# ESTABLISHING CORPORATE GOVERNANCE IN AN EMERGING MARKET: BULGARIA

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# TABLE OF CONTENTS

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# Introduction

Nowadays, few countries in the world can afford to ignore the problems of corporate governance and control, especially if they seek to attract foreign investment. This is particularly true for the economies in transition. Good corporate governance and control ensure benefit for the stockholders, limit malfeasance and corruption, and are ultimately a guarantee of economic growth and social development.

It is a positive fact that the Bulgarian experience is becoming a part of the global theoretical discussions and practical initiatives for implementing the best international standards in this field. In Bulgaria until very recently corporate governance and control were a perplexing and unintelligible concept not only for the bulk of small shareholders, who had acquired equity through mass privatisation, but also for representatives of government institutions and private businesses. Today, the importance of the problem, particularly for an economy badly needing restructuring, is realised at the top government level. As a result of the active efforts of the professional community and the media, in Bulgaria meetings, discussions, training workshops and sociological surveys were conducted, which led to the first serious publications on corporate governance and control.

This publication presents the state and the specific problems of corporate governance and control in Bulgaria. It has been prepared as part of the activities of the Corporate Governance Initiative in Bulgaria, with the financial support of the US Center for International Private Enterprise. Its principal objective is to facilitate the implementation of modern standards for corporate governance and also of procedures which would guarantee responsibility, accountability and transparency in the economy and in the control mechanisms of the companies.

The current publication consists of two studies analysing the trends in corporate governance in Bulgaria after the first wave of mass privatisation and the initial stages of concentration of ownership. These studies are focused on the major characteristics and problems of corporate governance and corporate control as well as on the expected consequences for the future of corporate governance in Bulgaria.

# 1. Priority Problems of Corporate Governance in Bulgaria

The study analyses the major issue areas of corporate governance in Bulgaria over the period, when the largest number of enterprises, holding approximately half of the assets have been privatised. In addition to diversifying the forms of ownership, the privatisation of state-owned enterprises requires new mechanisms for control of the management and for reconciliation of the interests of owners. The objective is to identify the specific features of corporate governance and control of the economies in transition, taking Bulgaria as an example, and to suggest adequate measures for overcoming existing problems[1].

## 1.1. Ambiguity of the concept and terminological difficulties

In Bulgaria, the content and scope of corporate governance is not clearly defined yet , there is no generally accepted understanding of the concept, and even experts differ in their interpretations. A typical illustration of the absence of generally accepted understanding of corporate governance is its repeated confusion with strategic and operational management. In a number of cases, elements of human resources management, sales, financial management, etc. are included in the scope of this concept. The difficulties in this respect are also manifested in the „terminological deficiency“, arising from the use of the notion of governance which is charged with a multitude of meanings. The general public, represented by the individual shareholders, and the media interpret the issues of corporate governance exclusively from a practical perspective, without analysing their conceptual basis.

In Bulgaria, corporate governance is most often understood as management of relations and reconciliation of interests between the owners (principal) and the managers of corporations (agent). In addition, a specific detail is the notion that corporate governance also affects the relationships between various categories of shareholders, who have specific interests and, quite frequently, unequal opportunities to influence the operation and management of joint-stock companies. The issues of organisational structures, rights and responsibilities of managerial bodies, as well as the relations within the managerial bodies (e.g. between internal and external directors) are also included in the scope of corporate governance. This understanding of the essence of corporate governance indicates that terminological omissions and ambiguities are gradually overcome, primarily be-

[1] The publication is based on data from sociological surveys conducted by Vitosha Research Agency (commissioned by the Center for Economic Development), as well as publications of international organisations and specialised editions. The conclusions for Bulgaria are based on information from a qualitative sociological survey on the problems of corporate governance. It was carried out in the end of January 1999 and the methodology was focus-groups discussions. Representatives of branch ministries, the Privatisation Agency, the Center for Mass Privatisation, the Bulgarian National Securities, the Bulgarian Stock Exchange-Sofia, managers of enterprises and investment companies, investment intermediaries, investors' organisations, individual shareholders and journalists took part in these discussions.
The principal empirical data in the report came from a quantitative sociological survey, made in the autumn of 1998. The sample included 52 enterprises with over 100 employees and value of assets of over BGL 20 million (by December 31, 1995), privatised before the year end of 1996.

cause of the day-to-day need to apply the rules of corporate governance for resolving many specific cases, which emerge in the process of economic restructuring and change of ownership.

As a specific element of corporate governance in the process of transition in Bulgaria, the role of the State stands out – both as being responsible for the development of the general legal and economic conditions, under which corporate governance is exercised, and as a specific agent in these relationships. In practical terms, in Bulgaria the relations between the stakeholders – customers, suppliers, the local community – are usually not included in the content of corporate governance. A connection is seldom made between corporate governance and the role of banks.

## 1.2. The processes of restructuring of ownership and control

The bulk of Bulgarian enterprises are relatively small which explains the preference to restructure them as limited liability companies, rather than joint-stock companies. Today, most of the joint-stock companies in Bulgaria are a result of the massive and urgent transformation because of the forthcoming privatisation, and not so much a result of the development of the market mechanisms. This is the most serious challenge of restructuring during the transition. In a very short period of time privatised enterprises have to set up and strengthen corporate structures, and to adopt efficient mechanisms of corporate control.

A substantial number of enterprises, privatised under the mass privatisation scheme, as well as former privatisation funds, have already the status of public companies. The new model of stockholders' equity with its various schemes of interaction of the capital (private and state-owned), as well as the status of a public company are the basis for the development of corporate governance and control in Bulgaria. The development of corporations and of public companies, in particular, does not always follow economic needs. For this reason administrative and legal instruments are applied. This is a major obstacle for the implementation of the principles of corporate governance and control.

Currently, joint-stock companies do not have established corporate culture and serious economic motivation to apply the principles of corporate governance. This leads to perceptions among the community of experts of „artificiality“, „coercion“, and „inefficiency“ of the legal framework.

The on-going changes in the structure of ownership develop constant uncertainties which have also negative impact on corporate governance in Bulgarian companies. The distortions of the structure of ownership, typical for other former socialist countries, are not observed in Bulgaria. Such distortions are, for instance, the excessive dispersal of ownership as a result of mass privatisation and the considerable equity participation of investors from the company (employees and managers).

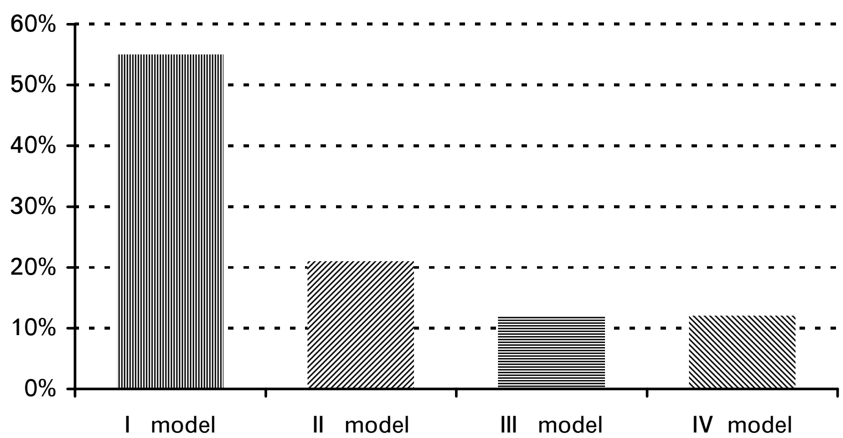
Data from the quantitative sociological survey indicates that the most significant category of owners of privatised Bulgarian enterprises are local legal entities (23%) and privatisation funds (19%). They are followed by employees and managers of the company and former personnel (24%), and then by foreign investors (10%). The state still owns 18% of the surveyed enterprises.

A characteristic feature of the structure of ownership is the high degree of concentration. In 60% of the companies, there is a strategic investor holding over 50% of the shares. In 32% of the surveyed companies, this investor holds more than two-thirds of the stock, which guarantees full management control. In the remaining 21% of the companies, the biggest investor is not able to influence the management, as he holds less than one-third of the equity.

In the surveyed companies, the transformation of ownership as a result of privatisation developes four main models of the structure of shareholders participation. The first and most widespread model (55% of the companies) is characterised by predominant participation of external local investors – privatisation funds (25%) and other Bulgarian legal bodies (30%). In the second model, the participation of employees and managers predominates (21% of the surveyed enterprises). In the third model, the participation of foreign investors is dominant (12% of the cases). In the fourth model none of the owners has a dominant participation (12% of the cases). A similar pattern of concentration of stockholders equity is also revealed by the second report, which focuses on the enterprises subjected to mass privatisation.

