSANAT: yritysten hallinta ja valvonta, osakemarkkinakeskeinen ja pankkikeskeinen järjestelmä, yksityistäminen, Itä-Euroopan transitiomaat

---

[1] YSSP participant 1995, IIASA, Economic Transition and Integration (ETI) Project and ETLA. I am grateful to Janos Gacs and Merton J. Peck for very useful comments and discussion at IIASA during summer 1995. I would like to express my gratitude to Dennis C. Mueller in University of Vienna for his thoughtful comments, suggestions and supervision on this research field.

CONTENTS

Executive Summary

1. Introduction 1

2. Theoretical Background of Corporate Governance 3
2.1. New Theory of Organization 3

3. External Contracts and Corporate Control 6
3.1. Which Western Monitoring Model? 7
3.1.1. Capital Market as Monitoring Force: the US and the UK 8
3.1.2. The Role of Banks and Governmental Institutions: Germany and Japan 11

4. Corporate Governance in Transition Countries 14
4.1. The Significance of Privatization 14
4.2. Privatization and Theory of Contracts 16
4.2.1. Why Private Ownership? 16
4.2.2. Privatization: Case of Hungary and Czech Republic 19
4.2.3. Corporate Monitoring and Incentives 21
4.2.4. Capital Markets and Information 23
4.2.5. Role of Banks and Financial Institutions 24

5. Conclusions 27

References

EXECUTIVE SUMMARY

This study presents evidence on the internal governance mechanisms, and the role of banks and capital markets as a external controlling force in two main economic systems. Other mechanism is called Anglo-Saxon system as in UK and US, and other bank-based system as in Germany and Japan. Using this experience, it explores ownership issue and the relationship between industrial organisation and financial interest groups in the Central and Eastern European (CEE) circumstances.

The objective of the study is to provide a valuable perspective and to enhance understanding on organisational power mechanism and development for large corporations in the transition environment.

Secondary objectives were to extend and modify those needed mechanisms for institutional development, corporate control and governance. It can then be assumed that this economic goal is based on the assumption that profit-seeking incentives and informative contracts between different interest groups will describe the final success or failure of the enterprise. Furthermore, the formation of incentives and contracts depend on the information available, which instructs the behaviour of different economic actors.

The future success or failure of the firm may be determined as much by the randomness of the valuation of the claims as by the efficiency of management in running its enterprises. Therefore, this study points out the importance of marked-based internal and external governance during the transformation process to control residual claims. Then, the analysis raises two questions: What ownership structure are needed to form profit-seeking incentives, less incomplete contracts and valuable information flows? Which factors explain the formation of functional institutional mechanism controlling and instructing the enterprises in the CEE circumstances?

1. Introduction

The approach of corporate governance has become widely discussed in the recent years and it is an issue of immense importance both to the policy makers and individual firms. In various contexts, the influence of external and internal mechanisms to control managerial decisions have been focused upon. The literature on this field is more concentrated to analyze capital market-based mechanism in the UK and the US, but recently the importance of banks and other financial institutions as an external controlling force are also discussed in many studies. In some countries, as in Japan and Germany, large banks own large stocks of company shares and their representatives have a significant role through supervisory boards in the company. Transformation process in the Central and Eastern European (CEE) countries has accelerated the magnitude and importance of such governance mechanisms. It is valuable research field because large state-owned corporations and financial institutions are under reconstruction. During socialist period, the role of banks was passive and their purpose has been to transmit credit for the state-owned enterprises. The lack of private ownership has led to poorly developed capital markets. The financial bureaucracies were insolvent, and not usable in the new system. (i.e. immature centralizes banking system, the absence of institutional investors and other financial intermediaries).

This working paper explores the significance of incentives and the contractual relationship between industrial organization and financial interest groups. It summarizes the literature on corporate governance and presents evidence on the role of banks and capital markets as an external controlling force. *The method is comparative and it presents main theoretical findings and some empirical results from this research field.* It exploits the experiences of two different governance systems as a background to form a theoretical framework for the transition economy circumstances. Paper is motivated by remarkable privatization and restructuring

process in the transition economies where the privatization has used to enhance managerial incentives and to provide necessary monitoring system in the transition environment. Therefore, it discusses many aspects of corporate governance, while the control mechanisms over the firms in the command system have broken down before alternative mechanisms of a market economy could be established.

In the chapter 2, the theoretical background of corporate governance and its influence to form incentives by insiders and outsiders of the enterprise, to decrease asymmetric information, and to enter into more complete contracts is presented. This is guided by the assumption that the loss of control and valuable information can deteriorate managerial incentives and 'effective' contracts.

Chapter 3 points out the implications for external control mechanisms of the enterprise. The transformation process raises many doubts how financial capacity and production resources may be harnessed to create durable internal structure of the firm and modify the behavior of institutions. In this context can be asked which factors explain the formation of functional institutional mechanism to control and instruct the enterprises in the transition circumstances. Since a market economy can be built from the entrepreneurial initiative of the new private sector and from successful privatization and reconstruction, the process has to include the functional range of financial institutions that are required in the decentralized economy. Domestic financial institutions will play an important role in this process. Therefore, chapter discusses the importance of these institutions and concentrates on the necessary contributions to build an external governance structure. Hence, it is concentrated on the view that how the responsibility of new managers can be controlled to raise the value of the firm, and how these new firms are controlled by external stakeholders. In this controlling mechanism it might be separated which belong to the banks and which to the capital markets. Corporate governance approaches in the western economies include monitoring systems such as capital markets, banks, mutual funds, but their incentives to affect the firm's management vary in different economies. The evolution of capital markets in the UK and the US, but not in Japan or continental Europe has resulted different signalling nexus between shareholders and the management.

2. Theoretical Background of Corporate Governance

In the classical theory of the firm, the firm adjust its costs to product price movements and thereby pursue to maximize its profits. The economic agents who are acting inside or externally connected to the firm are poorly measured and it does not explain equilibrium if individual participants have conflicting objectives.

2.1. New Theory of Organization

The new progress of theory of the firm was established by transaction cost theory (Coase 1937, Williamson 1985) and agency theory (Fama 1980, Jensen and Meckling 1976, Hart 1983 and Holmström 1979, 1982). These theories focus on the set of contracts among individuals, and each of them is motivated by its self-interest in a world of incomplete information.

The initial point of departure for the hierarchical behavior, contract and transaction cost theory is established in the classic article by Coase. This article pointed out that voluntary contracts among individuals will be needed to create more efficient behavior in the firm. The hierarchy, the institutional form of a firm, is established in part to provide the head with the ability to manage the coordination of the various factors of production (Coase 1937). This hierarchy is established when activities of different individuals yield higher profit when managed together than when managed separately. Hence, the purpose of context is to lower the transaction costs inside the hierarchy organizing more efficient production rather than lowering transaction costs forced by the markets.

Alchian and Demsetz (1972) object to the notion that activities within the firm are governed by authority and correctly emphasize the role of contracts as a vehicle for voluntary exchange. They emphasize the role of monitoring in situations in which there

is joint input or team production. They identified the contractual framework of managers on joint team production with one party who is common to all contracts of the joint inputs. Manager has right to renegotiate any input's contract independently of contracts with other input owners. The function of the top manager is to oversee among factors and to ensure the viability of the firm. The optimal allocation of the firm's inputs, for example, well-organized human capital between other participants like employees and other managers and investment for 'profitable' capital, guarantees the success or failure of the manager's work.

Fama (1980) examined the problem of management control measuring how the signals provided by the managerial labor market and the capital market, and along with other market-induced mechanism, discipline managers. In the managerial labor controlling process ongoing firm is in the market of new managers and they seek information about the responsiveness of the system in rewarding performance. A concern for reputation alone will take of any deviant incentives. In the firm, each manager is concerned with the performance of managers above and below him since his marginal product is likely to be a positive function of theirs. The future wage level of the manager is determined through the success or failure of the team that he coordinates. Top managers try to choose such policies that provide the most positive signals to the managerial labor market. Fama argued that competition among top managers themselves perhaps is the best one to control the board of directors. They are most directly in the line of fire from lower managers when stock markets and managerial labor markets give poor signals about the performance of the firm.

