Corporate governance cycles during transition: Theory and Evidence from the Baltics

by

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December 2003

Abstract

We begin by identifying a typical governance life-cycle, defined as changes in ownership structure, and including both the identity of the major owner and ownership concentration. The cycle is marked by key events and phases including start-up, initial growth, mature growth, and possibly a crisis and restructuring stage or exit stage. The governance cycle for transitional countries reflects some specific characteristics – e.g. often privatization produces specific initial ownership structures, with an unusually high proportion of insider, especially, employee ownership. Subsequently pressures for restructuring produce strong impulses for ownership changes. There is limited possibility for external finance because of the embryonic development of the banking system and the capital markets during early transition. The governance cycle is also influenced by specific features of the institutional, cultural and economic environment in a country. The varying importance of these factors is expected to produce differences in key features of ownership cycles such as the speed at which particular ownership changes occur.

To provide simple hypothesis tests, we use new and rich enterprise panel data sets for the three Baltic countries. The data enable various measures of ownership to be constructed (including the identity of major owners and ownership concentration). The empirical analysis covers the ownership cycle with emphasis on initial ownership and subsequent changes. Our key method is to assemble a series of transition matrices showing both starting and final ownership configurations for sample enterprises and to simultaneously provide information on changes in concentration for the largest single owner. For Estonia this is supplemented with an analysis of the frequencies of different ownership-cycles including intermediary stages of ownership. In spite of important differences in institutional development, especially concerning the privatization process, we find that governance cycles are broadly similar in all countries. Employee ownership is rapidly fading and mainly being succeeded by managerial ownership. There are changes back and forth between manager and domestic external ownership, while foreign ownership is quite stable. Ownership concentration is mostly increasing after privatization, which included diversification both to employees and external owners. Since ownership diversification did not sit well with the slow development of the institutional framework, as expected we see a subsequent concentration of ownership on both managers, external domestic and foreign owners. However, variation in institutions, there are also important differences across countries. The adjustment of ownership structures is faster in Estonia and this can be explained by the relatively fast pace of institutional change and evolution of important governance institutions, including tough bankruptcy legislation and advances in the financial system.

JEL-codes: G3, J5, P2, P3

Keywords: corporate governance, life-cycle, privatization, ownership change, transition economies, Estonia, Latvia, Lithuania .

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I. Introduction

The transition in Eastern Europe has been characterized by development of quite specific types of ownership structures. These ownership structures have been changing quite fast not only in relation to privatization, but also in the post-privatization period. The aim of this chapter is to analyze the specific patterns in these ownership dynamics, which is an important part of the development of new enterprise governance structures. In the analysis we focus on ownership identity and concentration, we do not include board representation, management position, compensation etc.

The theoretical starting point is that the choice of governance structure is determined by: enterprise characteristics: size, need of capital, information asymmetries, etc. as well as surrounding institutions, market conditions etc. The enterprise characteristics change over the life cycle of the firm. Ownership structures are expected to change because different stakeholder groups can contribute in different ways to the development of the company at different times in the firm's development. This means a change in governance structure over the life cycle - a specific governance cycle. However, the surroundings differ between countries, and countries in transition have specific features and specific paths of development. Therefore, there can be identified a specific governance cycle during transition. Because of the rapid changing environment corporate governance patterns established at early stages of transition can be expected to change quite fast. But the speed of transition, the institutional framework, and the needs of capital and other inputs from different stakeholders vary across countries and are expected to produce differences in the nature of the typical life cycle across countries - for example in the speed at which particular ownership changes will occur.

Although the three Baltic countries show many similarities in the transition process there are also important differences in the developments in the institutional environment. Special attention is paid to differences in the privatization process and also to the sophistication of the security of property rights. The speed and the

depth of reforms have varied in the three Baltic countries. It is of special interest to examine these similarities and differences and to analyze if these are associated with differences in key dimensions of governance cycles across countries.

To provide simple hypothesis tests, we use new and rich enterprise panel data sets for the three Baltic countries. The data enable various measures of ownership to be constructed (including the identity of major owners and ownership concentration). The empirical analysis covers the ownership cycle with emphasis on initial ownership and subsequent changes. Our key method is to assemble a series of transition matrices showing both starting and final ownership configurations for sample enterprises and to simultaneously provide information on changes in concentration for the largest single owner. For Estonia this is supplemented with an analysis of the frequencies of different ownership-cycles including intermediary stages of ownership.

The structure of the chapter is as follows. The next section outlines the conceptual framework for governance changes over the life cycle of the company both in general and in relation to the specific conditions in countries in transition. In section 3 we describe the differences in the transition process and developments in the institutional environment in the three Baltic countries. Section 4 outlines the data, reviews previous work on ownership changes in transition economies, and present the results of the Baltic analysis in a series of transition matrices that show the start and end of the governance cycles both covering ownership identities and concentration. In a final section we offer conclusions and implications.

II. Governance cycles: Conceptual Framework

Since our idea of the governance cycle for firms in transition economies draws on well-established concepts for firms in developed economies, it is useful to begin by highlighting some themes in that literature and also by examining some matters of scope and definition.

In this chapter the type of ownership is connected to the identity of the owners defined in relation to their specific stake in enterprise activities – as pure capital providers, managers, employees, and state representatives. We also distinguish between foreign and domestic owners since in economies in transition this is often an important difference. Furthermore, we analyzes the concentration of ownership among the largest single stakeholders, defined as an individual, group or legal entity with specific interests in the enterprise - managers, other employees, creditors, external owners, customers, suppliers, central or local government. The governance structure for an enterprise can be defined as the distribution among stakeholders of both the formal rights and the appropriated rights concerning: 1) control, 2) income flow, 3) assets and liabilities, and 4) information about the enterprise (Mygind 2001). The ownership rights are the residual rights left for the owner, when the fixed rights to other stakeholders (like wages, interest, taxes) have been fulfilled. Thus, the identity of the owners is a central part of the governance structure. Other aspects like the actual organization of governance in relation to the board structure and the stakeholders' representation on the board are beyond the scope of this chapter.

The ownership structure in market economies is determined by a combination of institutional, cultural and economic factors. To the extent that there is a possibility for ownership structures to adjust it can be assumed that, given the institutional setting, the type of ownership that gives the highest return to the owners will prevail. The optimal ownership structure can be explained from several perspectives including agency-, property rights-, and the transaction cost approaches. In addition, resource dependence theory analyzes the firm from the point of view of its ability to get access to critical resources (Pfeffer and Salancik, 1978). The importance of these resources varies over the life-cycle of the firm. At the start the entrepreneurial skills connected to the initial business idea is the crucial factor while supply of necessary capital is more important in the following stages. While these different theories emphasize different factors, the fol-

lowing elements are of recurring importance and are likely to be included in an eclectic approach to ownership dynamics. We begin first by considering factors whose main impact is at an individual firm level.

Ownership-determinants: Technology and market at the company level

The size of the company is connected with higher demands on capital and entails a pressure away from concentrated ownership. The size and capital demands of the company may be very high even in relation to a wealthy owner. Therefore, growth is associated with a more diversified ownership structure, a fall in owner concentration (Jensen and Meckling 1976, Putterman 1993, Shleifer and Vishny 1997). A large size of the company is often used as an explanation for no employee ownership. Alchian and Demsetz (1972) argue that a large group of employees need a central monitor to avoid shirking. The larger the group the smaller is each employee's share in the ownership rights and the easier it is for a single employee to free-ride. Hansmann (1996) argues that a larger group of employees combined with higher heterogeneity means higher costs for collective decision making.

A second factor is the *need for capital*, which is connected to capital intensity, the size of the company, and the specificity of capital (see below). This means that it is difficult for wealth-constrained insiders to take over the company, and if they own the company it will mean a high concentration of risk. Insiders put all their eggs, jobs and capital, into one basket (Meade, 1972). While for employees this argument is connected with capital intensity, for management ownership it will be linked to the absolute amount of risk capital that is needed. There is a trade off between single proprietorship by the manager with no governance problem between manager and owners and the possibility of diversification and higher capital supply by external more diversified investors with less control with management (Fama and Jensen 1985).

The *specificity of the different inputs* constitutes another microeconomic factor. If the fixed assets can be used in many alternative activities it is much easier to finance them by loans instead of by direct risk capital. In these cases banks will play a strong role (Williamson 1985). However, the sunk cost of

specific capital puts the risk on the provider of capital. In turn, the larger the need for direct risk capital, there is less likelihood that a single provider of capital will emerge to fulfill these needs and more diversified ownership can be expected (Fama and Jensen 1985, Putterman 1993). On the other hand, the existence of specific capital means a higher dependence on other links in the value chain. The hold-up problem may lead to a stronger connection to core suppliers or customers with quite concentrated strategic ownership of the company (Grossman and Hart, 1986). A special relation concerns the inputs of human capital. If it is highly specific, the risk is high for the employees. To limit this risk, the employees have an incentive to take direct control and ownership of the enterprise.

Transaction costs for outside investors are also closely connected to the specificity of the assets of the company, information asymmetries, and of the institutional framework (see below.) New and yet unproven business ideas with complex human capital make it very difficult and costly for external investors, including both passive suppliers of capital like banks and active external owners to get reliable information about the company and to monitor the performance of managers.

The *economic performance* of the firm is another potential influence on the ownership type with, for example, an economic crisis often implying a shift in ownership. However, this ownership change may take several directions: An outside raider or a strategic investor related to the value chain may take over the company and perform the necessary restructuring. A managerial buy-out may be the result if, based on insider information, the managers estimate the value of the firm to be higher than estimates of external investors (Wright et al., 2001). An economic crisis may induce a defensive take-over by the employees to introduce more flexible wages and to save their jobs and their specific human capital. (Ben-Ner and Yun 1996). However, it can also be argued that high performance increases the value of equity and therefore cash constrained employees are tempted to sell their shares. In general, high performance means that the company can be sold for a high price, and this will attract strong external investors.