**Figure 1**

**Models of the Structure of Ownership in Bulgaria**




In 64% of the cases from the sample, the enterprises have a one-tier system of management, while in 36% of the cases there is a two-tier system of management. As a whole, the composition of the managerial bodies of the companies corresponds to the structure of ownership. However, individuals connected in some way with the state institutions are still largely represented. The expectations are that the restructuring of ownership and its concentration will be completed in the coming years (particularly in the former privatisation funds) and the state will finally withdraw from its ownership role.

Considering the structure of ownership, the prospects for implementing modern corporate governance and control in the Bulgarian economic environment are encouraging. Significant difficulties in reconciling diverging interests and views on business development of the various groups of owners are not very likely. The more substantial problem is how to overcome the short-term thinking of owners and managers through the mechanisms of corporate governance.

## 1.3. Exercising of shareholders rights and their protection

In 1996–1997 as a result of mass privatisation approximately 3.5 million Bulgarian citizens became owners of financial instruments. (The total number of eligible Bulgarian citizens of full legal age is about 6.5 million.) Approximately 3 million citizens hold shares in 81 privatisation funds. Around 0.5 million citizens hold shares in the 1,050 enterprises offered under the mass privatisation programme.

The mass privatisation programme expanded significantly the number of individual shareholders, the majority of which usually do not have sufficient knowledge of their rights and responsibilities, as well as experience to exercise their rights. The practice of rights is also impeded by the shortage of financial resources and the unwillingness of management to work for the benefit of their shareholders. The motivation and the interests of individual shareholders are quite weak.

Under the existing economic environment in Bulgaria in most cases individual shareholders are passive. At present, their role is regarded as peripheral and from an economic point of view it is of secondary importance. Shareholders are not considered a source of financial resources and are perceived as a problem rather than a potential. In spite of the current scepticism about the role of individual shareholders, it could be expected that in the future their significance as a source of accumulating financial resources will increase. Their role as participants in corporate governance is imminent. It is very likely that in Central and Eastern Europe shareholders could become more active than their counterparts in the US and Western Europe because of the smaller average size of the enterprises in the region and the efforts to „catch up and compensate the lost time“.

The issues related to the most efficient way for protecting the rights of minority shareholders has not been yet resolved in Bulgaria. The experience in practising and protecting the rights of minority shareholders is also insufficient.

The rights of shareholders to control the governance of companies and to prevent possible mismanagement are protected by the existing legal framework. These rights would be enhanced by the enforcement of the regulations, stipulated in the Public Offering of Securities Act. Suggestions for legal provisions allowing voting by mail, cumulative voting and the like are under discussion as well.

At the same time, there is still a number of organisational and bureaucratic obstacles for full exercising of the rights of minority shareholders: participation in shareholders general meetings, representation in managerial bodies, receipt of dividends, etc. One can not rely entirely on the judiciary either as it is too slow and not always professional in the settlement of disputes related to corporate governance and control. This environment and the underdeveloped institutional framework, which is still failing to define clearly the relations between owners and managers, create substantial difficulties in protecting the rights of shareholders and at the same time is not ensuring the required degree of managerial freedom. In this situation, it is necessary to find an acceptable balance between the interests of shareholders and managers.

In addition to legal provisions, a number of other measures will be of paramount importance. These measures have to be aimed at „transforming" individual shareholders into „active" owners, for instance, by training and support from non-governmental organisations, by information and educational campaigns with participation of all stakeholders, by media publicised positive examples and the like.

### 1.4. Composition and behaviour of managerial bodies

Another important issue in the field of corporate governance and control, with specific dimensions during the period of transition, is who are the members of managerial bodies and what is their role in the restructuring and development of the company. Here it is necessary to examine whether the requirements for representation and team-work, for transparency and responsibility in the operation of managerial bodies are met.

In Bulgaria, these aspects of corporate governance and control are not fully understood and are inadequately implemented in the practice of companies. The available data is not sufficient to determine the role of insiders and outsiders in the company and whether there is a balance between them in the managerial bodies. The motivation of the operational management to work for the interests of the company and the shareholders is also not sufficiently studied.

Similar to other post-communist countries, in Bulgaria the organisational structure and personal composition of the bodies of corporate governance are not fully established yet. Data from the sociological survey indicates that in more than half of the companies representatives of the former owner (the state) are members of the respective boards of directors. This category is represented even in 20% of the companies with foreign investor. On the one hand, this fact points to the endeavour of the state to retain its influence in privatised enterprises and, on the other hand, in the best case it suggests that in a large number of companies the inertia of the past and the dependence on government bodies has not been overcome. In the worst case, this can be an indication for some form of corruption.

The next largest group of members of supervisory boards and boards of directors are owners who are „internal“ for the company. They are present in 44% of the enterprises and are typical for Management-Employee-Buy-Outs (MEBOs) where the equity is owned primarily by employees and managers. In 36% of the cases, there are also representatives of Bulgarian legal entities (excluding privatisation funds), while in 22% of the companies there are representatives of privatisation funds. If data is analysed taking into account dominant positions of the respective groups of owners, then „external“ representatives, not connected with the government, form the dominant group in 66% of the cases. In 24% of the surveyed companies „internal“ representatives (employees and managers) are dominant, while in 10% of the cases the dominant group consists of „external“ representatives, connected with the government.

This aspect of corporate governance in Bulgaria is also connected to relations between owners and elected representatives in governing and executive bodies, and most of all to appointed executive directors. The role and functions of these major actors, whose relationships are regulated by corporate governance, are not clearly defined and differentiated yet. This situation provides grounds for conflicts and the existing practice diverges from the principles of corporate governance.

Executive directors still have not developed attitudes that the management of joint-stock companies has to be subjected to the interests of owners. Top executives usually do not realise their obligation to work in the interest of the company and its shareholders, and driven by the momentum of the past they either act as sole proprietors or protect the interests of some of the major shareholders. This management model is rather stable and this impedes the adoption of the principles of corporate governance. Sometimes, executive management can influence quite strongly certain shareholders (e.g. employees) by using possible redundancies as intimidation. In its turn external shareholders are frequently deprived from access to important company information.

To a great extent, the current situation is a result of the long absence of efficient control on managers because of the delayed privatisation, the permanent instability of management teams, the presence of environment and mechanisms, which facilitate executives to misuse their position and enrich themselves at the expense of the companies managed by them. Furthermore, Bulgaria is still lacking satisfactory conflict-of-interest regulations. Such cases are not investigated and the involved executives are not prosecuted or penalised.

The problem related to the lack of knowledge and experience to operate in a market environment is also very serious. The attempts to link remuneration of managers to their performance (e.g. bonuses for executive directors calculated as a percentage of the company profit) were not always successful. This gives grounds for assumptions that the legally allowed economic incentives do not have motivating power as personal interests are often formed and served better outside the legal economy.

In conclusion, it should be noted that in Bulgaria a substantial share of former executive managers, who have retained their positions after the privatisation, will continue to oppose the restructuring and the development of new type relationships with the owners. It has to be taken into account that in Bulgaria after the end of the first wave of mass privatisation, privatisation funds have replaced 3% to 7% of the managers of the former state enterprises, while in the Czech Republic this share ranges from 80% to 90%[2].

The gradual introduction of the standards of corporate governance in Bulgaria will lead to the creation of new type of managers who have knowledge of market economies and skills to work with shareholders as well as respect for all stakeholders. These will be managers, who are familiar with and could use capital markets, and who will promote the ideas and norms of publicity and transparency. The adoption of practices, such as the disclosure of information on remuneration of management bodies and executive directors, the establishment of supplementary bodies such as remuneration appointment committees, as well as internal audit units will substantially improve corporate governance. There is also a need to activate and expand the training programmes and to improve the professional qualifications of members of managerial bodies and senior executives.

### 1.5. Corporate governance and capital markets

The Bulgarian public is becoming increasingly aware of the mutual relationship between the implementation of the principles of corporate governance and the development of capital markets. The adoption of professional standards of corporate governance is a necessary condition and a strong incentive for development of capital markets. Appropriate standards for corporate governance are particularly important for maintaining the confidence of investors and for ensuring the liquidity of the market. The feedback connection (capital market – corporate governance) is also developing. Capital markets are exceptionally important mechanism of assessing corporations and selecting those, which have good management and efficient operations.

At the same time, a number of factors impede the realisation of this type of interaction. The predominating assessments of the experts are that at present the capital market in the country is still rudimentary and stagnating. It exists primarily as a secondary market, and in practical terms services the redistribution of equity among shareholders. The expectations are that without a primary market, which would create favourable conditions for accumulation of financial resources, the capital market in Bulgaria will have a very insignificant role.