The basis for principal-agency theory is an article by Jensen and Meckling (1976) that form a firm as legal fiction that serves as a nexus for internal and external contracting relationships. A firm is also characterized by the existence of divisible residual claims on the assets and cash flows on the organization that can generally be sold without permission of the other contracting individuals. Principal-agency theory is concentrated on the contracts and claims on the assets of the organization; precisely with the problem of information and the incentives of different individuals or institutions connected externally of the firm (Holmström 1979, 1983). Owners are viewed as a homogeneous group, that can be represented by the preferences of a single person, the

principal. The principal seeks to establish incentives for an agent, who takes decisions that affect the principal, to act in ways that contribute maximally to the principal's own objectives. However, there is two particular details that hinder to establish how agent is operating. First, the incentives of principals and agents will typically diverge, which are expressed as incomplete contracts, and agent can defraud those with whom he has a contractual relationship. Incentives of agent are a package of pecuniary and non-pecuniary goals, which may not maximize profits (Milgrom and Roberts 1987, Shleifer and Vishny 1986). This will create agency problems, when the agent does not agree to act in the principal's interest, and second, the principal has incompletely informed about movements of the agent. It is expressed in two forms: moral hazard reflects the inability of the principal to observe without costs the decisions of agents. Self-selection reflects uncertainty regarding a characteristic of an individual.

Furthermore, Jensen and Meckling (1976) discussed the behavior implications of the property rights specified in the contracts between the owners and managers of the firm, and the analysis of agency costs generated by the contractual arrangements between the owners and management. When owner-manager do not own all equity claims then he bears only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his own utility. Thus, he may generate larger amounts of the firm's profit to various non-pecuniary aspects. Agency costs are defined as the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss. The principal has to use his time and skills to design some monitoring system to limit the aberrant activities of the agent, that creates monitoring cost. Monitoring reduces managers hazardous behavior and increases the value of the firm. Bonding expenditures will rise when manager has to use his time to collect some accounting data and other information to convince owners that he spends his time to maximize firm's profit. Residual loss will come into existence when total value of the firm is entirely imposed on the owner-manager. The residual loss represents the total agency costs engendered by the sale of outside equity because monitoring and bonding activities have not been allowed. The magnitude of the agency costs will depend on the tastes of managers and the costs of monitoring and bonding activities.

Therefore, we can sum up that the formation of incentives and contracts depend on the information available, which instructs the behavior of different economic actors. The profit-seeking incentives and informative contracts between different interest groups will describe the final success or failure of the enterprise. The future progress of the firm may be determined as much by the randomness of the valuation of the claims as by the efficiency of management in running its enterprise.

3. External contracts and corporate control

The question who controls the large corporation is one of the most enduring in the industrial economics literature. The first premises in corporation governance issue are, posed by A. Berle and G. Means (1932), that ownership and control in the large corporation were often separated, while owners were restricted to control management.[1] Study of Berle and Means have approached the question being concerned about possible negative effects of the ownership structure in maximizing profits. Several reasons can be found. First reason is that there is little incentive for a shareholder to devote much attention to the monitoring and control of a company if only a minute fraction of a total shareholdings in a firm is owned. Shareholders can only freeride rather than take part of decision-making. Second, the theory suggests that managers avoid courses of action that could potentially threaten them. Management

[1] Already classical economists have noted the implications connected to the corporate governance: A. Smith (1776): 'The directors of such companies...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 private copartnery frequently watch over they own. J. S. Mill (1885): 'The administration of a joint stock association is, in the main, administration by hired servants....the board of directors, who are supposed to superintend the management have no pecuniary interest in the good working of the concern beyond the shares they individually hold....the business being the principal concern of no one except those who are hired to carry it on....when hired service must be employed, is the master's eye to watch over it.' Marshall (1890): 'After the business has once got out of the hands of its original promoters, the control of it is left chiefly in the hands of Directors; who, if the company is very large one, probably own but a very small proportion of its shares, while the greater part of them have not much technical knowledge of the work to be done. J. Schumpeter (1934): 'The entrepreneur is never the risk bearer. The one who gives credit comes to grief if the undertaking fails....Risk-taking is in no case an element of the entrepreneurial function. Even though he may risk his reputation, the direct economic responsibility of failure never falls on him'

could include settling for lower but more stable profits by aiming at growth in sales and assets over profits, acting for the public interest instead of shareholder interest and implementing strategies that involve low risk-taking behavior.

It is often argued against such criticism that, even though individual shareholders cannot act as ideal monitor, the stock market will function as a monitoring mechanism. Manne (1965) argued that competition for votes that are generally attached to equity shares, or the market for corporate control, was the most important force driving managers to maximize shareholder wealth. The main conclusion is that if firms did not maximize stock market value, they would simply be taken over by somebody who can probably do it.

Hence, corporate governance issues are thrown into stark relief by events as takeovers, owners' reactions in shareholder meetings and proxy contests, and controversies between boards and management. Nevertheless, this is only a half truth of the story while in different economies, there is a distinct brand of corporate governance, reflecting networks between institutions and firms, capital markets, and depending on legal, regulatory and tax regimes. Regulation can affect the way in which firms are owned (stock exchange rules), the form in which they are controlled (legal forms), and the process by which changes in ownership and control take place (take-over codes) (Jenkinson - Mayer 1992).

3.1. Which Western Monitoring Model?

The different national brands of corporate governance fall into two broad types. First is based on the Anglo-American governance system, as in the United Kingdom and the United States, which emphasizes liquidity in the stock market. The UK and the US have created a system in which ownership and control is conferred on outside investors with little direct stake in the firm, little incentive to monitor by individuals and little ability to control. The ownership is dispersed among large number of individual and institutional investors and cross-holdings are restricted by law. The Japanese-German

governance structure has originated different way. Corporate power is shared between managers and active financial intermediaries, because banks have large proportion of corporation shares and banks' role is remarkable in debt-financing. Ownership of individual firms is concentrated in the hands of a small number of other firms, banks and families, and crossholdings are remarkable.

3.1.1. Capital Markets as Monitoring Force: the US and the UK

The classical context of corporate governance can be stated through external contracts and capital markets. External contracts are written implicitly or explicitly between firm and some other participants that are not 'working' inside the firm. In the Alchian and Demsetz (1972) framework, risk bearers (stock holders) are identified as the residual claim holders, and who has right to sell his central contractual residual status. When stock holders have right to residual profit, they have right to control the firm's decision making. Financial securities give their holders certain right concerning decision making and control. The risk bearers provide important but indirect assistance to the managerial labor market in its task of valuing the firm's management. They have a strong interest in the existence of a capital market that efficiently valuate the firm's securities. The information from the capital markets assists shareholders to revaluate firm's management.

In the UK and the US, the role of corporate governance has been mentioned to be formed into liquidity of stock markets, by financial institutions and by influence of takeovers. The benefits of contractual relationship in the capital markets can be identified as follows: first, it provides possibility to affect to the agents through the share price movements; Second, it enables takeovers as a monitoring mechanism; and third, it provides information to agents about anticipated cash flows of particular projects or activities.

The first argument supports the view that changes in share price will change effort and behavior of agents. If share price falls, the agent will be afraid of possible reactions of

boards of directors or shareholders. Thus, he will use more effort to improve firm's productivity or effectiveness. However, some doubts can be found in this corporate governance system. The main problem to use 'shareholder power' is connected to the dispersed ownership. The shareholders as residual claimants can hedge against failings of any given team by diversifying their holdings across teams. Therefore, if portfolios are largely diversified, no shareholder has individual effort to control detailed activities of any firm. Smaller shareholders with largely dispersed shareholdings are more mobile and they do not suffer remarkable loss liquidating shares. Therefore, they can just sell their shares if they are dissatisfied. Moreover, while shareholders optimal allocation of risk bearing produces a problem that portfolios are too diversified across the securities of many firms to take much direct interest in a particular firm and they are too lazy to use his voting right, there have to be some other mechanism which control firm's management.