Ownership-determinants: economic, institutional and cultural environment for a country

There are also several factors that together constitute the economic, institutional and cultural environment for a country, with differences across countries expected to be associated with differences in ownership dynamics. If economic performance is found to influence the type of ownership, then *macroeconomic cycles* can also be expected to have an impact on the governance structure, and the governance cycle will be related to the business cycles. Thus it has been estimated that MBOs are more frequent in business cycle troughs because of the general low pricing of assets during dips. This can be seen in relation to tendencies of going private (CMBOR, 2003), while boom periods on the stock market means that IPOs and going public give companies a cheaper possibility for raising external finance. Defensive employee take-overs can be assumed to be more frequent in recessions because of higher threats of closure and lower alternative employment possibilities (Ben-Ner 1988). However, the focus in this paper is not the macroeconomic business cycle, but rather the life-cycle of the firm.

The *institutional setting* in relation to legislation may present specific barriers or provide advantages to different forms of ownership. Thus U.S. legislation has limited bank ownership of non-financial companies and ESOP legislation has included tax benefits that favor some elements of employee ownership. In Denmark foundation ownership has been favored by tax benefits (Pedersen and Thomsen 1997). The degree of protection of minority owners through legislation and the liquidity and development of the stock markets can be determining for the diversification of ownership. Thus, *concentrated ownership* is widespread in countries with a lower degree of minority owner protection and less developed capital markets, while diversified ownership is more frequent in countries such as US and UK with highly developed capital markets and a high degree of protection of minority owners (La Porta et al 1999, Becht et al 2002). Also, the development of the banking sector enhances the possibility of financing growth through bank-loans, and for the role of the banks as creditors and potential owners in the governance structure of the firm.

Informal social relations and *Culture*, defined as the historical traditions, cultural values, norms and preferences of the stakeholders, can also explain important differences in the governance structure between countries. Thus, the optimal ownership structure in Japan is expected to be different from the optimal structure in the US because stakeholders have different objectives and different relations to each other.

Changes in ownership over the life-cycle of the firm

Based on these influences on and determinants of ownership some trends in the development of a typical ownership structure for a firm can be noted in relation to the *typical life-cycle of the firm*. The stages in the typical life-cycle of a company can be related to specific stages of the development in the ownership structure. Over its life-cycle, a company will change technology, markets and relations to the different stakeholders. These shifts will have an impact on the role of different stakeholders including the identity of the dominant owners, which is the part of the corporate governance structure we focus on when examining the *governance cycle*.[1]

The governance cycle can be developed in relation to the core stages or core events in the company life-cycle. Most companies *start-up* as small entities with few employees, low capital, and low knowledge about the economic potential of the firm. A high proportion fail in the early stage; but most of the succeeding companies go into a stage of *early growth*, with demands for higher inputs of capital, knowledge, networks and employees. The need for extra capital may be spread over *several growth stages* eventually leading to some diversification of ownership. However, a specific shock in the environment may also lead the company into a stage of *crisis*, which makes some kind of new inputs necessary. This will often be a new input of capital, which can only be facilitated through an ownership change. During these stages the change in ownership can be related to the different determinants of the ownership structure. Changing conditions both from within and from outside the company generate changes in ownership and hence changes in the development of the governance cycle.

The *classic entrepreneurial company starts up* as a small entity often only based on the entrepreneur and a few close friends or relatives as partners. It is often based on relatively low capital inputs, which can be covered by the entrepreneur and debt based on personal loans e.g. with collateral in the family-house. For the newly started firm, information about the core-competence, the main business idea, is yet unproven and difficult to transmit to an external investor. The asymmetry in information between the insider and external investor is thus very large and the transaction costs of writing and controlling a contract are very high. High uncertainty and lack of reliable information about the prospects of the new business and its market potential enhance the problem of asymmetric information and risks to the external investor. Therefore, most new companies are started by single proprietors, and they are often owned by the entrepreneur sometimes with participation of close relatives and friends. The capital needed can in most cases be covered by the founders and by loans with collateral in the entrepreneurs' personal assets.

The exceptions for starting up new entities are capital-intensive projects developed inside large companies or as joint ventures between several companies. When new entities are started by parent companies or venture companies from the start external ownership, with a separation of ownership and control, exists. However, these types of start-ups (spin offs) are rare in comparison to the high number of entrepreneurial management start-ups.

Many small entrepreneurial companies close down during the initial stages but eventually, those that survive enter an *initial growth stage*. The expansion of the company to benefit from economies of scale demand high capital investments, knowledge and network relations to facilitate continued high growth. At the same time, the firms start to create some reputation and market-experience, which can improve the information relevant for potential external investors. It becomes possible to give external investors the necessary information and guarantees based on the assets of the new company. Suppliers of capital can be banks or other financial institutions. In most cases these creditors will not claim direct control, but often they require to closely monitor the collateral behind the loan. In other cases venture capital with a dominat-

ing ownership share may supply capital. This happens mostly in the early stages of the life-cycle. In some cases the owner tries to attract other owners by issuing extra share capital. Often the new owners are found within a rather closed circle of stakeholders, typically top-employees of the company, investors from the local society or close business partners.

At a later more *mature growth stage*, when the company has developed its potential, it may attract a strategic investor with an interest in including the company in its value-chain. Another possibility for attracting capital at a developed stage is to go public. This stage could be connected to the exit of the venture capital, which sells the company after fulfilling its task. The development of going public is also often part of a process of diversification of ownership. Therefore, the process of growth is often combined with a lower degree of concentration.

Sooner or later many companies run into a *stage of crisis*. Diverse internal and external factors, including changes in technology and/or markets or the institutional setting, force the company to adjust to the new conditions. The company faces strong pressures to undertake some restructuring. New external capital and expertise are needed, and banks, venture capital and strategic investors may play an important role. As an alternative to closure insiders may make a defensive takeover to protect their jobs and their specific human capital. The crisis may also result in an exit of the company and liquidation of the assets, which is then taken over by new investors for other activities.

To a large degree, the institutional setting determines both the extent of external ownership and the timing of when external owners become involved in the life-cycle. Particular concerns include the choice between debt and equity, and the involvement of minority shareholders. The protection of minority shareholders depends on the functions of legislation, the transparency of the information about the company, the functioning of the market for shares (not only in relation to publicly traded, but also for closely held companies). In countries with developed markets for ownership and strong protection of minority owners we see a more diversified ownership structure (LaPorta et al. 1999).

Specific conditions for the governance cycle in transition economies

Returning to the case of *transitional economies*, we expect that a specific governance cycle exists in firms in those countries. The dynamics of enterprise governance and ownership are quite distinct in transitional economies because enterprises go through both a transition in ownership structure, a transition in relation to the changing institutions in the environment, and a transition of the market in relation to prices, costs, and competitive structure with a strong pressure for restructuring of products and production methods. Therefore, most enterprises in transition economies start with rapidly changing the structure of governance combined with a strong pressure for restructuring production simply to be able to survive. The specific elements in early transition that influence the governance cycle are shown in Table 2.

To understand the specific governance cycles appearing in transitional economies there are three special conditions that must be taken into account. The first of these factors is *the privatization process.* The early years of transition created specific conditions for the initial development of private ownership. The different methods favored different types of owners. For example, in some countries employees had a strong political position resulting in a very high frequency of employee ownership. Also, often managers had a strong position in relation to the political system. On the other hand, voucher privatization could lead to a high degree of domestic external ownership, while direct sale without restrictions for foreign capital gave foreign investors the lead in the change to concentrated external ownership (Mygind 2001). The privatization process can be seen as a state governed process where the specific privatization methods creating a specific ownership structure, which would not have developed in a more market based system for ownership adjustments. It can be argued that path-dependency may create a learning process and institutional development, which may lead to specific paths for subsequent developments in the governance structure. Such path dependencies can to a high degree be used for explaining persistent differences in the govern-

ance structure in the West.[2] On the other hand, it can be expected that there will be post-privatization adjustments bringing the ownership structure back to a more "normal" equilibrium.

A second condition occurs because, from the start of transition, nearly all state owned enterprises are confronted with a strong *pressure for restructuring* of production, production methods, organizational structure and markets. They are in a situation of crisis with an acute need of capital, new skills, and new networks. In the developed market economies this would very often lead to a change in ownership bringing new investors with the necessary resources for restructuring. In some cases, privatization has delivered the best-fitted investor for this restructuring. In other cases post privatization dynamics include a takeover to facilitate such restructuring.

However, there is a third and most important feature of transitional economies, which delays this kind of ownership adjustment. This concerns the process of building up a well-functioning market economy and especially developing the necessary *institutions* that are required to facilitate the adjustment of governance structures in enterprises. In the early stage of transition, the lack of developed institutions favors special types of ownership arrangements. For example, insiders have an advantage in relation to outside owners because the institutions supporting outside ownership such as credible auditing procedures and transparent stock markets are not developed (Mygind 2001). The delayed development of the institutional framework combined with stabilization and more developed markets enables other adjustments of the ownership structure to be made.

Hypotheses about the specific governance cycle in transition economies

Based on these three special conditions some specific hypotheses about the governance cycle in transition can be developed. However, since some conditions can give tendencies whose directions are ambiguous, the final conclusions must be based on empirical analysis.