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[2] S. Petranov, G. Miller, The Mass Privatisation and the Building of a Capital Market in Bulgaria, Free Enterprise Foundation, Sofia, 1998, (in Bulgarian).

Investors are not sure that their resources will be efficiently managed. On the one hand, this is related to the unsatisfactory implementation of the principles of corporate governance, and on the other hand, it is related to the limited, and frequently inaccurate, release of information on the state of public companies.

A significant part of the joint-stock companies which have the status of public companies are not interested and willing to maintain it. For them, this status leads only to more administrative pressures, requires substantial additional expenses and is not securing any extra economic returns and benefits. The Public Offering of Securities Act has provisions allowing change of the status of public company if certain conditionalities are met, which would gradually regulate the existing situation.

Even in cases when corporations have expressed interest to issue shares and bonds, the government policy, conducted by the Bulgarian National Securities, is very often strongly restrictive. According to experts, there is an endeavour for „over-regulation“, which impedes further the development of the primary market.

A strong disincentive to invest in company securities is their low liquidity. Shareholders are not sure that they will be able to sanction possible inefficient management of joint-stock companies and this prevents the capital market realising its control functions.

In the post-privatisation period in Bulgaria, the capital market will play an increasingly active role in restructuring of enterprises (the rights of ownership and control). The market will force managers to restructure as they will begin to feel threatened by the owners and the other stakeholders, as well as by a possible take-over. An efficiently operating capital market can play an important role for enhancing the discipline of managers and for securing an objective market evaluation of their performance.

The capital market should also provide opportunities to those participants in the mass privatisation, who are not willing to remain owners to sell their equity at a fair price, which would additionally consolidate ownership and improve corporate governance. The restructuring of portfolios of strategic and institutional investors will also continue. A developed and liquid capital market in Bulgaria will direct company assets to most efficient structures of ownership and will concentrate the ownership in the most efficient investors.

## 1.6. Transparency and disclosure of information

The establishment of a legal framework, procedures and mechanisms for free, quick and inexpensive access to information on the state of joint-stock companies is a key prerequisite for implementation of the principles of corporate governance.

All participants in the focus group discussions agreed unanimously that at present publicity and access to information are extremely limited. Even the legal requirement for publication of the annual balance sheets of joint-stock companies is not observed. The managers of enterprises indicated that they are very reluctant to submit information on the state and operations of their companies and do it only if they are compelled by the existing legal obligations.

The paradox is that in many cases a large amount of almost identical information is collected by several institutions. However, the subsequent access to this information is extremely difficult, and thus, the efforts for its collection to a large extent become meaningless.

Public companies which by definition have to ensure maximum transparency of their operations practically do not follow this basic principle of corporate governance.

The main reason for this situation is that joint-stock companies lack motivation to make information publicly available. First, the important motive to attract financial resources by releasing information to the general public is absent. The public release of information is driven not by real economic interests, but by legal and administrative pressures. Second, there are concerns that the information which is available to the public could be used against the interests of the organisation. Third, there are strongly voiced opinions that it is not to the benefit of companies to submit full and reliable information, which in some cases becomes evident from the different data submitted to the Internal Revenue Service and the National Institute of Statistics.

The state of public companies can not be made transparent by administrative pressure, even if it is supported by legal regulations. The envisaged penalties if not supported by economic incentives remain inefficient.

Recently Bulgaria made considerable progress in this respect. The Bulgarian National Securities is actively working to ensure rapid and inexpensive access to information on public joint-stock companies. The most efficient way to secure such access is an electronic integrated register. It has to provide operational retrieval of information and to allow computerised data analyses.

The need to provide adequate information to small individual shareholders is of particular importance. The availability of complete and reliable information on the state of the companies in which they hold shares is the most secure mechanism for protecting their interests. The confidence in the joint-stock company and the expectation to receive an yield higher than the average interest rate are principal motives for the small shareholders. From this point of view, reliable information on the existing risk and on the expected profitability of the purchased shares is exceptionally significant element in the information which has to be released to the general public.

## 1.7. Role of the former privatisation funds in corporate governance in Bulgaria

The programme of the first wave of mass privatisation in Bulgaria envisaged participation of privatisation funds as institutional actors. For this purpose, 81 privatisation funds were registered, and then licensed by the

Bulgarian National Securities. The specific terms and conditions for constitution of privatisation funds, as well as the characteristics and regulations of their operations have a substantial long-term significance for the development of the companies, in which they hold shares acquired from the mass privatisation programme. The impact of privatisation funds on corporate governance and on the prospects for restructuring of the companies depends primarily on their share in the capital of privatised enterprises and on their own long-term strategy. Former privatisation funds are also an interesting example of the implementation and development of the mechanisms of corporate governance.

As a result of the first wave of mass privatisation, approximately 3 million citizens hold shares in 81 privatisation funds, amounting to a total nominal value of around BGL 80 billion. The privatisation funds hold diversified portfolios in 1,050 companies. After the end of the first stage of the privatisation programme, most of the former privatisation funds were transformed into holding companies and very few of them – into investment companies.

Unlike other countries in Central and Eastern Europe, in Bulgaria there is a lack of sufficient empirical data and specialised studies on the post-privatisation behaviour and corporate governance of the privatisation funds. The impact of the privatisation funds on the development of corporate governance will be fully demonstrated and could be evaluated more precisely in the coming years. But even now it is obvious that to a great extent privatisation funds meet the requirements for ensuring a high concentration of capital and ownership, for efficient control on the operational management, as well as for professional management, orientated towards purely economic goals. This is confirmed by the analyses of the structure of privatisation funds portfolios, presented in the next report.

The objectives and behaviour of privatisation funds in the post-privatisation period indicate that they act more like strategic investors than typical institutional investors. An essential problem of the former privatisation funds is the lack of experience and poor training of the managerial bodies of their subsidiaries. For this reason additional training and re-qualification are extremely necessary. The importance of market mechanisms for recruiting suitable personnel with appropriate expertise and managerial skills will grow as well. There are also organisational difficulties caused by the desire of executive directors to take over most of the managerial functions. For the time being it is not possible to overcome the lack of interest of employees, who have received free of charge minimum packages of shares under the mass privatisation scheme, as well as their lack of understanding for the essence of relations between shareholders.

Serious problems for corporate governance also arise in cases, when privatisation funds are controlled by managers of the major companies in their portfolios, i.e. when they are controlled by internal shareholders. The external shareholders (owners of shares in privatisation funds) do not form a compact group with sufficient influence in the decision making process. There are also deficiencies in the legal framework, in the regulation and in the infrastructure of the capital market, which could facilitate embezzlement and infringement of the rights of shareholders in the former privatisation funds.

## 1.8. Specific role of the state in corporate governance

At the moment, in a large number of privatised enterprises there is a „partnership" between the state and private shareholders. In many cases, the state is still a majority shareholder. However, its participation is marginally higher than that of other shareholders and the finalisation of privatisation procedures is expected. In the larger number of cases, the state is a minority shareholder, i.e. for the first time the state is in a situation where it is just one of the shareholders and not the owner.

In this situation, the representatives of the state demonstrate several distinct types of behaviour. They either are not interested in the enterprise and do not participate in its governance at all, or they synchronise their personal interests with the interests of private shareholders and act to the detriment of the state as a stockholder. Finally, they often misuse their position as representatives of the state and interfere beyond their powers and competence of a shareholder. All of these cases lead to conflicts, the resolution of which should be sought in the strict implementation of the principles of corporate governance.

In the period of transition, while the state is practically withdrawing from the ownership of enterprises, and in cases when it will retain substantial or majority participation (e.g. in large infrastructure enterprises), it is very important to make clear what is corporate governance about. This requires appropriate forms of training and continuous dialogue with state institutions. Maybe it is still not too late to develop and adopt, in line with the changed structure of ownership, a relevant legal framework for state participation in corporate governance.

The state involvement in the operations of private economic agents creates a situation which facilitates undesirable informal affiliations between companies and government officials, and often unnecessary politicisation of purely economic decisions. This will be overcome with the end of the privatisation process and the formulation of comprehensive government policy on the participation of the state as a shareholder in the ownership of companies.

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As the analysis shows, in Bulgaria the rules and practices for efficient corporate governance and control are not yet clearly established. For the time being, the legal framework and the overall institutional environment have not „detected" a system ensuring the efficient governance of companies in the interest of all shareholders. The efforts of the Corporate Governance Initiative to implement the action lines, envisaged in its main document –

Policy for Corporate Governance Development in Joint-Stock Companies in Bulgaria (http://www.csd.bg/cgi/), also constitute an attempt at giving impetus to these processes in Bulgaria. After its adoption by all interested institutions at the forum held in the fall of 1999, in the coming few years specific measures are to be taken in the area of legislation, improvement of judicial practices, support for the development of the capital market and for enhancing the participation of institutional investors, training and provision of information to minority shareholders.