The second argument is connected to the takeover mechanism mainly used in capital market based economies as in the US and the UK. Stockholders can use their power through the threat of take-overs that are commonly viewed as playing two related roles. First is that the threat of take-over may contribute to efficient management by making managers concentrate on maximizing shareholder's value. Second role is connected to the managerial failures while take-overs allow, in theory, that poor management can be replaced with good one. Certainly many takeovers in the US and the UK in the 1980's bear out this view that gross managerial slack can be diminished by hostile takeover or even threat of takeover.[2]

While the takeover threat is clearly a force that motivates managers to look after their shareholders, it has distinct limitations. In reality, takeovers are known to be costly and imperfect mechanism for controlling the firm and its management. Even in the US, regulatory developments and the chilling of the junk bond market have restrained the

---

[2] The takeovers as a corporate control mechanism are rare in Germany and Japan. Merger markets are 15 to 20 times more active in the US and five to 10 times more so in the UK (Prowse 1995). Based on the analysis of Kaplan (1993) Only 2 per cent of large Japanese firms are taken over or merged in 1980-1989 in contrast 22 per cent of the large US firms.

takeover market, and even before these developments there were sizeable cost barriers to hostile takeover.

Therefore, it would be an overstatement to claim that the market for corporate control actually exacerbates managerialism on the part of acquirers. It is clear that the threat of hostile takeover places only broad limits on the degree to which managers can run the firm in the interest of parties other than shareholders. In practice, individual shareholders have thought to play little direct influence in the management because boards play minute role in corporate governance, especially in the UK (Franks - Mayer 1992, Jenkinson - Mayer 1992). Even if institutional institutions play a significant role in shareholding, the value of institutions themselves are measured on quarterly and annual share price appreciation, and they are not interested to control companies. Even if the large proportion of equity is held by institutions, none of these hold the large proportion of shares in any large companies. Some critics also appear to argue that Anglo-American corporate governance applies too much pressure to maximize short term shareholder value (Thompson - Wright 1995).

Third argument raises the question of information flows through the capital markets. As discussed earlier, the separation of ownership and control causes the problem of managerial discipline. The role of the capital markets is to give beyond those provided by reward schemes based on accounting data. Public trading allows managerial incentives to be provided according to the continuing performance of the firm' share price (Tirole and Laffont 1993, Holmström and Tirole 1993). Analyses of financial institutions affect at least partially firm's stock prices. Stock market prices contain information about the firm's future prospects and, thus, about the agents' long-term decisions. For financial participants, the capital market is all about the evaluation of risk, the pricing of risk, and the allocating of risk, and especially the risks associated with the activities of individual firms. It provides a mechanism for rationing credit or the funds available for new investment among the competing users of demanders or borrowers. Investors' choices as reflected in the capital market provide a vehicle for the evaluation of the risk of a portfolio activity for distinguishing between market risk and firm specific risk.

3.1.2. The Role of Banks and Governmental Institutions: Germany and Japan

In Germany and Japan, the liquidity of capital markets is significantly lower than in the UK and the US but the investors' role is more conspicuous in internal decision-making of the company. The shares are rarely traded and hostile takeover is a rareness on Japanese and German capital markets. Management follows mostly signals from supervisory boards than day-today stock price movements. Long-term crossholdings are common between banks, enterprises and other financial intermediaries. In Japan, power of individual shareholder voice is associated with main bank control within a Keiretsu-grouping of Japanese firms and similarly in Germany for firms with close relational banking links (Kester, 1991, 1992). Therefore, traditional explanations for the success of the Japanese and German main-bank system stress that financial intermediaries can serve a monitoring role. This provides a substitute for the external capital market and the market for corporate control (Stiglitz 1985, Sheard 1989, Fischer - Edwards 1993, Scheiner - Lenne 1992, Ziegler - Bender - Biehler 1985).

Banks are significant holders of equity shares. For example, German banks as a group own nearly 10 per cent of all domestically listed shares of German companies, and own more than 25 per cent of at least thirty-three major industrial corporations (Scheiner-Lenne 1992). Percentage of outstanding shares owned by banks is even larger in Japan where banks own more than 18 per cent of shares (see table 1). While banks are admitters of loans and remarkable equity holders, they are motivated to be concerned with long-term company effectiveness rather than short-term cash flow. While cross shareholdings are not restricted and banks are responsible to organize intra-group loans, many companies regard a long standing bank relationship as a kind of insurance bearing appropriate premiums in good times and offering corresponding protection when fluctuations go less well (Scheiner - Lenne 1992). Aoki (1990) remarked same behavior with Japanese banks. The main bank is as a manager of a loan consortium to admit a long term credit to the company. Therefore main-bank organizes various rescue operations to secure a loan repayment. Close banking relationship is significant to explain relatively importance to react profitability changes in the firm. While debt

contract is rather explicit by nature, banks have advantage to follow firm's accounts, repayment of short and long-term credits. In the case of negative profits or bad states, bank can force management to make changes in organizational structure to decrease transaction costs. If bad state continues, bank have possibility to take over the management. However, the role of banks in decision making still differs, while bank representatives rarely hire of fire manager or interfere in general policy making in Japan.

Table 1. Ownership structure in 1990: the UK, the US, Germany and Japan.

	United States	United Kingdom	Japan	Germany
All corporations	44.5	62.9	72.9	64.0
Financial Institutions	30.4	52.8	48	22.0
Banks	*0*	*4.3*	*18.9*	*10.0*
Insurance Companies	*4.6*		*19.6*	
Pension Funds	*20.1*	*48.5*	*9.5*	*12.0*
Other	*5.7*			
Nonfinancial corporations	14.1	10.1	24.9	42.0
Individuals	50.2	28	22.4	17.0
Foreign	5.4	6.5	4.0	14.0
Government	0	2.5	0.7	5.0

Source: Prowse 1995

One of the main reasons in order to explain differences in corporate governance are regulation and restrictions of ownership laws across countries. Prowse (1995) has made an extensive survey comparing differences of corporate control in leading industrial countries. In Japan, banks can hold up to 5 per cent but in Germany there is no restrictions how much a bank can own company's shares.

The evolution of universal banking has developed a large amount of services provided by banks. A bank owns both debt and equity and this capital is controlled by boards where stakeholders have possibility to use their voice by controlling decision making inside the firm.

Institutions as life insurance companies can hold up to 10 percent of a firm's stock in Japan. In Germany, it can hold up to 20 per cent of total assets in equities. In the case of mutual funds and pension fund there is no restrictions (Prowse 1995).[3]

In Japan, the role of Keiretsu groups and governmental institutions has also been noticed as one significant influencing force in corporate governance. Keiretsu's are classified as horizontal and vertical corporate groups. Main horizontal groups are Mitsubishi, Mitsui, Sumimoto, Fuyo, Sanwa and dai-ichi Kangyo and the organizational center of the group is 'president's council' (*shacho-kai*) (Shaede 1994a). Nevertheless, these groups are depended on the main bank, but this relationship between group firms and banks are weakening because of the de-regulation on international finance (Hoshi et al 1991). There are already some vertical groups as Matsushita Electric and Nintendo that are not the members of *shacho-kai* and they are more independent from the bank's control. Schaede (1994b) has also noted that 'the most important influence to the Japanese management is through a

[3] 'In the US, financial institutions are constrained to buy large stock from the firm: Banks are prohibited from owning any stock on their own account by the Glass-Steagall Act of 1933. Mutual funds have regulatory restrictions to the ownership that exceeds 10 per cent. Also, Pension Funds should diversify their portfolios. In the UK, Bank of England may restrict banks to own on prudential grounds. In the case of life insurance companies and pension funds, there is self -imposed limits on fund assets invested in any one company stemming from fiduciary requirement of liquidity. Mutual funds are restricted to take large stock holdings from some specific company, ' (Browse, 1995)

mechanism combining administrative and personal guidance, the roots, functions and mechanisms of which are based on an intricate combination of power and efficiency structure between the firms, and firms and government officials'. The central institution to influence by governmental officials has been MITI - The Ministry of International Trade and Industry. MITI targets certain key sectors of the economy, chosen after wide-ranging consultation and discussion throughout industry, and works to ensure that those sectors grow rapidly and efficiently. Therefore, Japanese industrial success can only partially explained by classical context of corporate governance.