The first set of hypotheses concerns the scope and resilience of employee ownership. We note that the privatization process in many countries, including the Baltic Republics, has led to a high degree of broad employee ownership. However, employees' lack of governance skills, their lack of capital and the risk-concentration may lead to a tendency to sell to other investors that is quite rapid. This movement away from employee ownership could be delayed by various factors including: if learning processes give employees higher governance skills; if there are strong defensive arguments for keeping ownership to protect employment; or if the specific company has a high degree of specific human capital, which would be threatened by a sale to another investor.

In general, the lack of development of the institutional environment weakens the role of external investors. The lack of transparency and high risk especially in the early stages of transition combined with the lack of markets for company shares means that, in general, managers have a strong advantage compared to external investors (Kalmi 2002). Therefore, it can be expected that managers often take over the shares that the broad group of employee wants to sell. Especially, during the early stages of transition there will be a strong tendency for *ownership changes from employees to managers*. The exceptions are expected to be relatively small enterprises with high human capital.

Some privatization methods provided for a high degree of public offering of shares to diversified external owners. To some extent this was the situation in Lithuania with voucher privatization. Also, in many countries, privatization to former employees in agricultural entities would be registered as sales to external owners. These kinds of sales would often mean overly diversified ownership in relation to the volatility of the markets, the low quality of information to external owners and the lack of development of the institutional framework. At the same time most of these initial small external shareholders were under strong wealth constraints. Therefore, during the early years these companies will be in a process of *concentration of ownership*. Because of their strong position it is expected that *managers will take over companies from diversified external owners*. Such management takeovers will be accompanied by an increase in

ownership concentration. Also concentration in the hands of a smaller group of external investors (including foreign) can be part of this process.

When the institutional framework becomes more advanced during the process of transition it can be expected that external investors will get a stronger position, and we will see shifts from *insider to outsider ownership*. This tendency will be strengthened if the company, either because of high growth or because of pressure for restructuring, has a strong need for extra capital.

The stock markets in the transitional countries are quite weak, with few companies listed, low capitalization and low turnover and IPOs are rare (EVCA, 2003). Therefore, it is too early to observe the tendency found in the west for more mature firms to diversify ownership to small external investors. Instead we expect a dominating tendency in the direction of higher concentration of ownership also when we look at continued external ownership.

The specific ownership development for privatized enterprises can be expected to be quite different from the dynamics for new start-ups. For new firms we expect developments to follow the cycle of Western economies to a much higher degree with manager-owned start-ups subsequently being taken over by external domestic owners or, for the most successful cases, by foreign investors. However, while new start-ups are not influenced by the special transitional privatization-bias, they are still subject to gaps in the institutional environment thus pushing them in the direction of the specific transition-economy governance cycle.

In many cases foreign companies establish their subsidiary companies directly as new greenfield entities. In these cases we expect a rather stable ownership structure. Also when foreign investors have taken over companies in the privatization process we expect that these enterprises have reached their final stage of development in the ownership cycle - we expect no further changes of ownership within the relatively short time-horizon of our analysis. However, in cases where the foreign subsidiary has been established as a joint-venture in early transition we expect a change to a wholly owned subsidiary when the legis-

lation opens up for this possibility. We summarize the expected governance cycle for a firm in a transition economy in Table 3.

However, it should be noted that the analysis has emphasized some general tendencies for the governance cycle in transitional countries in comparison to Western countries. This leads us to expect to find some quite similar tendencies in the three Baltic countries. We also expect that the existence of cross national differences, especially concerning institutional differences related to the speed and form of transition, may make the starting points and the speed of change between different phases of the cycle slightly different across countries. The dominant form of privatization will determine to what degree the starting point of the cycle for privatized firms will be employee ownership or perhaps foreign ownership (Mygind 2001). In addition to the specific privatization methods the advancement of the institutional development and the general economic and political stability will determine the level of foreign investment (Bevan et. al. 2004). The speed of change also depends on the transition of institutions. The development of the banking sector and the possibility of debt financing are especially important. The dynamics also depend on the development of the capital-market and the possibility of expanding the equity both for listed companies and for trading shares of non-listed companies. In turn this might be expected to produce differences in ownership concentration at particular times.

Hence, in the next section we look more closely at specific developments in the three Baltic countries. In turn, we will then develop some hypotheses for how this can be expected to affect the character of corporate governance cycles, especially the starting points and speed of ownership change in these countries.

III. Privatization and Governance Institutions in the Baltic Countries

The results of privatization in the Baltic countries are summarized in Tables 4 and 5. There have been important differences in starting conditions and in political development. Therefore, different paths

have been chosen for changing the ownership structure from a planned system to a market system based on private ownership (for a deeper analysis sees Mygind 1997 and 2000). In Estonia the nationalist-oriented policies in relation to the large Russian-speaking minority meant that the period supporting broad employee takeovers of enterprises was very short and except for a few experiments and some large agricultural enterprises only covered the privatization of small and medium sized enterprises. This was also the case in Latvia, but here a large group of small and medium sized enterprises initially leased by their employees were later formally taken over by employees. Therefore, we also have some privatizations to employees later in the process in Latvia. Before independence, employee takeovers implied that control was taken away from central authorities in Moscow to the Baltic Republics. When this goal was accomplished in Estonia and Latvia the next goal was both to strengthen the position of the titular population and to find a more efficient ownership structure.

In Lithuania, with a negligible Russian-speaking minority, workers and employees in general had a much stronger political role. The early ideas of insider-takeovers were further developed in the early years of transition with the implementation of the "Program of Initial Privatization", called LIPSP. At the same time, there was strong resistance against selling out Lithuania to foreign investors. Lithuanians feared Russian takeovers. Lithuanian policies for a long period were quite restrictive towards FDI. Estonia, on the other hand, implemented very liberal rules for foreign capital, opening up the economy to the inflow of especially Finnish and Swedish capital.

In the former Soviet Union, the first movements in the direction of private enterprises (in the form of new cooperatives, individual firms, leasing and joint ventures) began during the second half of the 1980s (Jones and Weisskopf, 1993). Similar developments took place in what were to become the Baltic Republics, especially in Estonia, which functioned as a laboratory for market reforms in the USSR. The "small state enterprises" with semi-private spin offs from state owned enterprises were part of this development. Also in Latvia, rapid development of new-cooperatives made an early start of private entrepreneurship.

Most of these firms had a strong element of employee ownership although often they were dominated by managers.

All three countries have had large voucher schemes involving most residents. However, in both Estonia and Latvia the bulk of vouchers were related to the privatization of land and housing. In Lithuania 65 per cent of the vouchers were used in enterprise privatization in the LIPSP program - in Estonia only 28 per cent and in Latvia 42 per cent (Mygind 2000). In Estonia and Latvia most of these vouchers went to broad public offerings of minority holdings after the sale of the majority to a core investor. A core investor could also finance a big share of the down payment by vouchers in the tender privatizations. In Lithuania, vouchers could only be used in the LIPSP-program. Often majority share holdings were bought mainly for vouchers. Although the LIPSP privatization resulted in a more diversified ownership structure than the tender privatizations in Estonia and Latvia, in most cases a core group of owners, most often insiders, acquired a majority of shares.

Because of the limited role of vouchers in enterprise privatization in Estonia and Latvia investment funds were not important. However, in Lithuania 300-400 investment funds were started in relation to the LIPSP program. While many funds were used as a mechanism enabling a group of insiders to take control of their companies, some of them developed into more orthodox investment funds representing a high number of investors and with a diversified portfolio in a large number of companies. However, there were severe governance problems, giving the shareholders too little influence on the administrators, resulting in asset stripping of many funds. When the regulation was tightened in 1997, most of the investment funds were dissolved.

The timing of privatization of small enterprises was quite similar for the three countries. The majority of small enterprises were privatized 2-3 years after the start of transition. However, for the medium and large enterprises there have been marked differences. With the implementation of the LIPSP program, Lithuania was at its peak of privatization in 1993 and larger enterprises were privatized by the end of 1994.

However, in most companies some shares remained state owned, and especially in some very large companies only around 10 per cent of the shares were privatized, so in total only around 50 per cent of the capital was privatized in the companies involved. In Estonia privatization had its greatest momentum by 1994 and most large enterprises were privatized by the end of 1995. In Latvia privatization gained momentum in 1995-96 to peak in 1997, and large privatization was nearly accomplished by the end of 1998. Looking at the largest enterprises in utilities and infrastructure, Estonia was fastest followed by Latvia. While being fastest in the first round, Lithuania was slowest in the last round of privatization although it regained momentum in 1998.

Foreign investors played only a minor role in the privatization of small enterprises. The advantages for insiders crowded out the possibilities for outsiders, especially foreign investors. However, after 1992, foreign investors had some possibilities in Estonia and Latvia. In Lithuania foreigners had a weak position not only in small privatization, but also in the LIPSP privatization. Foreigners, however, soon got opportunities to start up new firms. Again, this happened somewhat faster in Estonia than in the other Baltic countries.

Estonia was the first country to use privatization to promote foreign investment in relation to large privatization. In the tender process, foreign investors had a strong position because of their access to capital, management skills, and international business networks. From 1993 foreigners took over many of the largest enterprises under privatization. By the end of 1998 foreigners had taken over approximately one third of enterprise assets included in large privatization. Latvia started the same process in the autumn of 1994 and the foreign share of purchase was 38 per cent for the years 1994-1998. In Lithuania the LIPSP privatization gave very little room for foreigners, and only 4 enterprises were taken over by foreign investors in “the privatization for hard currency” of 46 enterprises in the period up to 1995. After LIPSP the pace of privatization stagnated and not until 1998 did foreign capital start to play an important role in privatization in Lithuania.