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## 2. Structure of Corporate Control in the Enterprises Privatised through Mass Privatisation

The mass privatisation had and continues to have a very strong and large-scale impact on the restructuring of the national economy. The impact is not only on the enterprises included in the mass privatisation programme, but also on other important institutions of the market economy, such as the stock exchange. Because of the enormous number of individual participants in the programme, its impact has influenced the confidence and attitudes of both domestic and external portfolio investors. The most significant effect of this impact is perhaps the emergence of a new structure of forms of corporate control in privatised companies.

This report presents part of the findings of a study on the structure of the new forms of corporate control, funded by the PHARE-ACE Program and the Institute of Economics of the Bulgarian Academy of Sciences[3]. It is based on the classic approach in this field, derived from the underlying research of A. Berle and G. Means, which suggests that the efficient control over the management of the enterprise is determined by the scale and the distribution of shareholders participation in its capital. This classic approach does not invalidate or exhaust the whole diversity of the different aspects of corporate control. Along with ownership, it also covers the issues of the structure and rights of the management bodies of the company, the remuneration of managers, and other issues widely discussed in academic literature. This approach only outlines the basis and helps to classify companies along broad main forms of control. The outlined forms of control were subsequently studied in greater details. This gave grounds for development of methodological approaches of practical research by authors, such as Cubin, Leech, Zeitlin, and last but not least by John Scott, who has applied it to a comprehensive comparative study on corporate control in the UK, the United States and Japan[4].

The rationale for selecting this approach is the possibility to compare the trends in the establishment of structures of corporate control in Bulgaria, as a result of the impact of mass privatisation, with similar structures in the above-mentioned developed market economies. This focus of the report is determined not only by the scale and the impact of mass privatisation, but also by the fact that in the beginning of this process there was an initial dispersion of ownership This is the fundamental difference, compared to all other forms of privatisation, which in Bulgaria were almost exclusively based on the transfer of ownership to a single buyer. In this way, mass privatisation was so far the most ambitious attempt to enhance the development of corporate control based on the capital market and to encourage the introduction of the Anglo-Saxon model of corporate governance.

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[3] R. O. Dragneva from the University of Sussex in UK, U. Bakhaus from the University of Maastricht, Frank Steven from the University of Strathclyde in UK, R. Petkova and V. Minchev from the Institute of Economics of the Bulgarian Academy of Sciences in Sofia have taken part in the preparation and discussion of the paper.

[4] J. Scott. Capitalist Property and Financial Power. London, Wheatsheaf Books, 1986.

On the basis of this approach, the fundamental concept of *majority-minority* control and the full range of derivative forms (mechanisms) are developed – the presence (or absence) of a majority shareholder, the presence / absence of a second strong shareholder or group of shareholders in the company, the ratio between the capital controlled by the biggest (leading) shareholder and the one controlled by other shareholders, and finally, the general structure of equity participation – all that determines the identification of one or another *form of corporate control*. The entire set of specific forms of corporate control defines the *structure of corporate control* in a given country. These criteria, taken not only in their temporal development, but also in their national specificity, are analysed in details in the report. The most significant conclusion, presented in the report, is that the emerging concentrated forms of control do not facilitate the development of the capital market in Bulgaria.

## 2.1. The role of privatisation funds in the first wave of mass privatisation

This section examines the strategies and behaviour of privatisation funds as major participants in mass privatisation for the development of their portfolios in order to find out to what extent their actions have determined the structure of corporate control, presented in section 3[5].

A group of eleven funds which were not able to accumulate the necessary minimum of investment vouchers for meeting the minimum capital requirement dropped out, thus leaving the remaining 81 privatisation funds to participate. These funds had different objectives in the process of attracting capital and constructing portfolios. Within the framework of a preliminary study, the funds were classified by their founders and according to their intentions for the type of portfolios, stated in the pre-privatisation prospectuses. The study is an attempt to analyse the impact of these variables on the implementation of the new forms of corporate control after the privatisation.

### 2.1.1. Founders of the privatisation funds

The fragmentation of ownership of privatisation funds among thousands of shareholders enhanced the role of their founders. According to the Privatisation Funds Act, the founders did not have more rights than other shareholders. For this reason they ensured their control by using a number of other mechanisms. First, the owners of vouchers were required to delegate powers to some of the founders for the first general meeting. In this way, the founders were able to determine almost arbitrarily the management of privatisation funds. Actually, most of the small shareholders never attended these meetings, their opinion was not taken into account and

[5] For more details see P. Tchipev. The Privatisation Funds in the Bulgarian Mass Privatisation Scheme (Some Early Results), *Ikonomicheska Misal*, 1997 (in English).

practically they did not participate in the decision making process, which was dominated by founders and managers.

These peculiarities require a more detailed study of the founders and of their objectives and programmes for realisation. This study differentiates between five main groups of founders, typical for the Bulgarian mass privatisation.

**State-owned financial institutions – banks and insurance companies**

The privatisation funds falling within this category were organised by financial institutions – banks and insurance companies – controlled by the state. They owned most of the capital and determined the strategy for developing the portfolio of the fund. It is very important to distinguish this group of founders, as the specificity of Bulgarian financial institutions to a great extent determines the role of these funds in the privatisation. These funds were among the largest and enjoyed the same confidence which the state financial institutions had during the crisis in the banking sector. They also had specific investment policy and management. The close connection between the founders and the state suggested additional advantages for rapid restructuring of acquired enterprises because of the possibilities to implement specific policies of corporate control.

**Legal entities, controlled by the managers of companies subject to privatisation or by high-ranking officials**

This was the second most widespread group of founders. Managers are the most active economic group and usually they have business initiative in most sectors. If we add here privatisation funds, set up by former directors of enterprises, this group would be the largest. It was characterised by predominant personal and friendly relations between the founders, which played a very important role, at least in the early stages of the funds operations.

**Private sector or product based companies**

This was the largest group in terms of number of participants but not in terms of accumulated capital. To a certain extent it overlapped with the group of former directors and government officials, who had started successful business. In some sectors their companies formed a core, which grouped together other companies, included by privatisation funds in their portfolios.

**Private financial institutions**

This category of founders had the clearest and most well defined programmes for investments. In many cases, they had well established business and the privatisation funds were able to play structural role, until it was possible to make a sectoral distribution of investments in a more strengthened and growing economy.

### Private financial and economic groups with diversified activities

This type of founders had established structures and diversified activities in several sectors of the economy. They were strongly motivated to set up holding companies and consolidate their positions in different sectors of the economy.

### Natural persons and small companies

The founders were new entrants in business. In some cases, they represented larger investors who had hidden agenda and interests, and preferred to keep a low profile in the initial phases of privatisation. Another important component of this group were persons with economic initiative who had accumulated substantial amounts of investment vouchers from friends and relatives.

Table 1 presents privatisation funds by type of founder. The third type (the group of sector-based private companies) is predominant and consists of 23 funds. It is followed by the second type which includes 19 funds. In terms of available capital, these two groups are again dominant and hold 53% of the total capital of all privatisation funds. The number of privatisation funds from the fifth type (private financial and economic groups with diversified activities) and the first type (state-owned financial institutions – banks and insurance companies) is minimal. The group of natural persons and small companies is the smallest and represents only 4% of the total capital.