4. Corporate Governance in Transition Countries

The issue of corporate governance and its main implications on restructuring process is plentifully analyzed and varying. As earlier have been noted, the ownership dispersion is the initial stage and it is a base of the new ownership structure. Nevertheless, it does not solve the internal evolution of the SOEs but it adapts on incentives of economic actors. The main opinion on the wide point view is that state-owned enterprises will be corporatized, moved out from the influence of the ministries that in principle were controlling them. Shares should be distributed to some selected combination of different interest groups including various interest groups as current workers, management, different funds, holding companies, financial companies, insurance companies, citizens, and the government.

4.1. The significance of Privatization

More viewpoints and criticism are observed that how western types of privatization methods are suitable in the CEE circumstances. Even in western privatization, it has been recognized by many researchers that simple ownership transfer may not guarantee a performance improvement of the enterprise (Vickers and Yarrow 1988, Vickers 1991). There are two main exceptional features in the privatization process, which do

not exist in the more industrialized countries. These features are connected to the scale, duration and pace of the process.

Without controversy, a scale of privatization is the main discrepancy between more industrialized and transition countries. Vickers (1991) has characterized privatization programs into three types of privatization: i) privatization of firms, which have to operate in competitive product markets, ii) privatization of monopolies, which transfer SOEs with substantial market power to the private sector, and iii) contracting out of publicity financed services. In the former socialist economies, the large proportion of privatization will relate to potentially competitive industries with substantial market power. Unlike in market economies, privatization is not only a change of ownership, but it actually generates a basis of ownership (Hunya 1993).

The duration of privatization determines the length of the unstable period, during which organizational coordinations have been reorganized, and economic agents still have no long term perspective guiding their decisions (Raiser - Nunnenkamp 1994). Therefore, in the industrial progress the normal Schumpeterian innovative development from the entrepreneur- manager firm to the publicity owned firm run by managers is more painful in the transition enterprises, while partly nonviable capital stock already exists and normal development like in the western European countries is not possible without restructuring large part of enterprises.

In the common point of view, the pace of the privatization can be seen as two-fold process. Therefore, for example in Hungary, there are SOEs that are rather effortless to reorientate to the new market environment or sell to the foreign investors, and then SOEs that will stay under state ownership. It is true in any case that companies with valuable assets and human capital will be sold first and then are already sold. The pace can be separated through different industrial sub-branches where the speed has been different depending on their ''convertibility'' to the market circumstances.

One of the main problem is that privatization can worsen the transformation process if there is not an effective control mechanism as stock markets or financial institutions. For ecxample, the russian privatization is made by voucher privatization. The lack of governance will lead to the situation that main shareholders can use the company's

property to their own purposes. In Russia, firms are the coalition of managers and workers, but the management is the main stockholder and it holds an average of twenty-five percent stake. While legal restrictions agaist such benefits are lacking in Russia, the battles over corporate control are attempts by outsiders to displace the current dominant stockholders to obtain the associated benefits, and not to increase stockholder value (Peck 1995).

4.2. Privatization and Theory of Contracts

4.2.1. Why Private Ownership?

As emphasized by Williamson (1985) and Grossman and Hart (1986) the ownership structure does not matter if complete contracts can be written. In this hypothetical situation, nothing was left to contingency, no uncertainties in cash flow, and no difficulties to ensure that the agreed actions would be implemented (Milgrom - Roberts 1992). In the world of incomplete contracts, however, it can not be directly argued why private ownership would be preferable, while both ownership forms face agency problems associated with the separation of ownership and control. The multiprincipal situation in private company dilutes incentives and may yield low-powered managerial incentive schemes. In the case of a state ownership the government represent both regulator and shareholder.

For state-owned firms, the task of monitoring managerial performance is entrusted to government. Compared with private ownership and exploring the principal-agency framework, the obvious superiority of private ownership over state ownership in transition economies can be stated as follows: i) principals (politicians) do not exclusively seek to maximize profits, which raise a problem of managerial incentives and incomplete contracting, and ii) there is no sufficient control for the soft budget and the bankruptcy constraint on financial performance.

The incentives of politicians to control the state-owned enterprise is complex for several following reasons presented by Vickers and Yarrow (1988). Two distinct groups of state officials are involved in monitoring activities: politicians and civil servants. Therefore, monitoring mechanism is constructed by general public, its elected politicians, nonelected civil servants and management of the state-owned firm. If politicians have a monitoring role, there is a possibility that decisions are taken with view to maximizing the probability of electoral success because of considerable informational asymmetries between politicians and voters. Politicians are unable or restricted making decisions, which are politically sensitive and perceivable such as reductions in working force or plant closures. While politicians pursue to achieve economic efficiency, the average voter has little incentive to acquire costly information about the performance of elected politicians in monitoring particular firms. Moreover, the objectives of government can vary frequently, because the periods spend by one politician for the control of a state-owned enterprise is frequently rather brief, and may be ended by electoral failure.

State and private ownership imply different objectives and therefore different behavior in the case of contract incompleteness. The multiplicity and 'social welfare' character of government objectives extends the problem of managerial incentives in state-owned enterprises, because a government has other objectives than profit maximization. The problem with many government objectives is that, unlike profit maximization, they are hard to contract upon. Therefore, government cannot commit to detailed incentive contracts.

This contract incompleteness is the foundation for the cost of state ownership. In the state-owned company, managers are concerned that they will be forced to redeploy their investment to serve social goals such as containing unemployment, national independence, or promoting regional development (Tirole and Laffont 1993). The cost of state ownership can be measured as a suboptimal investment by the firm's managers in those assets that can be redeployed to serve social goals pursued by the public owners. The tighter congruence of managerial and ownership goals in a private firm offers a better protection of managerial investments.

The most common argument against state ownership is based on the notion of 'soft budget constraint' as proposed by Kornai (1979). The state-owned firms in former socialist countries do not have the incentive to economize on resources because they can claim more resources from the state budget. A state-owned firm is not subject to the discipline of the bankruptcy process, because the government subsidize it in financial crisis, which reduces managerial incentives. Government frequently find exceptions that warrant continuing subsidies. The imposition of a hard budget constraint by the politicians may be politically impractical because of the opposition from those affected. For example, the employees and consumers or other firms who were previously getting their goods at subsidized price (Rowthorn - Chang 1993).

When the industry is experiencing a period of recession or more intense product market competition, the role of the bankruptcy threat as a control mechanism is likely enhanced. Bankruptcy helps to protect debt-financed investments against dissipation by those who are actively involved in the management of the firm. If creditors are able to control the level of debt of the firm they will be able to use this instrument to influence managerial behavior by varying the incentive structure that faces the management. It entitles creditor to liquidate the assets and forces to reorganize the firm. Ministries often constitute obstacles to bankruptcy, and the interests of other stakeholders also work against bankruptcy. Liquiditating firms means relocating employees, and that is always painful. Furthermore, other claimants in a reform economy are often unaggressive in seeking recovery of their claims. Several factors explain the potential passivity of supplier-creditors and their debtors: First, the debtors obligations will be covered, and payment will eventually be forthcoming. Second, if the debtor is a monopsonist or the primary buyer, the supplier may be dependent on it for its survival. Third, if the supplier is controlled by the same branch ministry, then the managers may have no incentive to aggressively attempt to recover its claims. Fourth, creditors may be indifferent to their own financial standing if they expect to be bailed out (Williamson 1992). Bankruptcy is rarely as a first line of defence for capital. It is an extreme measure and comes in the late as a means by which to preserve and protect asset values. Even in a strong property rights regime, bankruptcy is not a powerful instrument. Therefore, it is the more unrealistic to ascribe potency to bankruptcy as an advocate for capital in weak property rights regime.

4.2.2. Privatization: the Case of Hungary and Czech Republic

Hungary and Czech Republic have followed rather different privatization methods. Hungary initiated its privatization program in 1989 using spontaneous privatization method. Therefore, employees and employers had permission to make offer to buy their enterprise. After spontaneous privatization, Hungary has fostered a domestic capitalist class and it has used selling methods to create domestic entrepreneurs in the small and medium-sized industries. Hence, the Hungarian privatization program has based on direct sale and case-by-case solutions, and no voucher schemes are expected to emerge. Privatization is coordinated by State Property Agency (SPA) and main investors in the large-scale privatization have been mainly found through negotiations. SPA provides an opportunity to make an offer by investors for the purchase of state enterprises of their choice or shares in companies that constitute the property of the State.