Table 6 gives an overview of developments in the Baltics of the main institutions for the functioning and development of the governance structures at the enterprise level. Although the Baltic countries started their transition two years later than the leading countries in Central Europe (Poland, Czech Republic and Hungary) they are about to catch up (EBRD 2003). The legislation on bankruptcy procedures was developed quite early in Estonia, September 1992. The law was strictly enforced so by 1995 more than 1000 bankruptcies had already been implemented. Therefore, takeovers of liquidated assets can be assumed to have an important role in the ownership dynamics in Estonia. In Latvia and Lithuania bankruptcy laws were passed in 1992, but implementation was relatively weak. The legislation was strengthened in Latvia in 1996 and in Lithuania in 1997 and the implementation has been tightened in the latest years. However, according to an EBRD survey, the implementation of laws has been somewhat slower in Latvia and Lithuania than in Estonia.

Quite early in the transition process state-owned banks were split into a two-tier system with a Central Bank and a number of commercial banks to be privatized later in the process. This bank privatization was performed fastest in Estonia peaking in 1995, in Latvia in 1996, and in Lithuania only in 2001. A large number of new private banks were established in the early years of transition to service some of the large enterprises. Many of these banks had a weak capital base, but the development of the financial sector shows a strong consolidation with a fall in the number of banks and a development of banking activities from simple money transfers to deepening the main activity of channeling savings from the population to lending to companies. However, this development has been quite unstable and most of the countries have been through severe financial crises. The financial system developed relatively fast in Estonia. As early as 1992-93 the system was strengthened after a major financial crisis. In Latvia there was an even more serious banking crisis in 1995 involving the largest commercial bank in Latvia. In Lithuania three of the largest banks were in crisis in 1995/96. In all three countries the largest banks are now owned by Scandinavian banks and the importance of the banks for supplying capital to enterprises has increased much recently.

The Tallinn Stock Exchange opened in May 1996. Before that time some trading of shares had taken place in the over-the-counter market. The privatization throughpublic offerings of minority shares facilitated the development of the exchange, but there has been no strong relation between the privatization process and the development of the stock exchange. The Tallinn stock exchange is characterized by a small number of companies and only a few of them are heavily traded. Capitalization and turnover on the Riga Stock Exchange are considerably lower than in Estonia. However, following the acceleration of privatization of large companies and the associated public offerings of shares, the Latvian stock exchange has developed quite rapidly in recent years. The National Stock Exchange of Lithuania was established in September 1993, closely connected to the LIPSP privatization process. Although more than 600 enterprises were listed, capitalization in relation to GDP was not higher in Lithuania than in Estonia and turnover has been low with thin trading of most companies. The three Baltic stock exchanges have started a common Baltic list of blue-chip stocks. The three exchanges are connected to NOREX, dominated by the stock exchanges in Stockholm and Copenhagen. This integration will probably further accelerate the strengthening of regulation and transparency. Importantly, however, for the overwhelming majority of Baltic enterprises, including those investigated in this paper, the stock exchanges have no influence on their governance because they are not listed.

The general picture of the transition in the three Baltic countries is that similarities dominate. For all three Baltic countries we expect to see a strong representation of insider ownership including employee ownership in the early years of transition. Especially, for Estonia and Latvia there is a bias towards employee ownership in relation to small and medium firms, while in Lithuania the LIPSP privatization also enables the introduction of employee ownership in quite large and capital-intensive enterprises (Mygind 2000). Since privatization to foreigners was allowed earlier in Estonia, this would lead us to expect that foreign ownership as a starting point of the governance cycle would be more frequent in Estonia than elsewhere.

Estonia's faster development of the financial sector, early tough bankruptcy legislation and in general the fastest institutional development can be expected to encourage a faster speed of change in the ownership cycle than in the other countries. This is both because the optimal ownership structure will converge to the western model at an earlier date and because the institutional development means that it will be easier to make the necessary adjustments. For example, managers have better access to capital for takeovers from the more developed banking system. A fast reactive restructuring means that employment is expected to be cut quite fast in the early stages of transition in Estonia. When employee owners leave the company they may keep their shares and for employee owned companies this may mean a change in ownership from employees to former employees. Finally, a fast transition process and development of the institutional system improve the business climate and attract foreign investors facilitating a faster change of ownership structures in the direction of foreign ownership.

IV. Data and empirical analysis

Much literature has examined ownership structures after privatization in transition economies with considerable attention paid to investigating the relation between ownership and performance (e.g. Estrin and Wright 1999; Djankov and Murrell, 2002.) By contrast, in part because of the inability to access panel data sets, studies that investigate post-privatization ownership dynamics are quite rare and have tended to be concentrated in a few transition countries (e.g. Earle and Estrin (1996), Blasi et al (1997), Estrin and Wright (1999) Filatochev et al 1999)[3].

Another body of work in this area is our own for the Baltic Republics. In our previous work (e.g. Jones and Mygind, 1999) we analyze the determinants behind the ownership changes after privatization by using panel data for Estonia. We find that high capital-intensive companies are more likely to be owned by outsiders and that economic performance does not seem to be the key determinant of ownership structure.

Outside ownership often develops in stages so that companies with minority outside ownership have a high probability of being taken over by outsiders[4].

In this chapter we build on our earlier work and provide a *comparative* empirical analysis of ownership dynamics in all three Baltic countries. Moreover the analytical focus on the idea of the existence of governance cycle dynamics is novel. Thus we wish to see if there is empirical support for our notion of the governance life cycle and to see if this is equally apparent in all countries. In addition, we progress beyond previous empirical work for the Baltics and include ownership concentration in the analysis. Furthermore, since we have obtained new data for Estonia, our analysis covers both the early years of privatization and also companies privatized in the main rounds through the Estonian Privatization Agency. Also, whereas previous work typically has investigated a *single* change in ownership, our analysis of governance cycle dynamics examines *several* steps in ownership changes. Ownership groups are determined according to the widely used "dominant owners" approach, where the firm is assigned to the ownership group holding more shares than any other group[5].

For each of the three Baltic countries we have collected data through ownership surveys designed by the authors. In this way we assemble ownership for a panel of firms in all three countries. However, for reasons including varying opportunities for data collection, the nature of the panel data sets data varies from country to country.

The *Estonian* panel is derived from a sample of 500 private enterprises in 1995, stratified by size and industry. Of the original 500 firms, 409 (82%) cooperated in the initial ownership survey undertaken in 1995. Respondents were asked to indicate the number of shares held by different groups on January 1st 1995 as well as at the time of privatization. Subsequent ownership surveys were administered annually with the last survey in 2002. During this process some firms exited the panel because of closure or denial of response[6]. Other groups were added later to give a broad coverage of later stages of the privatization process[7]. The total group of companies included in this unbalanced panel is 800 companies.

The ownership data for *Latvia* is based on an ownership survey performed by the Statistical Department of Latvia under the authors' direction. The sample for the analysis was chosen from the Statistical Departments financial datasets for Latvian enterprises and was based on the following criteria: availability of financial data; employment of at least 20 for at least one year during 1994-1997; and some overrepresentation of enterprises with more than 100 employees. Based on these criteria, the Statistical Department received responses from 1054 enterprises that contained details of ownership structures for 1997, 1998 and 1999. For 730 of these enterprises we also have ownership information for 1995 and 1996 from the surveys administered by the statistical departments themselves, though without the distinction for insiders between employee and manager ownership.

The ownership information for *Lithuania* is based on a manager-survey performed in the spring of 2000. It provides information on ownership at the time of privatization, and for start-up firms in 1993, 1996, 1999 and spring 2000 for 405 respondents. The sample is a stratified random sample and is derived from a database covering 7546 enterprises that provided financial data for 1997. In constructing our sample we applied the following criteria: eliminate firms that were fully state owned enterprises or were very small (in fact, employed fewer than 20 employees); include all (large) enterprises with more than 100 employees and one third of the smaller firms (employing 20-100). Applying these criteria resulted in 1372 enterprises being identified. Attempts were made to contact all these enterprises, though many were found to have closed and others refused to respond. The 405 responses make up around 30% of the initial group.

The first step in our empirical work is to report simple descriptive statistics for initial ownership structure. In Table 7 we show the relation between the initial ownership at the time of privatization or start up as a new private firm and the year of privatization/start up. From the description of the privatization process it can be expected that employee ownership is most frequent in the early stages of transition. In fact the data reveal that this tendency is most pronounced for Estonia and that it is also evident for Lithua-

nia. However, this phenomenon is not apparent in Latvia, probably because of the high number of leased enterprises, which were not formally taken over by the employees until later in the privatization process. For Estonia, privatizations to domestic external owners[8] increase over the observed period, while privatizations to foreign and managers have no clear tendency[9].

Most of the foreign dominated enterprises are new firms; this is especially the case in Lithuania. The exception is the Estonian large privatization during 1994-99 when many companies were taken over by foreigners. The relatively low total number of privatized foreign enterprises makes it difficult to see a clear development over time for privatizations to foreigners. Management ownership is dominant for new enterprises, but management has also assumed ownership of a high share of privatized enterprises. Domestic and especially employee ownership is more frequent for privatization than for new start-ups. However, external domestic start-ups vary from 15% of the total start-ups in Lithuania to 30% in Estonia. The high frequency may be explained by the entrepreneur being backed by closely related external investors or by external investors setting up subsidiaries e.g. in trade. The importance of new employee-owned enterprise varies from 7% in Lithuania to 12% in Estonia. For the early years this can probably be explained by the emergence of new cooperatives and new entities spun off from existing state-owned enterprises[10].