**Table 1**

**Types of Privatisation Funds by Founders[6]**

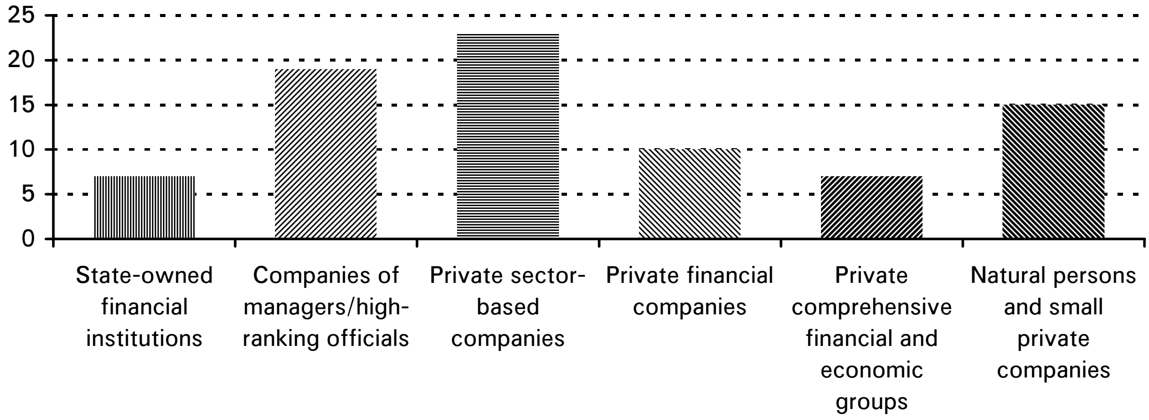
| *Founders* / *Amount of the capital (in bln BGL).* | *State-owned financial institutions* | | *Companies of managers/high-ranking officials* | | *Private sector-based companies* | | *Private financial companies* | | *Private financial and economic groups with diversified activities* | | *Natural persons and small companies* | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number | Capital (mln BGL) | Number | Capital (mln BGL) | Number | Capital (mln BGL) | Number | Capital (mln BGL) | Number | Capital (mln BGL) | Number | Capital (mln BGL) |
| **Very large (over 2.0)** | 2 | 10,444.10 | 4 | 13,018.80 | 2 | 4,895.22 | 1 | 2,108.06 | 2 | 4,868.59 | 0 | 0.00 |
| **Large (0.5–2.0)** | 2 | 1,266.37 | 3 | 3,005.69 | 4 | 4,915.18 | 2 | 1,798.67 | 4 | 3,727.86 | 0 | 0.00 |
| **Medium-sized (0.2–0.5)** | 0 | 0.00 | 7 | 2,260.43 | 7 | 2,402.72 | 3 | 1,052.93 | 1 | 214.08 | 3 | 870.54 |
| **Small (0.07–0.2)** | 3 | 402.91 | 5 | 652.48 | 10 | 1,135.12 | 4 | 515.32 | 0 | 0.00 | 12 | 1,655.71 |
| **TOTAL** | **77** | | **119** | | **223** | | **110** | | **77** | | **115** | |

*Source: Calculations based on the prospectuses of privatisation funds for subscription of capital.*

[6] All amounts in this paper are in non re-denominated local currency (BGL).

**Figure 2**

**Number of Privatisation Funds by Founders**




## 2.1.2. Portfolios of privatisation funds

The pattern of portfolios is determined by the type of packages of shares which the privatisation funds sought to acquire. Largely, they are of three types: (1) strategic packages, allowing control of the enterprise; (2) packages, ensuring maximisation of income without taking the risk of excessive involvement, and (3) the so-called packages „for sale".

### Strategic packages

Practically all privatisation funds sought (and managed) to invest in various enterprises a substantial part of the acquired capital in packages of the maximum size allowed by law – 34% of the total value of the privatise company. This is explained by the desire for an active role in the governance of privatised companies and the intention to use the invested financial resources for restructuring and for ensuring long-term profitability. The criteria for selecting enterprises varied. The most important were the economic state, the significance and position of the enterprise in the respective sector. The definition of „strategic interest", however, often requires some additional criteria, such as for instance, availability of a potential buyer or strategic investor; links with the other operations of the founders and opportunities for closing the production cycle; size of the enterprise; amount of the offered shares under the mass privatisation scheme; availability of cash privatisation; sector.

The presence of another strategic investor would hardly assist the management of the funds. As we shall see below, the presence of a second serious investor leads to different forms of control. Thus, in theory this factor should have a negative effect on the inclination to form a strategic interest. In practice, however, a substantial part of the shares of enterprises included in the list for mass privatisation was offered or envisaged to be offered for privatisation through other techniques. In some cases, privatisation funds were (or tried to become) representatives (coalition partners) of those „other" strategic investors. This factor had a positive effect on the interest of privatisation funds to make strategic investments. Nevertheless, from the management point of view, this model of strategic investments should be assessed with some caution. Such a trend in the policy of privatisation funds suggests quite passive and conservative actions, but it could also mean the establishment of a governing coalition at a later stage. In particular, the possibility of a coalition determined the lowest share of 25 % in the capital of privatised enterprises for the packages regarded as strategic. Thus, each of two funds having an agreement to exchange packages, acquired in two companies, after the invalidation of restrictions on trade could secure a majority interest in one of these companies, even if the packages are at the lowest level: $25\% + 25\% = 50\%$. Summarising, all equity participation of privatisation funds in privatised enterprises within the range from 25 % to 34 % are regarded as strategic.

**Maximisation of the income**

This policy of privatisation funds is designed as a main source of dividends during the interim period and has to ensure a „cash-cow" in the portfolio. A privatisation fund could appreciate a certain enterprise and at the same time may be reluctant to acquire shares in it. This is a typical case when the fund is not sure that it can manage the privatised company or when it decides that acquiring a large interest and playing an active role among the shareholders would be inefficient. The considerations here would be a small amount of the available capital or a small size of the privatised part of the company.

The most important criteria for choosing such packages are the financial stability, the market potential of the enterprise, its size and, in some cases, its connection with a „strategic" group. This is only one interpretation of the discussed above case with available strategic investor. In practical terms, the distinction of these packages is based on 10 % of the shares as the lower level and 25 % of the shares as the upper level.

**Packages for sale**

These are predominantly residual packages. Here we could classify shares which are acquired in order to diversify the portfolios. In this category we could also add the so-called undervalued enterprises, which could be acquired inexpensively, but then have to be resold as soon as possible. The shares in this group of packages were bought for the purpose of quick resale. For a long period of time this kind of stock was the basis of the active trade on the stock exchange. High liquidity could be also a criterion for selection. Finally, within this category fall the shares which the funds bought in order to ensure maximum expenditure of the available investment capital. It can be assumed that this kind of stock was not included in the active strategies of the funds.

In reality, the prospectuses of the funds made a clear distinction only of the first group of packages of shares. In fact, the availability of such packages determined the possibility to set up holding companies for the management of privatised companies. This trend became very obvious after the privatisation when most funds – no matter whether large or small, with well or badly structured portfolios – reregistered as holding companies. In practice, only one of the larger funds reregistered as an investment company. In other words, privatisation funds regarded strategic investments as the most important. From the point of view of our study, strategic investments are also regarded as most important, as this category of packages has the greatest significance for restructuring of corporate control. For this reason the classification and the typology of the funds is based on it.

Depending on the share of strategic packages in the entire portfolio of the fund, there are three types of funds – with purely strategic portfolios (over 60%), with balanced portfolios (from 40% to 60%), and with primarily investment portfolios (under 40%). The last group includes funds, the portfolios of which correspond more to the functions of an investment intermediary than to a company which has to control privatised enterprises.

Table 2 illustrates the distribution of privatisation funds by their preliminary strategies, described in the prospectuses, and are grouped by the amount of their capital. The law specified the minimum amount of capital to be BGL 70 million. The record amount of capital from investment vouchers was accumulated by the „Doverie“ Privatisation Fund – over BGL 6 billion.

Only half of the privatisation funds announced in the prospectuses a clearly formulated strategy for the structure of portfolios. From the three main types of portfolios, the strategic portfolio was the most preferred one. It was selected by 23 funds, while the other two types of portfolios were the choice of 17 privatisation funds. Therefore, most funds began the privatisation process with the intention to play an active part in the reconstruction and governance of the privatised enterprises. This conclusion is also confirmed by the analysis of the distribution of investments – 31% of the total capital of all funds was designated for strategic objectives, while only 25% were allocated in the other two types of portfolios.

**Analysed by type of portfolios**, the groups of privatisation funds displayed the following specific features:

*The group of privatisation funds with strategic portfolios* consists primarily of medium-sized and large funds. With regard to the capital, the funds with a large and very large capital account for 85% of the total capital of the group.

*The group of privatisation funds with balanced portfolios* does not include funds with very large capitals. Obviously, this type of portfolio was not of interest to the privatisation funds with the largest amount of investment capital. The small-sized privatisation funds are the most typical case for this group. With respect to the capital, however, the large funds account for approximately 70% of the total amount of investment capital in this group.

*The group of privatisation funds with investment orientation* consists of funds with various sizes, however, the large funds predominate. The analysis of the capital ratio indicates that they account for 95% of the total investment capital of the group.