The role of foreign investors was seen as having a necessary significance in attempts to solve Hungarian ownership issue (Hunya 1991). There is same notions by Mihalyi (1993) that the large scale privatization is used to sell ''family silver'' to foreigners. During 1990-1993, the half of state revenues collected by privatization have been remarked to come from foreign investors. The final purpose of such privatization policy is to find ''foreign core investors'' who has an incentive to control the management, and to bring new information, knowledge and innovation to the firm.

While State is still main owner in many companies this does not implicate that State authorities are main decision makers because 'strong owners' can control the company as minority stockholders (Mihalyi 1993). The foreign interests are directed towards industrial companies with remarkable market shares and stable markets such as consumer goods (Nestle, Phillip Morris), industrial production to lower production costs in electronics (General Electric) and automotive industry (Volkswagen-Audi, Suzuki Motor Co., General Motors), and infrastructure investments such as telecommunication (Amertech, Deutsche Bundespost Telecom, the US West International, CGE Telecom Division, UTS).

The Czech Republic has followed a markedly different path particularly in large-scale privatization. Because of slow development the Czech government opted for a free distribution of a large part of state industrial assets to its citizens according to a voucher scheme entitling them to receive shares in enterprises of their choice up to the value of the voucher (Winiecki 1991). This method was intended to increase the incentives of ordinary citizen's over the enterprises.[4]

Results of voucher privatization method are analyzed in different studies. Specific reports to describe the behavior of the investors during the rounds of voucher bidding is documented by Svejnar and Singer (1994). During five bidding rounds, 93 per cent of all shares were sold and the participation of citizens and institutions has been remarkable. As a result, less than 2 per cent of voucher points has not been converted into shares. The individuals who take part into the bidding process can allocate their voucher points into privately formed investment privatization funds. According to the analysis by Svejnar and Singer, individual investors allocated 72 per cent of their voucher points into the such funds.

Boycko, Shleifer and Vishny (1993) have discussed the design of voucher (mass) privatization focusing on denomination and tradability of the voucher itself and the realization of the auction process. Mass privatization has its weaknesses and benefits. Boycko et al. raise the question how to find effective owners to the distributed assets and what institutions are needed to arrange efficient governance. The main efficiency argument for mass privatization is that it is much faster than privatization by sales. Before to sale the firm it has to prepare for it, valuate etc., while mass method will avoid most of these phases. Other benefits are not so clear because mass method has neither power to make changes in previous management nor set up efficient governance of privatized enterprises. There is in any case political constraints to make necessary changes and dispersed ownership by mass method will not give large

[4] For example, in Poland privatization began by mass privatization. According to the program enterprises are firstly owned by ministry and then shares are yielded to the national privatization fund which are governed by domestic and foreign management. Enterprises are reorganized and then ownership is transferred to the shareholders by sale. In practise, domestic and foreign consultant firms and investment banks have played the main role in the privatization process.

stockholding to any shareholder. Moreover, the progress of the ownership restructuring scheme in the Czech transformation process is discussed for example by Bouin (1993), Mejstrik (1993) and Parker (1993). Parker remarks that Czech privatization program is creating ''arm's lenght'' shareholder relationship that can be found from the US and the UK. In Czech republic, there has been attempts to avoid this behavior by founding funds to concentrate shareholdings some active investors. Mladek and Hashi (1993)has noted, that these financial intermediaries can actively take part in the management of enterprises' operations. They still are concerned about corporate control in practise by asking: ''who will run these intermediaries and how will their management be monitored and controlled effectively?''

4.2.3. Corporate Monitoring and Incentives

In the Central and Eastern Europe, more crucial question is, i) how different agents will behave under reconstruction and privatization of state-owned firms and ii) what kind of power coalitions this will create? There is, therefore, a short-term problem of how to restore and reinforce control over enterprises, especially in the huge, monopolistic SOEs. The history and evolution of the CEE enterprises have affected complex exchange production structures with high transaction costs. In Czech Republic, for example, large-scale public enterprises have dominated manufacturing. Before privatization process, over 90 per cent of the industrial labour force worked in enterprises employing more than 1 000 employees. These enterprises were common in engineering industry. The break-up of such companies have resulted the growth of smaller enterprises. Although the industrial labour force as a whole decreased, there was a significant increase of employment in enterprises with less than 500 employees (CA 1/94). The transformation of enterprises has created 'the new environment of contracts'. New entrepreneurrs and bank relationship will need a new form of financing to negotiate loan possibilities and repayment; new firms has no history and a need of fresh capital and shareholders are significant factors.

In general, the change in allocation of property rights leads to a different structure of incentives for management and hence to changes in both managerial behavior and company performance. Goodhart (1994) has noted that, there is, nevertheless, a longer term question of which model of corporate control relationship should recommend and whether new restructured enterprise is governed either mainly through the capital markets or through the banks.

It is obvious that without corporate monitoring mechanisms the power of management can be easily misused. Managers may have a strong profit-based incentives to maximize profits, and to minimize costs, but without a market value of the firm, or without such mechanism that can determine it, they can defraud those with whom he has a contractual relationship. The private ownership approach base on the hypothesis that it increases economic efficiency decreasing the lack of information and increasing managerial incentives to take higher responsibility of the profit-based decisions. In this issue, privatization express alternatives to choose methods how to break up the industrial structure and share ownership claims. In Hungary, the government has resisted cross-ownership in order to prevent management benefitting their position in the old regime. Splitting up monopolistic structure the new vacancies in smaller enterprises, supervisory boards, etc. has opened up the possibility to use old discretion in the new position. While privatization has made possible to form managerial labor market, there are still lack of managers who will take over the previous management elite (Mihalyi 1993).

Adjustment incentives are shown to depend critically on institutional arrangements and policy interventions that encourage discipline in the financial sector and shape the process of control mechanism. Keeping track of financial positions it is important for both incentive and selection reasons. Stiglitz (1991) has pointed out that 'any society has to know how well each of its units is doing, so that the less efficient may be weeded out and the more efficient can be allocated more resources to manage'. After the break-up the mono-banking system, concerns are concertized into incumbent refinancing through the soft budget constraints, and inability and reluctance to control the credit, i.e., bad debt issue. Strategic situation of SOEs both in the domestic production matrix and in the livelihood of their immediate localities made bankruptcy

impossible and therefore created a soft budget problem. This situation is not based on the absence of managerial incentives, rather it is based on the inability of the state to make certain commitments to competition and the commitment not to subsidy. The issue of soft budget constraint is not only between banks and enterprises but also between enterprises. The soft budget constraint of one enterprise becomes translated into the soft budget constraint of other enterprises. Given the importance of interfirm lending the disease of soft budget constraints, and the resulting softening of incentives can spread quickly through the economy (Stiglitz 1991).

4.2.4. Capital Markets and Information

The behavior of agents and principals as financial participants (debtholders and shareholders) will transform in the privatization process due to the capital markets. While the capital market monitoring is absent, the manager of a state-owned enterprise has remarkable discretion to the firm's assets, and state ownership reduces the acquisition of information about the agents' activity by stock market participants. When a state-owned enterprise is privatized, the transferability of private ownership rights reveals information by prices, as share prices. One of the major aspects performs monitoring is the acquisition of relevant information about the firm subject to the proviso that adequate part of the firm's shares is available in efficient stock markets. The increased information flow into the market improves the information content of the stock price (Tirole 1991). The resulting information can be used in contracts between shareholders and managers-remuneration packages may include stock options, for example - and it might be further incentive effects via the managerial labor markets. Stock market prices contain information about the firm's future prospects and, thus, about the agents' long-term decisions. For financial participants, the capital market is all about the evaluation of risk, the pricing of risk, and the allocating of risk, and especially the risks associated with the activities of individual firms (Fama 1980, Holmström 1982, Vickers 1991).