In the rest of this section we present fresh evidence on ownership dynamics. Before doing so, however, some methodological remarks are in order. The datasets we use are as described which, for Estonia, spans the time of privatization until 2002, for Latvia from 1995-1999, and for Lithuania from 1993-1999. The longer observation period for Estonia mean that the data can be used to analyze a sequence of up to four ownership changes, rather than the single switch that is customary. To maximize the number of observations we have included companies, which have been privatized later in the process, and companies for which we do not have information about the full period.[11]. The changes for Latvia and Lithuania are reported as a two-step process for the first and the last observed ownership types. These processes are shown in a series of ownership transition-matrices as explained below.

We should note that not all the changes in the nature of the identity of the dominant owner are reported in the tables. If the governance cycle follows a pattern by which dominant ownership reverts to an earlier configuration, for example "employee-manager-domestic-manager", then this is considered as a shift from employee to manager ownership. That is, we assume that intermediate changes such as manager-domestic-manager are simply temporary adjustments involving relatively few shares.

For all three countries we have information about the concentration of ownership for the largest single owner. For the descriptive ownership analysis we have used this to define ownership of former employees as diversified domestic ownership with the largest single owner having less than 20% of ownership. This definition can be justified because practically no enterprises were privatized to diversified external owners. It is important to distinguish between the groups of domestic external investors and former employees because there are basic differences between the process behind the ownership change to external investors and to employee-owners leaving the firm but keeping their ownership.

The transition matrix for Estonia[12] (Table 8) shows the change between first ownership type after privatization (or when the firm started as a new entity), until the last year for which information are available[13]. The matrix shows that 114 enterprises, which were foreign owned at the start of privatization (or when they were set up as new firms), also were foreign owned at the last year of record. From the relevant row it can also be seen that 10 changed to domestic dominant ownership and 9 to manager ownership while none ended up as employee owned. This means that, as predicted, foreign owned enterprises have a quite stable ownership structure with a total "ownership-change" rate of only 14%. Therefore, as expected, foreign ownership can be placed at the last part of the governance cycle. Firms that became foreign owned can be seen by examining the first column. Such firms emerge mainly from domestic externally owned enterprises, but also from management owned. Only four take the shortcut directly from employee ownership. These results fit well with the last stage of the predicted governance cycle: management➔external domestic➔foreign.

Firms with external domestic ownership from the start have a higher rate of "ownership change" (26.7%). 19.1% has changed into management ownership. In 5 of the reported cases in Table 9 the accompanying change in concentration was constant and in another 5 cases it was increasing, while in 3 cases ownership concentration fell. However, the fall for these three is quite steep so that the average development for all 13 enterprises for the period 2000-02 was a fall in concentration. This is reported in Table 9, which only covers the later years when we started to collect concentration data in Estonia.

Of firms that were initially management-owned, 23.6% have changed ownership type and most of these have changed to outside ownership (15.7% to domestic and 5.7% to foreign). For the later years reported in Table 9 these changes are accompanied by both upward and downward changes in concentration leaving the average quite constant. Only 3 (2.1%) have changed into employee ownership. However, movement away from employee ownership proceeds at a very high rate with more than seven in ten cases switching ownership type. In about half of these 71.7% the move is to ownership by management. This includes 35.4% of the initial group, compared to 28.3% to outside ownership and 8.1% to former employees. The high rate of change of employee owned firms confirms the prediction of the high frequency of this specific type of changes in transition economies. It is a bit surprising that ownership by former employees is more stable than employee ownership. However, the continuation of ownership by employees leaving the firm can be taken as an indicator of inertia, which also functions as a barrier for further ownership changes. Employee ownership has quite low concentration of ownership on the single largest owner and Table 9 shows that the changes away from both employee and former employee ownership is accompanied by quite steep increases in concentration. In general the concentration rate is increasing over the period and the steepest increases happen in parallel with shifts in ownership.

The results on ownership dynamics are robust to shortening the period to 1999 or to including only firms with full information for the period 1995-1999. For this restricted group (N=373) the rate of change away from foreign ownership is 15%, while the corresponding numbers are 26% from domestic ownership,

22% from dominant ownership by managers, 72% from employee owned firms and 29% away from firms owned by former employees. These changes are similar to those generated by the larger sample except for the category of "former employees" where the rate of change is rather lower (by some 8%) compared to figures based on the total sample.[14]

Surprisingly, the results are also quite robust to dividing the groups into privatized and new start-ups. Because of the initial disequilibrium in ownership caused by privatization one might expect a higher rate of change for privatized companies. However, the initial years of transition are very volatile both for privatized and new companies both because of rapidly changing markets and institutional environment. In a more stable institutional environment one might expect a higher change-rate for new companies compared to more mature companies.

Table 10 shows findings derived from the analysis when intermediary changes between the initial and final ownership configurations that are given in the transition matrix are examined.[15] While dominant ownership changes in 171 cases, in 29 instances we observe a second ownership switch while in 5 cases there is third categorical change.[16] The most frequent initial change is from employee to managerial ownership change and the most frequent three-step change is, as predicted, from employee➔manager➔outsider (1 to foreign and 5 to domestic). The pattern employee➔external domestic➔manager is recorded with 5 cases, but 3 of these have a fourth step with the firm ending up as foreign-owned, and therefore they come close to the predicted employee➔manager➔outsider. Hence we conclude that this is clearly the most frequent ownership cycle in our sample. Our predictions are also supported by the high frequency of initial ownership changes that are of the type manager➔domestic (representing 73% of the first-changes from manager ownership), as well as the fact that 49% of the changes away from employee ownership are from employee➔manager. The existence of a frequency of domestic➔manager movements that is quite high might reflect the fact that our cases labeled domestic also may include former employee ownership, but

with a concentration higher than our limit of 20%. It could also be the case when diversified domestic ownership is substituted by more concentrated management ownership, as predicted in the theoretical section.

For **Latvia** we report transition matrices both for the period 1995-99, for which we cannot distinguish between manager and employee-ownership in 1995, and for 1997-99 where the available data do enable us to make the distinction (see Tables 11-13). If we do not include the broad insider category for the starting point of 1995 we are able to identify ownership cycles with 3-steps for only 4 out of 915 enterprises.[17] Therefore, we report ownership dynamics in transition matrices with only two points in time. The combination of insider ownership in 1995 and manager ownership in 1997 is counted as manager ownership for both years. Therefore, the switch from employee ownership to manager ownership, that is expected to be the most frequent change, is not able to be identified during this period. The change in this direction is in the table only for firms with no data for the first years[18].

Table 11 shows some of the same patterns that we saw for Estonia. Insider ownership is by far the least stable ownership category. The most frequent change is from insider to former employee (38 cases). If we include these cases as employee owned from the start, we end up with a change away from employee ownership on the same magnitude as in Estonia. Except for the 13 cases coming from ownership by former employees we see very few cases switching over to employee ownership. Many enterprises owned by insiders are also seen to be moving to domestic external ownership.

When we only look at the period 1997-99 (Table 12) managerial ownership is surprisingly stable, whereas both ownership by employees and former employee again are changing most commonly. As in Estonia, the most frequent changes are from employee to manager ownership and from ownership by former employee to ownership by external domestic owners. Both these changes are accompanied with steep increases in concentration among the largest single type of owner (Table 13). Switches from domestic to managerial ownership and in the other direction from manager to domestic are also quite frequent. In addition, as in Estonia, some changes are accompanied by an increase in concentration. However, it is also

worth noting that the level of concentration on average is lower in Latvia than in Estonia. This difference can be only partly explained by the fact that the Estonian concentration data are observed three years later. Also, switches to managerial ownership from external domestic ownership probably include cases of take-overs from former employees.[19] Finally, when we split the group into new and privatized enterprises, this does not reveal any differences in patterns of ownership dynamics between these two groups.

The last Baltic republic for which we are able to furnish new empirical evidence is **Lithuania.** There we can follow the change during the period from the time of privatization and the years when data from ownership surveys were collected, namely for 1993, 1996, 1999 and 2000. From all of these cases in only 15 instances was there more than one shift in ownership. Since this group is too small to identify specific tendencies, as in Latvia, ownership dynamics are shown in a matrix that covers only the first and the last recorded private ownership type. The results show the same pattern as we have seen earlier with employee and former employee owned enterprises being the least stable. Although the period covered is the same length as in Estonia, the rate of change away from employee ownership is somewhat lower than in Estonia. This is probably due to the slower development of the surrounding governance institutions in Lithuania. The average concentration rate on the largest single owner increases in Lithuania from 41.6% to 47.5% during the period of observation. While this is around the same level as in Latvia, it is still far less than the level of more than 60% observed in Estonia (compare Table 9 and Table 15). Part of the difference can be explained by a higher proportion of foreign and domestic external ownership and a lower proportion of employee owned enterprises in the Estonian sample. Nevertheless, Estonia has a higher concentration rate separately for each of these ownership categories. These differences can be interpreted as another manifestation of the more advanced development of institutions in Estonia having facilitated more rapid adjustments of ownership. This adjustment concerns both ownership concentration and owners' identities. At the same time, it is expected that it will take several years before the Baltic countries reach the next stage in the development of institutions favoring small diversified external owners in large enterprises.

The most frequent change in Lithuania is clearly from employee to managerial ownership, followed by the change from employee and former employee ownership directly to external domestic ownership. All these changes are accompanied by steep changes in concentration. As in other countries, except for one case, there are no shifts from outside ownership to employee ownership. Foreign owned companies again are the most stable form of ownership, although here they are not significantly more stable than is domestic outsider ownership. While the number of foreign owned enterprises is increasing, it remains quite low. The frequency of 11 former employee owned firms going to outside domestic ownership is quite high. In these firms the concentration on the single largest outside owner has increased from below 20% to more than 20% or, for the 5 enterprises included in Table 15, from 11.4% to 42.9%. Finally, as is the case with the two other Baltic countries, there are no significant differences between the dynamics of privatized firms and new firms. Hence, all in all, findings based on the Lithuanian data also fits quite well with the proposed transitional governance cycle of employee➔manager➔external domestic➔foreign.