**Table 2**

**Privatisation Funds Portfolios by Investment Strategy**

| *Groups of PF by the capital (BGL bln)* | *PF with strategic portfolios* | | *PF with balanced portfolios* | | *PF with investment portfolios* | | *PF of undisclosed strategy* | |
|---|---|---|---|---|---|---|---|---|
| | Number | Capital | Number | Capital | Number | Capital | Number | Capital |
| **Very large (over 2)** | 3 | 7,832.85 | 0 | 0 | 2 | 8,543.97 | 6 | 18,917.95 |
| **Large (0.5–2.0)** | 7 | 8,347.14 | 3 | 2,620.83 | 3 | 2,363.70 | 2 | 1,382.10 |
| **Medium-sized (0.2–0.5)** | 7 | 2,123.65 | 2 | 604.266 | 1 | 289.866 | 11 | 3,555.31 |
| **Small (0.07–0.2)** | 6 | 764.85 | 4 | 483.781 | 2 | 316.491 | 22 | 3,024.14 |
| **TOTAL** | **23** | **19,068.49** | **9** | **3,708.881** | **8** | **11,514.02** | **41** | **26,879.50** |

*Source: Prospectuses of the privatisation funds for accumulation of capital.*

**The analysis of the funds by their size** indicates that *the very large privatisation funds* opt for one of the two clearly defined alternatives – active participation in the operations of most of the enterprises they intend to privatise, or active behaviour as an investment intermediary, i.e. trading of the acquired shares. Obviously such strategy is suitable in cases of diversified portfolios, including shares of enterprises with different profitability.

*The large privatisation funds* form the group with the most clearly formulated strategy. Half of them invested following strictly their strategic interest. With respect to the investment capital, this group is larger than the other three. The other half of the funds is almost equally distributed among the remaining two strategies for constructing portfolios. Most of *the medium-sized privatisation funds*, which demonstrated explicitly strategies, also pursued strategic economic interests. Apart from being less orientated than the others, *the smallest privatisation funds* are also the most heterogeneous group. The larger number of them were strategically orientated. From the point of view of the capital, however, the desire for an investment structure of the portfolio was dominant.

## 2.1.3. Portfolios after the end of the first wave of mass privatisation

Table 3 highlights the actual distribution of portfolios after the first wave of mass privatisation. This data provides possibilities for comparisons with the distribution according to the prospectuses of the funds, presented in the previous section. What is notable at first glance is that the group of funds with strategic portfolios (more than 60% of all acquired packages of shares amount from 25% to 34% of the capital of the privatised enterprise) not only has not grown, but has even contracted. The funds, which had not disclosed their strategy in the pre-privatisation period, had joined the groups with portfolios which do not have pronounced strategic character, i.e. the share of the packages allowing control was between 40% and 60%, or even under 40% of the acquired packages. This was most typical for the very large funds. The small and the medium-sized funds had managed to construct much more compact portfolios, whereas the number of the large funds in the strategic group had fallen, compared to what was indicated in their prospectuses.

**Table 3**

**Classification of Privatisation Funds by the Structure of Portfolios after the First Wave of Mass Privatisation**

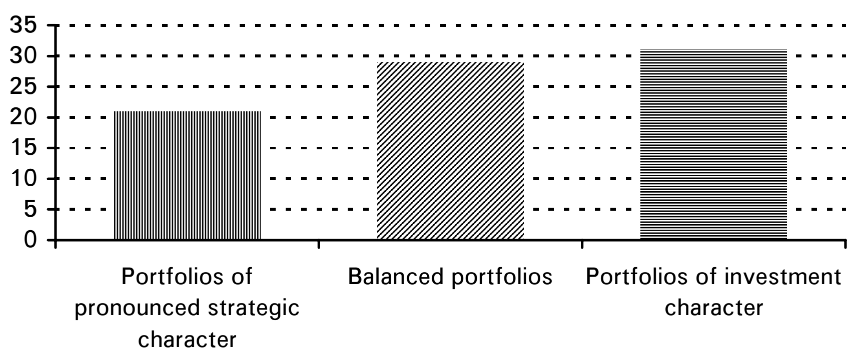
| *Privatisation funds by the amount of accumulated capital* | *Strategic portfolios* | | *Balanced portfolios* | | *Investment portfolios* | |
|---|---|---|---|---|---|---|
| | Number of funds | Number of shares | Number of funds | Number of shares | Number of funds | Number of shares |
| **Very large (over BGL 2 bln)** | 1 | 4,221.146 | 5 | 17,278.381 | 5 | 14,921.949 |
| **Large (BGL 0.5-2.0 bln)** | 4 | 3,466.817 | 4 | 4,345.304 | 7 | 5,004.664 |
| **Medium-sized (BGL 0.2-0.5 bln)** | 6 | 1,728.087 | 7 | 1,673.856 | 8 | 3,199.805 |
| **Small (BGL 0.07-0.2 bln)** | 10 | 1,193.487 | 13 | 1,943.707 | 11 | 1,092.997 |
| **TOTAL** | **21** | **10,609.537** | **29** | **25,241.248** | **31** | **24,219.415** |

*Source: Center for Mass Privatisation.*

**Note:** Unlike Table 2, here we have included the number of the shares acquired by the respective funds in the group, as until now data on the precise value of the portfolios of the individual funds is not available. The purchasing prices of shares could be misleading as they reflect the specificity of the privatisation procedure, rather than the real value of the acquired assets. This can be explained by the advantageous purchase of shares from privatisation funds. Their resource of investment vouchers turned out to have considerably higher than expected purchasing power. The attempt to utilise fully this purchasing power led to a large number of deals with participation of below 25% of the capital of enterprises.

**Figure 3**

**Number of Privatisation Funds by Structure of Portfolios after the First Wave of Mass Privatisation**



The non-strategic portfolios were the choice of an almost equal number of funds. This supports the argument that such portfolios emerged as ***a passive result*** of the privatisation process, rather than as a deliberate strategy.

Nevertheless, it is difficult to explain the large number of balanced portfolios typical for the funds in all groups. The great number of packages of shares from 10% to 25% of the capital of privatised enterprises is even more impressive. In reality, this particular structure of portfolios is not typical both for holding and investment companies – the two sole possibilities provided by the law for continuing the operation of privatisation funds.

A possible explanation of this phenomenon is the participation ***„in pairs"*** – two funds conclude a preliminary agreement to bid for packages of shares in two enterprises. In this way they acquire one package for themselves, and one for the partner fund. After that they swap the management or the ownership of the previously „ordered" packages and thus augment their „own package", increasing it to the required size for control of the company. As in principle the own package tends to reach the upper legal limit (34%), the size of the „ordered" package could be smaller and usually fluctuates around 17%. Altogether the two packages make up the classic 51%, required for majority control.

The hypothesis for participation „in pairs" has significant importance for explaining the relationship between privatisation funds and corporate control. In the course of the privatisation process a number of implications of such pairs were made, however, they were not supported by sound evidence. Somewhat more reliable criterion is the monitoring of cases of joint participation of two funds in the capital of a privatised enterprise. The presence of such connection could be presumed in more than five cases of joint privatisation.

**Table 4**

**Participation „in pairs" of Privatisation Funds in the First Wave of Mass Privatisation**

| *Joint participation of a „pair" of funds* | *From 5 to 10* | *Between 10 and 15* | *More than 15* |
|---|---|---|---|
| Cases | 11 | 2 | 5 |

*Source: Calculations of the author based on data from the Center for Mass Privatisation.*

Table 4 highlights the results of this test, grouped by number of cases. Of course, these observations should not be regarded as exhaustive. In practical terms, all coincidences have been traced mainly in the combination between *the largest and the second largest shareholder in an enterprise*, in some cases in the combination between *the largest and third largest shareholder*, and also some individual combinations between *the second and the third largest shareholder* were examined. The investigated 18 cases represent more than 30% the privatisation funds. The study of this issue gave sufficient grounds to assume that there are other types of combinations and that in some cases they include triangular configurations, where a large fund has arrangements with more than one partner.

This hypothesis fits in very well with another paradox of the first wave of mass privatisation. Although the portfolios of three quarters of the funds immediately after the privatisation did not favour strategic behaviour and approximately one third of the portfolios were particularly unsuitable for it, most privatisation funds (76) have been reregistered as holding companies, and only one large fund has reregistered as an investment company. We think that this gives us grounds to regard our assumptions as true and to use them in section 3 for the discussion of the transformation of the structures of corporate control.

## 2.2. Structures of corporate control in privatised enterprises

### 2.2.1. Theoretical grounds of the analysis

In a comprehensive comparative study of corporate structure of companies in the UK, the US and Japan, referred to in the introductory notes, J. Scott differentiates the following typical mechanisms of corporate control: *control by public bodies, primarily the government through its ministries and agencies; sole (full) proprietorship; a special type of control in mutual and friendly companies; exclusive majority control; shared majority control; exclusive minority control; shared minority control; limited minority control; constellation of interests*.

The first two mechanisms are classic – the familiar mechanisms of control in state-owned enterprises and sole proprietorships. Scott specifies that generally in the UK state-owned enterprises do not assume a corporate form and do not have share-capital. For a variety of reasons, these two mechanisms of control have no bearing on this study. There is not even one case when the ownership of an enterprise has resulted in such forms of control, and they are not the subject of any further consideration.