Shareholder monitoring is argued to increase a control of agent and the efficiency of firm's assets. The argument will be in any case two-fold, because privatization process (for example voucher method) by encouraging wider share ownership in general might lead to the suboptimal monitoring for several reasons: First reason is that it creates a large class of small shareholders who have little incentive to accomplish changes in firm's managerial behavior. When the private share ownership of the firm is largely dispersed, the activity of specifying and enforcing managerial contracts confers external benefits on others. Therefore, if one of the shareholders engages in this duty, he bears the full cost of the activity but receives only a fraction of the total increase of profit (Vickers - Yarrow 1988). Second, firm's monitoring mechanism operates in a framework in which monitoring activities are centralized by a board of directors. Then the behavior of the board of directors may lead to the inconsequent control because i) they receive too little relevant information, ii) members may collude with the management and iii) the existence of nonexecutive directors influence only partially the discretion of management. Third, to reduce risk, a shareholder will diversify his portfolio. For large institutional investor such as pension funds and insurance companies, the holdings are spread over many firms and they are reluctant to monitor the management (Jenkinson - Mayer 1992).

As earlier mentioned, dispersed ownership fails a management monitoring and it is not a factor of great significance for managerial incentives. If the management of a newly privatized firm is confronted by a large number of shareholders, the size distribution can change rapidly and it can accomplish possibility to the take-overs. When state-owned firm is privatized, it implies that the new shareholders have the legal freedom to operate with all rights. This right to capitalize the asset values means that anyone with ownership right who can effect an increase in productive values by moving an asset from lower to higher valued uses need not take on managerial duties to realize value (Williamson 1992).

In uncertain transition circumstances, it is unlikely that an efficient stock market can be developed until shares begin to be exchanged for money rather than vouchers or other shares. The share or voucher distribution schemes lead to widely dispersed share ownership and raise concerns about both the efficiency of the stock market and the

role that shareholders can play in corporate control. If all shareholders are small, none of them has much incentive to do the research that will lead to efficient asset pricing. Two approaches have been suggested to deal with these problems. The first is to develop institutional intermediaries, such as pension funds and mutual funds. The second is to set up self-liquidating holding companies. Mutual funds can be set up either by allocating shares in companies to them, and then allocating shares in mutual funds to individuals, or by allocating vouchers to individuals to bid for shares in mutual companies (Fischer 1992). Blanchard suggest that the holding companies should be self-liquidating, required to sell off their companies over the course of time and with specified end date. They would, therefore, serve as privatization agencies, and sooner these institutions can begin trading in the stock market, the more rapidly the stock market can develop.

4.2.5. Role of Banks and Financial Institutions

According to EBRD (1994), in the transition economies, banks suffer from a low capital base, imperfect or missing prudential regulations, and excessive dependence on a limited number of large state enterprises. As it is widely analyzed, the role of banks has been simply to check whether the payment flows, in and out, were consistent with the plan (for example Goodhart 1994). Therefore, the actual interest rates were kept low and there was no signalling mechanism between interest rates and the allocation of funds, and banks had a limited role in investment decisions for which bank loans were to be extended. The commercial banks were credit allocation agencies funneling loans to industtry - sometimes without maturity - with no concept of collateralor of risk and they had some specific centrally allocated activities. In Czech Republic, for example, Ceskoslovenska Obchodni Banka was the foreign exchange arm of the State Bank enjoying a monopoly of all foreign exchange activities. Also it acted as the agent of the Czechoslovakian government for borrowing hard currency to finance the country' foreign debt, and Quaranteed overseas borrowing by the State enterprises. One of the main problems for the banking sector is accumulated bad debt. While banks are under pressure for privatisation their old clients - mainly State enterprises - are already under

privatisation. The Privatization of banks is different process compared for the enterprise privatization and, therefore, they need some supervisory system by the government.

It can be supposed, however, that the banking reform might be more substantial than capital market evolution on these circumstances. For example, in Czech republic the State Bank passed its banking activities to three state-owned financial institutions. A two-tiered banking system was established with the State Bank acting as the central bank and commercial banks providing banking operations on a commercial basis. However, most bank employees lack experience of routine banking operations which are needed in market-based circumstances, bank managers are faced by with distorted incentives, while the lack of competition due to regional and branch specialization of domestic bank combined with restrictions on operations of foreign banks makes the necessary restructuring remarkably slow and difficult. And while inefficient and poorly endowed financial sector may be a serious drag on the process of market transformation in its early stage the overhauling reform of the financial sector should be high on the list of policy priorities for reformist governments.

The role of banks and their position in restructured enterprise is also connected which privatization method is used. As Boycko (1993) et al. have emphasized, the effective governance will be created by large stockholders and banks, as opposed to capital market based mechanisms. Fund owners through sales will become more interested by controlling assets of the firm to build effective governance system. In Czech, the investment fund are in the significant role. While citizens were buing the books, they were asked to decide whether they would invest the coupon points directly or entrust them to some of investment funds. Some sceptism over investment funds is already expressed. Even if the investment funds are committed to the reconstruction of the industry rather than only buying and selling of shares the question is who manage them? On esolution is that many of the funds have used experienced consultants. Another problem is that ownership structure may become highly concentrated and privatization just replace the state monopolies with private monopolies. To prevent this behaviour, investment fund are not allowed to hold more than a 10 per cent stake of the company and they have to invest at least to the 10 companies (CA 4/1992).

While banks primarily are attended to debt financing, there can be assumed, that banks are responsible for more necessary contributions as the complexity of bad debt issue and soft budget constraints and right to the bankruptcy threat. This financial disease, i.e., bad debt issue is closely connected to the soft budget constraints. According to Raiser and Nunnenkamp (1994), as long as banks are not privatized and competition in the banking sector is weak, there is little incentive for creditors to discontinue financial laxity. Begg and Portes (1993) point out, that achieving higher incentives for banks to enforce debt contracts are as follows: First, to tighten enactment of bankruptcy laws, Second, to alter incentives that government is better-off credit allocation. Third, to correct major credit market failures so that the success of privatization and the continuity of the banking sector can be secured.

4. Conclusions

Many restructuring programs envisage a major role for a stock market. While there has been considerable skepticism about efficiency of the Anglo-American stock market in the literature, we can still hypotize that is there any other arrangement that will perform the information processing and corporate control functions as a stock market provides. I still suppose that banking reform is more substantial than capital market evolution on the short run. While banks primarily are attended to debt financing there can be interpreted that banks are responsible for more necessary contributions and more explicit contracts. It will take some time to develop stock markets with the necessary depth and efficiency and in the first stage banks play a relatively more important role in transition countries.

The efficient monitoring system is anyway a learning by doing process, whether it is capital markets or financial intermediaries of large banks, the result will be measure through the competitive markets. The system of laws, restrictions and learning process of economic actors will control this development. The monitoring system in the UK and the US compared to Germany and Japan is depended of these rules and it is, however, affected by culture, history and evolution of enterprises. In the privatization

process of Eastern Europe, two main quidelines can be recognized. The voucher method will create largely dispersed class of shareholders that will require efficient capital markets. To avoid inefficient monitoring funds are found to collect shares to some active investors. The sale method is merely concentrated finding core investors to restructure firm's assets. In this process, the functioning of banks is essential to monitor larger blocks of shares.

References:

Aghion, P. - O. Blanchard - R. Burgess (1994): The Behaviour of State Firms in Eastern Europe, Pre-privatisation, European Economic review, 38.

Alchian, A. - H. Demsetz, (1972): Production, Information Costs, and Economic Organisation, American Economc Review, 62.

Aoki, M. (1990): toward an Economic Model of the Japanese Firm, Journal of Economic Literature, 28.

Begg, D. - R. Portes (1993): Enterprise Debt and Financial Restructuring in Central and Eastern Europe, European Economic Review, 37.

Berle, A. - G. Means, (1932): The Modern Corporation And Private Property, Macmillan.

Blanchard et. al. (1990): Reform in Eastern Europe, Cambridge, Mass.

Blommestein, E. - M. Kumar (1991): Proposals for Privatisation in Eastern Europe, IMF Staff Papers, Vol. 38, 2.