V. Conclusion

We have investigated changes in governance structures and focused on the identity of owners over the life-cycle of the company. Based on agency, property rights, transaction cost and resource dependence theory and related to key stages of the life-cycle of the firm, we can identify a typical governance cycle for developed market economies, namely: manager➔outside investor participation➔outside investor takeover. This cycle develops in parallel with a tendency for a change from concentrated to more diversified ownership. Specific governance cycles are also determined by developments in the country's institutional and cultural framework and by specific market developments.

The transitional economies are undergoing fundamental changes in institutions with emerging and changing markets creating specific transitional conditions for enterprises and their life-cycles. Privatization, pressures for restructuring and weak, but developing institutions define the conditions for the evolution of

ownership structures. Therefore, specific transitional governance cycles can be predicted. Most medium and large enterprises have gone through a process of privatization. The specific method used for the change from state to private ownership determines the initial ownership structure of the privatized enterprises. In many countries employees were favored in the privatization process. This was the case for the privatization of small and medium sized enterprises in Estonia and Latvia and for the privatization of medium and large enterprises in the first half of the 1990s in Lithuania. For these enterprises we predict an ownership cycle of employee→manager→outsider (domestic or foreign). This process is expected to take place in parallel with increasing concentration of ownership. Since the institutional framework (and especially stock markets) are not so developed in transition economies, we do not expect to observe the tendency towards diversification that is observed in developed economies. In some cases diversified outside domestic ownership has been the result of privatization. In such cases we expect to witness a cycle: diversified domestic→manager→outside concentrated ownership. The shifts in owner-type are expected to be accompanied by an increase in concentration. In the large privatization in Estonia and later in Latvia and even later in Lithuania, enterprises were sold to a core investor, often a foreign owner. This ownership structure is predicted to be the last stage in transitional economies and we therefore expect that this type will be relatively stable. This does not exclude the possibility for changes in the long run to other foreign investors or to new strong domestic investors. The speed of the adjustment process for ownership-types and the accompanying concentration processes are expected to be closely connected to the development of the surrounding governance institutions. Change will be slow when, for example, property rights are uncertain, bankruptcy legislation is weakly enforced, and the financial system is too weak to play an important role in the financing of investments for enterprise restructuring. When institutional reform is successfully implemented the development over the governance cycles will speed up, and countries with the fastest transition are expected to have most companies reaching the final stages of the specific transitional cycle.

Our empirical work is based on data generated from new and ownership surveys designed by the authors and administered in all three countries. We undertake two kinds of analyses. The first and more static analyses involve investigating ownership structures at the time of privatization. In these exercises we divide firms into privatized and new enterprises and examine the relation between time of privatization (time of start-up) and the initial ownership structure. The other analyses are more dynamic. Transition matrices that combine information on initial ownership type with ownership at a later stage are used to investigate ownership dynamics. This work is supplemented by a direct analysis of the frequencies of different cycles of ownership changes for the long panel of Estonian enterprises. The change in concentration on the largest owner is directly connected to the analysis of change in ownership-identity. While the ownership data goes back to the mid 1990s the concentration data, however, only covers the period from 1997 in Latvia and from 2000 in Estonia.

The static analysis of the initial ownership structure provides support for the predictions derived from our theory of the corporate governance life-cycle. Privatization and the specific conditions during early transition lead to a specific private ownership structure. Employee owned enterprises are found to make up a large share of privatized enterprises in all three countries and they are especially related to early privatizations in both Estonia and Lithuania. For Latvia employee owned firms are also frequent during later privatization when many companies that were initially leased by employees were fully privatized. As predicted employee ownership is rare among new start ups – the exception being the new cooperatives started up in the late 1980s or early 1990s. Ownership concentration is lowest in employee owned enterprises, higher in firms owned by domestic external owners or managers, and highest in firms that are foreign owned. Initial management ownership is both frequent among privatized and new start ups in all three countries.

The dynamic analysis of ownership changes for each country strongly supports the proposition that employee ownership is expected to be the least stable type of ownership and that the most frequent take-

overs will be undertaken by managers. The analysis also supports the next step in the predicted governance cycle for transition economies since managerial ownership mainly changes to outside ownership. Most often this involves a shift to external domestic ownership, but there are also cases of direct shifts to foreign ownership. Changes back to employee-dominated ownership are extraordinary. External domestic ownership shifts quite frequently to foreign ownership. In this way the analysis strongly supports the predicted transitional governance cycle of employee→manager→external domestic→foreign. The detailed analysis based on the long time-span information from Estonia covering 1993-2002 also supports this specific governance cycle. The most frequently observed cycle is in fact the predicted: employee→manager→outsider.

In addition some of our findings were not completely anticipated by our theoretical model of the corporate governance cycle. Quite frequently we observe shifts from external domestic to manager ownership. Especially in Latvia and Lithuania this change is accompanied by an increase in concentration. Thus, many of the changes are connected to the predicted concentration process, a move from relatively diversified domestic ownership to more concentrated management ownership. Over time there is a general tendency toward higher concentration. This tendency also applies to enterprises with stable ownership, but it is especially strong for enterprises that change their dominant ownership group. This is particularly the case for shifts away from employee ownership, but it is also quite strong for movements from domestic outsider to foreign ownership and also for shifts from foreign to domestic outsider ownership. The reason behind this strong tendency towards higher concentration is that, initially, privatization together with slow development of the institutional framework, resulted in an ownership structure that was too diversified. The limited development of the banking sector during early transition meant that reinvestment of profits and extra equity capital from existing or new core owners was the main source for investment for the necessary restructuring. Small diversified shareholders and institutional portfolio investors were rare and they were involved in only a handful of listed companies.

In the analysis of ownership dynamics we separate ownership by former employee from the group of domestic outsider dominated enterprises. We assume that low concentration or high diversification of external domestic owners can be understood as a situation where employee owners have left the company, but have kept their shares. A substantial part of the changes away from employee ownership can be explained by this process[20].

Although there have been quite important differences between the three Baltic countries in the privatization processes and the development of different governance institutions, our findings indicate that the similarities are more important. In all three countries the corporate governance cycles follow the expected patterns and are accompanied by a strong tendency for higher concentration. The main differences occur in the speed of the adjustments. The change away from employee ownership was fastest in Estonia, and here also the level of concentration is significantly higher than for Latvia and Lithuania. In general, Estonia had the fastest transition process. The faster development in corporate governance institutions such as the banking system and the implementation of strict bankruptcy procedures are probably important factors explaining the faster development over the governance cycle of Estonian enterprises compared to firms in Latvia and Lithuania. However, further research on transition countries with more differences in relation to the institutional development can dig deeper into these relations.

In the literature privatization methods that favor insiders and especially those favoring employee ownership have often been criticized for delaying restructuring of the economy[21]. However, performance studies are quite ambiguous on this point[22]. In any event, this study shows that developments away from employee ownership are quite fast and follow certain patterns with managerial ownership playing a key role. To a large degree the speed of change depends on the development of the institutions for corporate governance including the development of the financial sector. In other words, there is no reason to worry about unwanted effects of employee privatizations, so long as institutional developments are fast. This was the case in Estonia (and in later years in Latvia and Lithuania) and, under these circumstances, ownership

adjusts and runs through the governance cycle. The developments over the transition-specific governance cycle that are documented in this chapter mean that many companies have taken important steps in their restructuring process and also transformed the Baltic economies into more advanced market economies. With further institutional developments, including in banking and capital-markets, we would expect the governance cycle in the future to be much more similar to what is observed in "old" developed market economies[23].

Table 1. Governance cycles in developed market economies
Core stages of change in governance/ownership – classical cycle

start up stage entrepreneur-ownership (management, family ownership) **early growth stage** change in ownership/governance because of need of supply of external capital, management skills and networks by: - bank (often rather passive role in relation to management) - closely related investors, take active part in management - venture capital, take active part in management **later growth stage** change in ownership/governance because of need of supply of external capital, management skills and networks by: - strategic investor, take full control with the company - public investors, often diversified ownership **crisis/restructuring stage** change in ownership/governance because of takeover by - bank (bad loans de facto transferred to ownership capital) - venture capital (often specialized in takeovers (often unfriendly)) - strategic investor (use opportunity to take over cheap assets) - defensive takeover by insiders (to avoid close down and unemployment) - close down (assets transferred to other use)

Table 2. Specific elements in early transition influencing the governance cycle

Starting stage determined by privatization method, which may favor managers, other employees, concentrated foreign investors or diversified external ownership. Most enterprises have a **strong need of restructuring** (inputs, production methods, outputs not adjusted to new market conditions, with a new set of prices and incentives.) The **financial system** not developed, - external finance from banks limited - the stock exchange not functioning - venture capital firms not existing The **governance institutions** for securing property rights (especially shareholder rights) not fully developed => widespread insider ownership enterprises have to rely on internal finance slow strategic restructuring

Table 3. Expected governance cycles in countries in transition

Privatized (starting point depends on privatization method)

employee → manager → outside concentrated (domestic → foreign)

diversified domestic → manager → outside concentrated (domestic → foreign)

outside concentrated, foreign stable (very long run more diversified for large listed companies)

New

manager → outside concentrated (domestic → foreign)

foreign concentrated (stable)

Table 4. Overview over privatization

	Private % GDP	Large priv.	Small priv.	Main method	Secondary method	Peak years
Estonia	75	4 .	4+	direct sale	voucher	1994-95
Latvia	70	3 .	4+	direct sale	voucher	1996-97
Lithuania	75	4 -	4+	insider/voucher	direct sale	1992-94

The Table is based on Mygind 2000, and EBRD 2003, where scores for privatization and governance range from 1 = none to 4+ = full.