The third mechanism (mutual and friendly societies) is characterised by the specific regime of rights in such companies, where one man has one vote in the decision-making process. It becomes immediately clear that this regime has not been used in the privatisation process because it is based on a special legal regulation, which is absent in Bulgaria. Yet it is interesting to note that some privatisation funds in their deliberate advertising campaigns, at different stages of the privatisation without any grounds associated themselves with the mutual funds in market economies, claiming that they were their analogues. This form of control is also not of interest to us and is not treated further in this study.

#### Exclusive majority control

This is a classic form of control. A shareholder, or a group of related shareholders owns a majority package of shares, which provides the opportunity to take decisions on all principal problems of the management and development of the privatised company. The size of the package has to ensure half plus one votes from the total voting power. This definition differentiates companies (enterprises) with sole proprietorship control, but does not draw a distinction between cases of one hundred percent sole proprietorship control and cases, in which the owner exercises ***full*** control but does not possess all of the stock. This distinction is not just formal. It emphasises that, unlike sole proprietorship enterprises, in the instance of exclusive majority control there are cases, in which other (minority) shareholders also own part of the capital. Although they are not in a position to influence the operational management, they also have interests. These interests can be and in many countries are protected by the legislation. This type of protection has even greater significance for Bulgaria because of the higher share of majority forms of control, compared to the developed market economies.

**Shared majority control**

The next form of control is the case when the largest shareholder acquires the majority of votes, needed for the operational control of the company, through „stable co-operation of a small group of allies“ [7].

There is a clear need to distinguish this form of control. It is actually one of the most widespread. Here the question is not only the protection of minority interests in the company, but also the different forms of their expression – representation in managerial bodies, blocking decisions and the like. The scope of such interests is much wider in this form of control. Here the regulation of the ways of voting by proxy is particularly important – who holds the voting rights, in what form it is done, etc.

**Exclusive minority control**

The serious difficulties in the typology of corporate control begin with this category. ***Minority control*** as an economic category was introduced by Berle and Means[8]. They used the category to define cases, when owners do not hold the majority of votes but can exercise efficient control. And if the upper level (50%) of such control is obvious, this is not true for the lower level, i.e. the size of the largest package of shares, under which efficient control is impossible. Berle and Means assumed that this level is 20%, and based their analysis on the role of managers in modern corporations on this assumption. According to them, the lack of a shareholder with at least 20% participation in the stock of the company, transfers the control to the managers. Subsequently, other researches analysing the dispersal of ownership in big corporations have suggested 10%, 5%, and even a lower percentage for this level.

The detailed analysis indicates that it is impossible to determine such threshold and that all cases under 50% should not be treated as one and

[7] J. Scott. Capitalist Property and Financial Power. London, Wheatsheaf Books, 1986, p. 52.
[8] A. Berle and G. Means. The Modern Corporation and Private Property.

the same category. For this reason, ***the concept of the top 20 shareholders*** has been introduced as an additional restrictive condition in the analysis. This concept requires a comparison of the share of capital owned by the largest shareholder (if his participation in the capital of the company exceeds 10%) with the share of capital, owned by the remaining 19 shareholders in the group of the top 20 shareholders. The concept is based on observations of a large number of cases of ownership distribution in modern corporations. For instance, the findings of Scott, based on a sample of 250 enterprises in 1986, indicated that in all cases when the largest shareholder owned under 14%[9] of the total capital, the remaining top 19 shareholders were able to outvote him, and vice versa, when the largest shareholder owned over 18% of the capital, he was always in a dominant position. Ownership of approximately 16% reflected in several borderline cases with dynamic majority, which voted in different ways. Without going into the details of the discussion of these mobile levels in the share of capital ownership, it is necessary to point out, in particular, that ***the limits and characteristics of the groups vary by country, and change dynamically over time.*** Here we have used only the most general classification as an guideline for differentiating of enterprises subjected to mass privatisation in Bulgaria.

According to Scott, there is also an exclusive minority control in cases, when the top 2–19 shareholders from the group of the top 20 are not in a position to outvote the largest shareholder. He defines this form as „secure minority control".

**Limited minority control**

Without applying the concept of the top 20 shareholders, this category would have a residual character for cases in which distinct minority control is not observed. By using this concept it is possible to relate the limited control only to cases when, in order to implement his management strategy, the largest shareholder has to secure the support of at least a part of the smaller shareholders. At the same time, the size of his share suggests a considerable fragmentation of the remaining packages. This leads to difficulties in establishing the necessary control and, what is even more important, the connection between the principal shareholder and the other shareholders is very volatile. It can be easily endangered by the emergence of a potential aggressive external investor offering overt or covert buy-out of the equity of smaller shareholders. As Scott points out, this is the determining feature of this type of control, which gives more definite characteristics to the group itself.

This feature, in its turn provides possibility to define two other forms of control – shared minority control and „constellation of interests".

[9] J. Scott. Op. cit., p. 58.

### Shared minority control

As in the case of limited minority control, the largest shareholder can not have an autonomous dominant position, but could exercise control in co-operation with some of the smaller shareholders. The main feature which distinguishes this group is the presence of a durable connection between two independent shareholders, usually the two largest. Frequently, the close co-operation between the first and the third largest shareholders, and even some of the smaller ones, allows them to „define the strategy of their common ally“[10]. At the same time, the two associated shareholders need to have a greater voting power than the remaining top 18 shareholders. It is difficult to ascertain the practical meaning of this distinction, but it is of interest to us because of the already noted model of frequent co-operation between two privatisation funds, caused by the specificity of the mass privatisation scheme.

### Constellation of interests

This is the last type of corporate control, analysed from a theoretical perspective. It is characterised by the absence of a shareholder owning more than 10% of the capital of the respective enterprise. This generates a strong diffusion of the ownership. Such situations lead to a complicated dynamic balance between the interests of various owners and does not allow the strategy of the company to be associated with any of the owners. According to the approach of Berle and Means, it should be assumed that managers dominate the management of the company. It is interesting that Scott, as well as other researchers, do not make such assumption and regard the strategy of such companies as an entity of the interests of the group.

A possible explanation can be found in the modern interpretation of Berle and Means thesis. However, it should be noted that in contemporary theory there is not a definite judgement for the validity of Berle and Means argument. Practically entire trends in company theory such as, for instance, *the theory of representation* consider management contracts as essentially limiting the freedom of action of management teams, thus protecting the supremacy of the interests of shareholders. Although along somewhat different argument, the global typology of corporate control leads to the same conclusions. According to it, in the Anglo-Saxon type of economies, it is exercised through the stock exchange. Obviously, what is meant is precisely the big public corporations, where there is not a sufficiently large single shareholder and which can not be classified in any of the other forms of minority control.

The „constellation of interests“ is also characterised by a discussion for the boundaries of the group. In this case, the debate is about the upper level in the ownership of the largest shareholder, whether it is 10% or even 5%. Cubin and Leach who were the first to use the concept for the top 20

[10] J. Scott and C. Griff. Directors of Industry, p. 22.

shareholders in their study of the 85 biggest UK companies over the period from 1970 to 1971, found out that in a substantial number of cases „control" can be also detected in the interval of 5% to 10% share in the equity, hold by the largest owner. At the same time Cubin and Leach argue that when the largest shareholder is a financial intermediary, the resulting form of control is more unstable[11]. For this reason, however, Scott disagrees with this limits of the levels of ownership.

This analysis represents a theoretical generalisation of the typology of corporate control, derived from ***a practical study***. The debate about the limits of the level of ownership and the characteristics of the individual forms, or even about their number should not be exaggerated, as it reflects the development of corporate relations at a certain stage. It is not unusual studies, conducted in different periods and based on different samples to contradict each other. It is more important to assess the approaches and the principles of classification, which could be applied in the study of the outcome of mass privatisation.

Although such approach could lead to some incompatibility[12] of data, in this survey we use the generalised results of the Scott's study on 250 industrial companies. These results can be used as useful guideline for the trends in the Bulgarian economic reform. Based on his suggestions for defining the groups more precisely, Scott provides two classifications. Here we refer to the first one. According to it, in 25 companies, which represent 10% of the cases there is exclusive majority control; in 6% of the cases it is a shared majority control; in 14.4% – it is exclusive minority control; in 4.4% – it is shared minority control; in 1.6% – it is limited minority control and in 40% of the cases it is a constellation of interests. The remaining percentage up to 100 accounts for forms that are not typical for Bulgaria, such as mutual funds and sole proprietorships or companies controlled by the government, all of which are not treated in our study. The highly diffused ownership prevails substantially and is dominant, compared to the other more concentrated forms of control. Precisely this form imparts the ***general characteristics*** of the modern UK economy and, at the same time, it is the subject of speculations as to what are the limits of the managers' freedom.