Boycko, M. - A. Schleifer - R. Vishny (1994): Voucher Privatisation, Journal of Financial Economics, 35.

Bouin, O. (1993): Privatisation in Czechoslovakia, in Privatisation, A Global Perspective, Edited by V. Ramanadham.

Calvo, A - F. Coricelli - Bossak (1991): Reforming Central and Eastern European Economics. The World Bank.

Coase, R. (1937) The Nature of the Firm, Economica 4.

'Corporate Covernance - Watching the Boss', The Economist,January 29th, 1994.

Credit Anstalt (CA) Quartely Reports 1991-1994.

Edwards, J. - K. Fischer, (1993): Banks, Investment and Finance in Germany, Cambridge University Press.

Fama, E. (1980): Agency Problems and the Theory of the Firm. Journal of Political Economy 88.

Fama, E. - M. Jensen, (1983): Separation of Ownership and Control, Journal of Law and Economics, 26.

Fischer, S. (1992): Privatization in East European Transformation. MIT.

Fligstein N. (1990): The Transformation of Corporate Control. Cambridge Mass: Harvard University Press.

Fligstein N., P. Brantley (1992): Bank Control, Owner control, or Organisational Dynamics: Who Controls the Large Modern Corporation, American Journal of Economics, 98.

Franks, J. - C. Mayer, (1990) Corporate Ownership and Corporate Control: A Study of France, Germany, and the UK, Economic Policy, 10.

Franks, J. - C. Mayer, (1992): Hostile Takeovers and the Correction of Managerial Failure, London Business School, Discussion paper.

Frydman, R - A. Rapaczynski (1991), Privatization and Corporate Governance in Eastern Europe: Can a Market Economy be Designed? in Central and Eastern Europe Roads to Growth edited by G. Winckler.

Fudenberg, - B. Holmström, - P. Milgrom, (1988): Short Term Contracts and Long Term Agency Relationships. Journal of Economic Theory.

Goodhart, C. (1994): Banks and the Control of Corporation, Economic Notes by Monte dei Paschi di Siena, 23.

Glete, J. (1989) Long Term Firm Growth and Ownership Organization, Journal of Economic Behaviour and Organization, 12.

Grosfeld, I. (1990): Privatization of State Enterprises in Eastern Europe: The Search for a Market Environment. Document No. 90-17, DELTA, Paris.

Grosfeld, I. (1994): Financial Systems in Transition: Is There a Case for Bank Based System?, CEPR Discussion Paper No. 1062.

Grossman, S. - O. Hart (1986): The Costs and benefits of Ownership: a Theory of Vertical and Lateral Integration, Journal of Political Economy 94.

Hart, O. (1983): The Market Mechanism as an Incentive Scheme, Bell Journal of Economics, 14.

Hermann, E. (1981): Corporate Control, Corporate Power. Cambridge: Cambridge University Press.

Holmström, B. (1979): Moral Hazard and Observability, Bell Journal of Economics, 10.

Holmström, B. (1982): Managerial Incentives Problems: A Dynamic Perspective. In Essays in Honor of Lars Wahlbeck. Helsinki: Swedish School of Economics.

Holmström, B. - J. Tirole, (1989): 'Theory of the firm' in Schmalensee R. Willig R. eds. Handbook of Industrial Organization. Amsterdam: North-Holland.

Holmström, B. - J. Tirole, (1993): Market Liquidity and Performance Monitoring, Journal of Political Economy, 101, 41.

Hoshi, T.- A. Kashyap - D. Scharfstein (1991): Corporate Structure, Liquidity, and Investment: Evidence from Japanese Industrial Groups' Quarterly Journal of Economics 106.

Hunya, G. (1991) : Speed and Level of Privatization of Big Enterprises in Central and Eastern Europe - General Concepts and Hungarian Practice WIIW, Discussion papers No: 176.

Hunya, G. (1993): Frictions in the Economic Transformation of Czechoslovakia, Hungary and Poland, WIIW, Discussion papers.

Jenkinson, T. - C. Mayer (1992) The Assessment: Corporate Governance and Corporate Control. Oxford Review of Economic Policy 8.

Jensen, M. - W. Meckling (1976): Theory of the Firm: Managerial Behaviour, Agency Costs, and Capital Structure. Journal of Financial Economics, 3.

Kester, W. (1991): Japanese Corporate Governance and the Conservation of Value in Financial Distress, Continental Bank Journal of Applied Corporate Finance 4, 98-104.

Kester, W. (1992a): Industrial Groups as Systems of Contractual Governance. Oxford Review of Economic Policy, 8.

Kester, W. (1992b): Governance, contracting, and investment horizons: A look at Japan and Germany, Continental Bank Journal of Applied Corporate Finance, 5.

Kornai, J. (1990): The Affinity Between Ownership and Coordination Mechanisms: The Common Experience of Reform in Socialist Countries, Journal of Economic Perspectives, 4.

Laffont, J. - J. Tirole (1993): A Theory of Incentives in procurement and Regulation, Cambridge, Mass., The MIT Press.

Lipton, D. - J. Sachs (1990): Creating a Market Economy in Eastern Europe: The Case of Poland, Brooking Papers of Economic Activity.

Manne, H. (1965) 'Mergers and the Market for Corporate Control, Journal of Political Economy 73.

Marris, R. (1961), The Economic Theory of Managerial Capitalism.

Marshall, A. (1890): Principles of Economics, New York, 8. publication, 1920.

Mill, J.S: (1885): Principles of Economics, London, 9. publication.

Mejstrik, M. (1992): Privatization in Czechoslovakia, in Ramanadham, privatization: A Global Perspective.

Mihalyi, P. (1993): Privatization in Hungary: An overview. In Privatization in the Transition Process, recent experiences in Eastern Europe. United Nations.

Milgrom, P. - J. Roberts, (1987): Informational Asymmetries, Strategic Behaviour, and Industrial Organization, American Economic Review, 77.

Milgrom, P. - J. Roberts, (1992): Economics, Organization and Management, Englewood Cliffs, NJ. Prentice-Hall International, Inc.

Mladek, J. - I. Hashi (1993): Voucher Privatization, Investment Funds and Corporate Governance in Czechoslovakia, British Review of Economic Issues, Vol 15, 37.

Mueller, D. (1986): The Modern Corporation, Profits, Power, Growth and Performance. Wheatsheaf Books ltd. Great Britain.

Peck, M. J. (1995): Russian Privatization: What Basis Does it provide for a Market Economy?, A Journal of the University of Iowa College of Law, Volume 5, Number 1, Spring.

Parker, D. (1993): Unravelling the Planned Economy: Privatisation in Czecho-Slovakia, Communist Economies, 5.

Prowse, S. (1995) Corporate Governancein an International Perspective: A Survey of Corporate Control MechanismsAmong Large Firms in the U.S., U.K., japan and Germany, Financial Markets, Institutions and Instruments, Vol 4, 1.

Raiser, M. - P. Nunnenkamp (1995): Output Decline and Recovery in Central and Eastern Europe: The Role of Incentives, in Holzmann, R. - J. Gacs - G. Winckler: Output Decline in Eastern Europe, Chapter 13, IIASA.

Rowthorn, B. - H. Chang (1993): Public Ownership ant the Theory of theState, Ed. by Clarke and Pitelis, The Political Economy of Privatization, London.

Sadowski, (1991): Privatization in Eastern Europe: Goals, Problems, and Implications. Oxford Review of Economic Policy, 7.

Sappington, D - J. Stiglitz, (1987), Privatization, Information and Incentives, Journal of Policy, Analysis and Management 6.

Scheiner-Lenne, L. (1992): Corporate Control in Germany, Oxford Review of Economic Policy, 8.

Schleifer, A. - R. Vishny (1986): Large Shareholders and Corporate Control. Journal of Political Economy, 94.

Schmalensee, R. (1988): Industrial Economics: An Overview, The Economic Journal, 98.

Schumpeter, J. (1934): The Theory of Economic Development. Cambridge. Mass: Harward University Press.

Shaede, U. (1994): Understanding Corporate Governance in Japan: Do Classical Concepts Apply?, Industrial and Corporate Change, Vol. 3, No 2.