Table 5. Overview over privatization of enterprises

	Estonia	Latvia	Lithuania
Early	In all three baltic countries end 1980'es: new cooperatives and leasing by worker collective according to Soviet legislation, formally worker owned, but management dominated From 1991 Estonian leasing 200 firms mostly to managers		1990-91 employee got shares for around 3% of the assets
Small	first law 1990 gave insiders advantages, but these were canceled in 1992-93	first law 1991 gave insiders advantages, but these were canceled by 1993	no formal advantages to insiders,
Large	few experiments 1989-91 mostly to employees From 1992 direct tender sale (=German Treuhandanstalt) Tenders based on price, and investment- +job-guarantees combined with few public offerings for vouchers	1991 experiments to insiders 1992-94 decentral process, 234 firms leased to insiders From 1994 direct tender sale through Privatization Agency combined with some public offerings for vouchers	1991-95 LIPSP privatization most shares sold for vouchers employees could buy 50% of shares for quite low price From 1996 direct tender sale through Privatization Agency 1998 State Property Fund speeds up tender process

Table 6 Overview of corporate governance institutions

	Estonia		Latvia		Lithuania	
Bankruptcy system	Strict legislation 92, tough enforcement		Strict legislation 96, tighter enforcement		Strict legislation 97, tighter enforcement	
Governance	1995	2002	1995	2002	1995	2002
EBRD governance-score	3	3+	2	3-	2	3
competition-regulation	2	3-	2	2+	2	3
Bank market	1995	2002	1995	2002	1995	2002
number of banks (foreign)	19 (5)	7 (4)	42 (11)	19 (12)	15 (0)	14 (4)
loans to private % of GDP	14.0%	29.8%	7.5%	33.4%	12.3%	14.2%
bad loans % of total loans	2.4%	0.8%	19.0%	2.1%	17.3%	5.8%
bank regulation	strict already 1992		strict from 1994		strict from 1995	
EBRD-score	3	4	3	4-	3	3
Stock market Start	May 1996		July 1995		September 1993	
	1996	2002	1996	2002	1996	2002
Listed firms	16	34	34	69	ca. 600	46
capitalization % of GDP	21%	33.6%	3.0%	8.0%	11.4%	9.5%
Turnover/capitalization	0.13	0.54	0.08	0.17	0.04	0.07
EBRD-score	2	3+	2	3	2	3

EBRD Transition Report 2003. Capital market data from central banks and stock exchanges.

Table 7 The relation between time of privatization/start and initial ownership

		Foreign		domestic		manager		employee		Total	
Estonia											
privatized	to 1992	9	19%	10	21%	10	21%	18	38%	47	100%
	1992 - 1993	9	25%	7	19%	13	36%	7	19%	36	100%
	1994 - 1999	33	13%	144	56%	66	25%	16	6%	259	100%
	total	51	15%	161	47%	89	26%	41	12%	342	100%
new firms	to 1992	8*	20%	13	32%	17	42%	3	7%	41	100%
	1992 - 1993	9	12%	27	35%	29	38%	12	16%	77	100%
	1994 - 1999	5	11%	17	39%	17	39%	5	11%	44	100%
	total	22*	15%	57	35%	63	38%	20	13%	162	100%
total		73	15%	218	43%	152	30%	61	12%	504	100%
Latvia											
privatized	1991	1	9%	4	36%	3	27%	3	27%	11	100%
	1992 - 1993	9	4%	109	46%	40	17%	79	33%	237	100%
	1994 - 1997	14	8%	54	32%	57	34%	43	26%	168	100%
	total	24	6%	167	40%	100	24%	125	30%	416	100%
new firms	1991	10	8%	19	16%	76	62%	17	14%	122	100%
	1992 -1993	37	18%	45	22%	101	50%	18	9%	201	100%
	1994 - 1997	43	28%	33	21%	66	42%	13	8%	156	100%
	total	90	19%	97	20%	243	51%	48	10%	479	100%
total		114	13%	264	29%	343	38%	173	19%	895	100%
Lithuania											
privatized	1991 - 1992	3	4%	30	38%	13	16%	33	42%	79	100%
	1993 - 1994	3	3%	38	41%	18	20%	33	36%	92	100%
	1995 - 1998	1	3%	19	51%	9	24%	8	22%	37	100%
	total	7	3%	87	42%	40	19%	74	36%	208	100%
new firms	to 1992	5	19%	1	4%	17	65%	3	12%	26	100%
	1993 - 1994	16	44%	6	17%	12	33%	2	6%	36	100%
	1995 - 1996	8	32%	6	24%	10	40%	1	4%	25	100%
	total	29	33%	13	15%	39	45%	6	7%	87	100%
total		36	12%	100	34%	79	27%	80	27%	295	100%

Only private companies included. We do not have the timing-information for all companies. Therefore, the number of enterprises is lower than in the total datasets.

*25 foreign new enterprises established before 1992 are not included in table because they were later added to the initial random sample.

Table 8 Estonia privatization/start -2002 ownership transition matrix: first year as private by last year recorded

\last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	114	10	9	0	0	133	14,3%
domestic	11	132	37	0	0	180	26,7%
manager	8	22	107	3	0	140	23,6%
employee	6	22	35	28	8	99	71,7%
former emp.	0	4	3	2	15	24	37,5%
total	139	190	191	33	23	576	

privatized

\last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	68	5	2	0	0	75	9,3%
domestic	8	106	15	0	0	129	17,8%
manager	2	11	56	2	0	71	21,1%
employee	1	12	15	11	3	42	73,8%
former emp.	0	4	2	2	12	20	40,0%
total	79	138	90	15	15	337	

new

\last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	46	5	7	0	0	58	20,7%
domestic	3	26	22	0	0	51	49,0%
manager	6	11	51	1	0	69	26,1%
employee	5	10	20	17	5	57	70,2%
former emp.	0	0	1	0	3	4	25,0%
total	60	52	101	18	8	239	

1. Former employee ownership defined as domestic dominant with concentration < 20% 1999.
2.Only those firms with domestic dominant ownership and with information on concentration in 1999 are included; their number fell from 649 to 568. Also including some companies, for which we have data only for some years e.g. 1997-2000.

Table 9 Estonia – Transition Matrix and Ownership Concentration 2000 / 2002

\2002 2000	foreign	Domestic	manager	employee	former employee	Total
foreign	83 77.5 / 81.1	6 61.1 / 74.0	2 88.0 / 75.5	- -	- -	91 76.7 / 80.5
domestic	6 63.5 / 76.6	122 78.1 / 79.7	13 52.1 / 47.4	1 14.0 / 18.0	- -	142 74.5 / 76.1
manager	- -	9 59.5 / 59.1	107 61.3 / 61.7	1 23.0 / 27.0	- -	117 60.8 / 61.1
employee	- -	3 27.6 / 60.7	5 24.8 / 63.4	18 19.6 / 20.3	2 5.0 / 6.5	28 20.3 / 31.3
former empl	- -	5 14.6 / 28.8	2 11.0 / 45.0	- -	15 8.5 / 9.5	22 10.1 / 17.5

total	**89** **76.6 / 80.8**	**145** **73.1 / 75.9**	**129** **58.6 / 60.1**	**20** **19.5 / 20.5**	**17** **8.1 / 9.1**	**400** **63.8 / 66.4**

Table 10 Overview over governance cycle ownership changes (N=576)

Estonia		
initial dominant owner after privatization or start as new	1st ownership change to:	2nd ownership change
foreign 114 (86%) stable 19 (14%) change 133 (100%) total	8 (42%) to domestic 10 (53%) to management 1 (6%) to employees 19 (100%) change	0 2 to domestic 1 to manager 3
domestic 132 (73%) stable 48 (27%) change 180 (100%) total	11 (23%) to foreign 36 (75%) to management 1 (2%) to employees 48 (100%) change	0 0 1 to manager 1
manager 107 (76%) stable 33 (24%) change 140 (100%) total	5 (15%) to foreign 24 (73%) to domestic 4 (12%) to employee 33 (100%) change	0 1 to foreign, 2 to employees* 1 to domestic 4
employee 28 (28%) stable 71 (72%) change 99 (100%) total	1 (1%) to foreign 23 (32%) to domestic 35 (49%) to manager 12 (17%) to former empl. 71 (100%) change	1 to domestic 3 to foreign, 5 to manager** 1 to foreign***, 5 to domestic 4 to manager 19
former employees 15 (63%) stable 9 (37%) change 24 (100%)	4 (44%) to domestic 1 (11%) to manager 4 (44%) to employees 9 (100%)	0 0 2 to manager 2
total 397 stable	171 first changes	29 second changes

The Principles for defining ownership change are as follows: Change between to equal values deleted. The ownership-sequence employee-employee-manager-domestic-manager-manager is recorded as manager-employee. There are observed 5 third changes: * 1 with 3rd change to foreign, ** 3 with 3rd change to foreign, *** 1 with 3rd change to domestic

Table 11 Latvia 1995-1999 Ownership transition matrix private firms all

\ last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	105	7	6	0	0	118	11,0%
domestic	11	139	20	4	1	175	20,6%
manager	1	9	308	2	1	321	4,0%
employee	1	4	13	118	6	142	16,9%
former emp	0	10	1	13	39	63	38,1%
insider	6	32	12	8	38	96	79,2%
	124	201	360	145	85	915	

privatized

\ last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	24	2	1	0	0	24	11,1%
domestic	4	79	9	2	1	95	16,8%
manager	0	1	89	0	1	91	2,2%
employee	1	2	9	83	5	100	17,0%
former emp	0	8	0	13	34	55	38,2%
insider	5	16	6	7	32	66	80,3%
	34	108	114	105	73	434	

new

\ last year first year	foreign	Domestic	manager	employee	former employee	total	Change
foreign	81	5	5	0	0	91	11,0%
domestic	7	60	11	2	0	80	25,0%
manager	1	8	219	2	0	230	4,8%
employee	0	2	4	35	1	42	16,7%
former emp	0	2	1	0	5	8	37,5%
insider	1	16	6	1	6	30	76,7%
	90	93	246	40	12	481	

Inside ownership 1995 followed by manager (employee) ownership in 1997 is recorded as manager (employee) ownership for both 1995 and 1997. Firms going from insider to manager in the table had another owner type in between. Former employee ownership is domestic ownership with concentration < 20%.