Sheard, P. (1989) The Main Bank System and Corporate Monitoring and Control in Japan, Journal of Economic Behavior and Organization, 11.

Smith, A. (1776): The Wealth of Nations, London.

Stiglitz, J. (1985): Credit Markets and the Control of Capital, Journal of Money, Credit and Banking, 17.

Stiglitz, J. (1989): Incentives, Information and Organizational Design, Empirica, 16.

Stiglitz, J. (1991): Symposium on Organizations and Economics, Journal of Economic Perspectives, Vol. 5,2.

Stiglitz, J. (1991): Some Theoretical Aspects of the Privatization: Applications to Eastern Europe, Ed. by Baldassari, Paganetto and Phelps, Privatization Processes in Eastern Europe - Theoretical Foundations and Empirical Results, St. Martin's Press, Rome.

Svejnar, J. - M. Singer (1994): Using Vouchers to Privatize an Economy: the Czech and Slovak Case. Economics of Transition, 2.

Thompson, S. - M. Wright (1995): Corporate Governance: the Role of Restructuring Transactions, The economic Journal, 105.

Tirole, J. (1991): Privatization in Eastern Europe: Incentives and the Economics of Transition, NBER Macroeconomics Annual, The MIT press, Cambridge.

Vickers, J. (1988): Privatization. An Economic Analysis. Cambridge, MA, MIT Press.

Vickers, J. - G. Yarrow (1991) Economic Perspectives on Privatization. Journal of Economic Perspectives, 5.

Williamson, O. (1985): The Economic Institutions of Capitalism, New York.

Williamson, O. (1988): Corporate Finance and Corporate Governance, Journal of Finance, 43.

Williamson, O. (1992): Private Ownership and the Capital Market.

Ziegler, R., Bender, D., and Biehler, H. (1985) 'Industry and Banking in the German Corporate Network,' in F. N. Stokman, R. Ziegler, and J. Scott (eds.) Networks of Corporate Power: A comparative Analysis of Ten Countries, Cambridge, UK, Policy Press.

E L I N K E I N O E L Ä M Ä N T U T K I M U S L A I T O S (ETLA)
THE RESEARCH INSTITUTE OF THE FINNISH ECONOMY
LÖNNROTINKATU 4 B, FIN-00120 HELSINKI

Puh./Tel. (90) 609 900
Int. 358-0-609 900

Telefax (90) 601753
Int. 358-0-601 753

KESKUSTELUAIHEITA - DISCUSSION PAPERS ISSN 0781-6847

No 528 ANTTI PUTUS, Matkapuhelinverkkojen kehitys ja alan kotimaisen teollisuuden kilpailukyky. 02.02.1995. 35 s.

No 529 PASI KUOPPAMÄKI, Climate Change and the Finnish Economy. 20.02.1995. 55 p.

No 530 MINNA PUHAKKA, Ulkomaisten yritysten suorat sijoitukset Suomeen - kyselytutkimuksen tuloksia. 06.03.1995. 38 s.

No 531 AIJA LEIPONEN, Human Capital and Corporate Growth. 06.03.1995. 27 p.

No 532 KARSTEN ALBÆK - MAHMOOD ARAI - RITA ASPLUND - ERLING BARTH - ERIK STRØYER MADSEN, Employer Size-Wage Effects in the Nordic Countries. 13.03.1995. 38 p.

No 533 NIILO SARANUMMI, Lääketieteelliset laitteet ja tietojärjestelmät. 24.04.1995. 89 s.

No 534 JUHA RUMPUNEN, Estonia: Policy and Criteria for EU-membership. 03.05.1995. 43 p.

No 535 JUHA KETTUNEN, Method of Pay in Finnish Industry. 02.08.1995. 71 p.

No 536 JUHA KETTUNEN, Job Tenure in Finnish Industry. 02.08.1995. 72 p.

No 537 MARIANNE PAASI, International R&D Cooperation in the EU: A Solution to the Technological Disadvantages of Small National Economies? 28.08.1995. 17 p.

No 538 ULLA KRUHSE-LEHTONEN, Perinnönjättömotiivit Suomessa - kotitaloustiedusteluun 1990 perustuva empiirinen tutkimus. 19.09.1995. 44 s.

No 539 JULIANNA BORSOS - MIKA ERKKILÄ, Regional Integration in the Baltic Rim - FDI and Trade-Based Integration in the Triangle of Finland, Estonia and St. Petersburg. 29.09.1995. 85 p.

No 540 JULIANNA BORSOS - MIKA ERKKILÄ, Foreign Direct Investment and Trade Flows Between the Nordic Countries and The Baltic States. 29.09.1995. 43 p.

No 541 RITA ASPLUND, The Gender Wage Gap in Finnish Industry in 1980-1994. An empirical analysis of non-manual workers. 11.10.1995. 28 p.

No 542 TOR ERIKSSON - SUSANNA FELLMAN, Determinants of Firms' Operating Times - Some Evidence from Firm-Level Data. 23.10.1995. 19 p.

No 543 TARMO VALKONEN, Corporate and Capital Income Tax Reform in a Numerical Overlapping Generations Model: The Case of Finland. 12.12.1995. 28 p.

No 544 REIJA LILJA, Career Mobility in Finnish Industry. 14.12.1995. 22 p.

No 545 JUKKA LASSILA - TARMO VALKONEN, Policy Credibility in Numerical Overlapping Generations Models. 28.12.1995. 28 p.

No 546 EIJA KAUPPI - JUKKA LASSILA - TIMO TERÄSVIRTA, Short-Term Forecasting of Industrial Production with Business Survey Data: Experience from Finland's Great Depression. 26.01.1996. 20 p.

No 547 JIAN-GUANG SHEN, FDI, Knowledge Spillover and Economic Growth in East Asia. 31.01.1996. 70 p.

No 548 MAARIT SÄYNEVIRTA - PEKKA YLÄ-ANTTILA, Integraation ja yritysten kansainvälistyminen - vaikutuksia kotimaan talouteen. 01.02.1996. 58 s.

No 549 LAURA PAIJA - PEKKA YLÄ-ANTTILA, The Impact of Structure and Competition on Employment in the Telecommunications Cluster Case Finland. 12.02.1996. 34 p.

No 550 PENTTI VARTIA - PEKKA YLÄ-ANTTILA, Technology Policy and Industrial Clusters in a Small Open Economy - The Case of Finland. 16.02.1996. 15 p.

No 551 PONTUS BRAUNERHJELM - PER HEUM - PEKKA YLÄ-ANTTILA, Internationalization of Industrial Firms. Implications for growth and industrial structure in the Nordic countries. 16.02.1996. 33 p.

No 552 REIJO MANKINEN, Alkoholiveron alentamisen kansantaloudellisia vaikutuksia. 26.02.1996. 42 s.

No 553 RITA ASPLUND, Koulutus, työura ja palkkaerot. 22.03.1996. 13 s.

No 554 MARIANNE PAASI, The Absorptive Capacities of Estonian Firms. - Can a Technology-based Industrial Strategy Succeed? 22.03.1996. 17 p.

No 555 HANNU HERNESNIEMI, Barriers to Economic Cooperation of Baltic Rim Countries. 10.04.1996. 46 p.

No 556 ANNICK LARUELLE - MIKA WIDGRÉN, Is the Allocation of Voting Power among the EU States Fair? 17.04.1996. 19 p.

No 557 JARI HYVÄRINEN, A Survey of Corporate Governance - Which Model for Transition Countries? 13.05.1996. 32 p.

Elinkeinoelämän Tutkimuslaitoksen julkaisemat "Keskusteluaiheet" ovat raportteja alustavista tutkimustuloksista ja väliraportteja tekeillä olevista tutkimuksista. Tässä sarjassa julkaistuja monisteita on mahdollista ostaa Taloustieto Oy:stä kopiointi- ja toimituskuluja vastaavaan hintaan.
Papers in this series are reports on preliminary research results and on studies in progress. They are sold by Taloustieto Oy for a nominal fee covering copying and postage costs.

d:\ratapalo\DP-julk.sam/13.05.1996