Table 12 Latvia 1997-1999 Ownership transition matrix private firms **all**

\1999 1997	foreign	Domestic	manager	employee	former employee	total	Change
foreign	110	8	5	0	0	123	10,6%
domestic	8	161	13	4	2	188	14,4%
manager	2	12	326	2	0	342	4,7%
employee	2	6	15	135	9	167	19,2%
former empl	0	16	0	6	73	95	23,2%
	122	203	359	147	84	915	

privatized

\1999 1997	foreign	Domestic	manager	employee	former employee	total	Change
foreign	26	2	1	0	0	29	10,3%
domestic	5	89	8	3	2	107	16,8%
manager	0	3	95	0	0	98	3,1%
employee	1	2	9	98	9	119	17,6%
former empl	0	13	0	6	62	81	23,5%
	32	109	113	107	73	434	

new

\1999 1997	foreign	Domestic	manager	employee	former employee	total	Change
foreign	84	6	4	0	0	94	10,6%
domestic	3	72	5	1	0	81	11,1%
manager	2	9	231	2	0	244	5,3%
employee	1	4	6	37	0	48	22,9%
former empl	0	3	0	0	11	14	21,4%
	90	94	246	40	11	481	

Table 13 Latvia – Transition Matrix and Ownership Concentration 1997 / 1999

\1999 1997	foreign	Domestic	manager	employee	former employee	Total
foreign	105 72.1 / 74.7	8 53.9 / 64.5	5 89.5 / 52.9	- -	- -	118 71.6 / 73.1
domestic	8 49.5 / 56.3	152 59.3 / 59.4	13 45.7 / 50.1	4 47.2 / 33.5	2 49.7 / 11.3	179 57.5 / 57.4
manager	2 100 / 100	12 48.6 / 47.7	323 55.8 / 58.4	2 33.9 / 58.5	- -	339 55.6 / 58.3
employee	2 26.7 / 38.8	6 33.1 / 32.5	15 35.9 / 59.8	135 19.1 / 20.2	9 6.7 / 10.3	167 20.5 / 23.9
former empl	- -	16 9.05 / 34.9	- -	6 6.5 / 21.2	72 5.2 / 6.1	94 5.9 / 11.8
total	117 70.2 / 73.2	194 53.4 / 56.1	356 55.1 / 58.1	147 19.6 / 21.2	83 6.4 / 6.72	897 46.4 / 48.8

Table 14 Lithuania ownership transition matrix: privatization/start to 2000 **all**

\2000 priv/start	foreign	Domestic	manager	employee	former employee	total	Change
foreign	31	3	2	0	0	36	13.9%
domestic	2	70	6	1	3	82	14.6%
manager	3	5	69	6	0	83	16.9%
employee	6	10	33	41	3	93	55.9%
former emp	1	11	4	2	18	36	50.0%
total	43	99	114	50	24	330	

privatized

\2000 priv/start	foreign	Domestic	manager	employee	former employee	total	Change
foreign	5	2	0	0	0	7	28.6%
domestic	2	60	5	1	3	71	15.5%
manager	2	3	37	2	0	44	15.9%
employee	5	10	30	39	3	87	55.2%
former emp	1	11	3	2	17	34	50.0%
total	15	86	75	44	23	243	

new

\2000 priv/start	foreign	Domestic	manager	employee	former employee	total	Change
foreign	26	1	2	0	0	29	10,3%
domestic	0	10	1	0	0	11	9,1%
manager	1	2	32	4	0	39	17,9%
employee	1	0	3	2	0	6	66,7%
former emp	0	0	1	0	1	2	50,0%
total	28	13	39	6	1	87	

Table 15 Lithuania Transition Matrix and Concentration privatization/start / 2000

\2000 priv/start	foreign	Domestic	manager	employee	former employee	Total
foreign	28 68.2 / 74.3	3 62.7 / 69.4	2 55.0 / 62.5	- -	- -	33 66.9 / 73.2
domestic	1 67.0 / 77.3	54 53.1 / 52.2	5 27.4 / 42.5	1 47.0 / 76.0	2 45,7 / 17,1	63 51.0 / 51.1
manager	1 100 / 50.0	4 43.1 / 54.4	56 55.8 / 59.8	5 77.5 / 44.3	- -	66 57.3 / 58.1
employee	5 24.8 / 69.5	9 32.1 / 36.7	27 19.5 / 37.6	30 17.1 / 20.5	2 16.2 / 16.3	73 20.3 / 32.1
former empl	1 1.0 / 21.1	5 11.4 / 42,9	4 11.5 / 49.1	2 12.9 / 37.2	16 8.9 / 12.1	28 9.8 / 25.0
total	36 61.2 / 71.6	75 47.6 / 50.5	94 41.9 / 52.1	38 25.5 / 26.0	20 13,3 / 13,0	263 41.6 / 47.5

N is smaller compared with table 14 because we do not have concentration data for all enterprises all years.

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Endnotes

[1] Country differences in relation to macroeconomic development, institutional framework and culture influence the development in the governance structure, and therefore, the governance cycle in transitional countries have some specific elements related to the transitional process. We shall examine these aspects at a later point in ther paper.

[2] For example, compare German and Anglo-American systems. See Roe, 1990.

[3] Most of these studies look at Russia and document the strong position of insiders in the Russian privatization and the tendency for management takeovers of employee owned enterprises.

[4] In a more recent paper Jones et al (2003) build on that work, again using data for Estonia, documenting the strong tendency away from employee ownership most often to manager owners. Gradual increase in outside ownership is often a process where former employees get majority (Kalmi 2002).

[5] It turns out that there are no essential differences from the results based on majority owner (for Estonia: see Jones and Mygind 1999). But by using the dominant rather the majority ownership approach we are able to include firms in our analysis which would otherwise be dropped (the "no overall majority" group) and thus we avoid issues of censorship and selectivity.

[6]The data on the reason for exit does not have enough reliability to be included in the analysis.

[7] The panel was supplemented with 25 fully foreign owned enterprises and 232 state-owned enterprises. Some prevailed state-owned and have been used as comparisons in the statistical analyses, other were closed. Some were later privatized and included in the yearly surveys. In 1999 134 enterprises privatized through Estonian Privatization Agency was added to the survey.

[8] Kalmi (2002) makes for Estonia a deeper analysis of the initial ownership in relation to the origin of the company. He finds that firms emerging from the consumer cooperative sector or construction association were mostly owned by external domestic investors (members of cooperatives or central cooperatives) and successor firms of collective and state farms were taken over by their employees.

[9] In Estonia and Lithuania there was a bias in the construction of data so that privatized enterprises were over-represented compared to new ones. Therefore, the high proportion of new companies in the Latvian sample cannot be taken as indicator of higher entrepreneurship.

[10] For spin-offs it is difficult for respondents to choose between the categories new and privatized.

[11] We do not have reliable information about whether the reason for exit is in fact close down or denial of answering. However, there are no significant differences between the ownership dynamics of the group with information for the full period and those that have exited the observation.

[12]From the 803 Estonian companies in the database we have excluded 154 state-owned for all recorded years and 73 domestic externally owned for which we have no concentration data to distinguish firms with ownership by former employees. This leaves 576 forms for the analysis. Normally we have ownership data for privatized firms from the time of privatization and, for new firms, from the date of start-up until 2002. However, in some cases the data series is abbreviated when companies stopped participating in later waves of data collection.

[13] The results follow the same pattern as the not reported matrix without estimates of former employee ownership.

[14] The total sample covers a longer period, which should give a higher rate of change, but this group also includes drop-outs and this draws in the opposite direction.

[15] In fact, some intermediary changes are excluded, because they are probably only caused by marginal variations.

[16] Reported in the notes to the table.

[17] Again excluding reversals.

[18] The presented results from insider to manager are in fact three-step observations with intermediate outsider ownership.

[19] Such cases can initially have been recorded as outside domestic ownership because the concentration has been larger than 20. In fact the 13 cases from domestic to management would fall to only 8 if the definition of former employee ownership were increased to less than 30% concentration. Half of the cases of former employees going to domestic would fall away if the borderline changed to 30%.

[20] This is supported by Kalmi 2002 and by case evidence from Estonia (Kalmi and Mygind 2004).

[21] See e.g. Djankov and Murrell 2002.

[22] For an analysis of Estonia see Jones and Mygind 2002, and for the Baltics see Jones and Mygind 1997.

[23] In this mainly descriptive paper we have identified the main tendencies among different possible sequences for the governance cycle as well as accompanying concentration tendencies. Deeper analysis of the specific conditions in the life-cycle of the company, including investigations of the different directions for ownership changes and ownership-concentration will require multivariate analysis. This will enable diverse issues to be addressed including: What characterizes the employee owned enterprises that are taken over by the managers? Which enterprises are most likely to take further steps in the transitional governance cycle? The corporate governance cycle theory has a specter of predictions and in future work we plan to use our panel data to test key hypotheses.