### 2.2.2. Trends in the development of the structure of corporate control, induced by the characteristics of enterprises offered for privatisation

As a first step, the study has analysed to what extent the scheme of the first wave of mass privatisation in Bulgaria facilitated the establishment of efficient control. The packages of shares and the frequency of offers were examined. According to the scheme, 1,050 enterprises were offered, 10 of which were not allowed to participate in the process. This study fo-

[11] J. Cubin and D. Leach. The Effect of Shareholder Dispersal on the Degree of Control in British Companies: Theory and Measurement. – *Economic Journal,* 93, 1983.

[12] The reason for this incompatibility is the difference in the legal frameworks and, furthermore, the different levels of development of corporate relations in a country in transition, such as Bulgaria, and in a developed economy, such as the UK.

cuses on the type of control, established in the remaining 1,040 and the data refers to this set of cases. The total amount of the capital of offered enterprises was 223,795,998, while the average capital of one enterprise was ***BGL 215,188*** respectively

The packages of shares which were offered under the scheme varied widely, in the range from 10% to 90% of the capital. At least 10% were always reserved for restitution claims. They should not be regarded as changing the concentration of ownership, although probably there were cases, when these shares could provide possibilities for coalition with another large investor, which may have an impact on the overall picture. Anyway, they do not have a direct relevance on the results of mass privatisation.

**Table 5**

**Classification of Enterprises by the Amount of Capital Offered for Mass Privatisation**

| | *Number of enterprises* | | *Average amount of the capital of one enterprise in the group (in thousand BGL)* | |
|---|---|---|---|---|
| | Under the scheme | Actual | Under the scheme | Actual |
| **I group** | 804 | 684 | 109,652 | 96,476 |
| **II group** | 8 | 53 | 109,746 | 150,345 |
| **III group** | 228 | 303 | 591,197 | 494,516 |

*Source: Center for Mass Privatisation.*

The first group consists of all enterprises with at least 67% of the assets offered for mass privatisation. The limitation for the share of the offered assets was not selected arbitrarily. It ensures two-thirds of the voting power in the company and corresponds to one of the most widespread forms of control. The characteristics of this form of control, well-known in market economies, related to preventing the blocking of any decisions in the governance of the company, are complemented by some Bulgarian peculiarities – the restrictions in a number of state enterprises, adopted immediately before the privatisation, for changes in the management boards (most often a majority of two-thirds was required), and also the very model of mass privatisation. The offer for privatisation of more than two-thirds of the voting power of a company allows, at least in theory, to achieve relatively easy a coalition of two funds for acquiring majority. This is very important, bearing in mind that initially none of the funds could accumulate more than a 34% share in the stock of a company. In this way, such a coalition could *a priory* be insured against the appearance of „surprising“ blocking packages of shares.

This is also the most common size of the offered packages of shares – it coincides with the *mode* in the distribution of the packages of shares of the enterprises offered for mass privatisation.

The second group accounts for from 50% up to 67% of the cases. The closest equivalent of this group in international practice is what is known as shared majority. Here a detailed analysis is not made, because of the exceptionally rare frequency, amounting to only 8 cases. Obviously, the occurrence of such cases should be attributed most of all to the endless inclusions and exclusions of enterprises from the privatisation list, which often compiled contradictory interests in weird combinations. This model will receive a more in-depth treatment at the next stage of the analysis related to the real distribution of ownership.

The third group of packages of shares amount to 50% (or less than 50%) of the capital of enterprises offered for mass privatisation. This group is heterogeneous and, in practice most of the contemporary studies on corporate control in the world are based on it, primarily because of the wide dispersal of shareholder ownership. These cases, both as number and variation, however, are less frequent. Besides their number being almost four times lower than the number of cases providing majority forms of control, even within the group, the packages are concentrated mainly in lots of 10% and 25% share of the capital. These are the mirror images of the enterprises from the first group, which also envisage majority forms of control, however, accomplished not by mass privatisation, but by other forms.

In the outlined three groups several trends became evident.

First, the offering of packages of shares which lead (or could lead quickly) to development of explicit control model(s) of the enterprise. This objective, combined with the 34% requirement, however, is accomplished in a very strange way.

Second, to avoid the offering of packages, which would lead to competitive models of control, i.e. to avoid the offering of additional shares, which combined with the above packages could preserve the possibility for future exclusive control, but achieved in a different way.

Third, the average amount of capital per one enterprise in the various groups, gives grounds to argue that the explicit control, allowed by mass privatisation, applies to considerably smaller enterprises. On the contrary, the large (or the important) enterprises do not presuppose the implementation of such control through mass privatisation.

### 2.2.3. Distribution of enterprises by forms of corporate control

Prior to presenting the results of the analysis, it is necessary to note some general methodological issues.

First of all, the data set which served as a base of the analysis was provided by the Center for Mass Privatisation after the completion of the privatisation process. This data reflects the results of the auctions. For this reason, the shares which, according to the Regulations were subjected to administrative distribution appear as unsold. The rule, according to which each actor (fund or individual) who had acquired a certain amount of shares was entitled to obtain additional unsold shares if they were not more than 25,000 and did not exceed 5% of the capital of the privatised enterprise, was applied. Thus, the data presented below reflects this surplus[13].

The next methodological issue is related to the distributed free shares, amounting to 10% of the capital which, according to the regulations, had certain restrictions on the value of shares offered to one person. Due to the decentralised character of the process (each enterprise subscribed these shares on its own), the control on subscribed (free) shares could be effected only by the capital in the enterprise, which was privatised at the auctions. It is assumed that where privatised capital was less than or equal to the announced in advance share for mass privatisation, minus 10% for free stock, there was a full utilisation of this option. In this way, the total number of individual participants was increased by the maximum of 10%. At the auctions, where the actually privatised share of the capital was higher, i.e. the quota for free participation was not completed, the increase in the share of individual participants was equal to the amount of the incomplete quota.

The most serious methodological issue is related to the implementation of the criteria for the different groups. In spite of the precision and the adaptation of these criteria to the specificity of mass privatisation in Bulgaria, a lot of complicated cases remained which were difficult to classify accordingly by groups of corporate control. For this reason in the study was designed a principle, according to which all borderline or contradictory cases have been assigned to a form of corporate control, typical for a certain group, despite the fact that this sometimes could contradict the formal quantitative criteria for the group.

Apart from these, there are other specific features related to the peculiarity of the process, discussed in details below.

### Exclusive majority control

The mass privatisation excluded the possibility for majority forms of control because of the restrictive regulation that funds could not acquire more than 34% of the capital of privatised enterprises. It is difficult to imagine that when adopting this regulation government decision-makers were considering and pursuing specific forms of corporate control. More likely, the effort to replicate the Czech model had played a greater role in this respect. In this model the regulations are even more restrictive, providing only a 20% ceiling for the share of privatisation funds in the ownership of privatised companies. The specificity of the Czech model comes as a result of the understanding that privatisation funds should act as investment intermediaries. At the same time, from the very beginning the Bulgarian mass privatisation scheme was designed to allow the eventual transformation of these funds into industrial holding companies.

Thus, the 34% requirement became a serious internal impediment for restructuring and forced the funds to look for different ways of by-

[13] In some cases, this led to a slight overstock above the 34% maximum permissible ceiling for participation of privatisation funds.

passing it. As illustrated in Table 4, these „ways“ were successful and a large number of funds worked together („in pairs“) to acquire control in a certain enterprise. After the end of the privatisation process, they legalised these packages by block transactions on the stock exchange. This fact gives grounds to regard the shares acquired by two funds as a single package for the purposes of classifying the respective enterprise. However, it is not always possible to determine accurately whether the two funds have contractual relations. Therefore, it is better to take the actual data on the distribution of ownership a few months after the end of the privatisation process.

Undoubtedly, the latter would be more correct, but it turned out to be impossible. The lack of clarity what part from the data base of the Central Depository is publicly available, in practical terms, has made impossible to procure data on the actual structure of ownership by any other date, except immediately after the end of mass privatisation. This data has been used as the basis of the analysis.

The other obstacle does not have any direct bearing on the problem. The fact that sometimes it is not possible to say exactly which of the funds, participating in the structure of ownership of a certain enterprise, form the group of the first and the second largest or the first and the third largest, is not of significance in this case. What we are interested in is whether the structure of ownership allows or blocks the existence of a specific form of corporate control. This relates to the more complicated cases. In cases where there are two funds only, the first one holding the maximum of 34%, and the second one – 17%, and there are no other institutional shareholders, the objective of the participation is evident. In many cases, such a pair is found in 10 different enterprises with the same distribution of the capital, however, the leading role of the two funds is switched.

Thus, cases where the sum of the shares of two funds in one enterprise exceeds 50% of the capital, are regarded as having ***a majority form of control***. According to the theoretical assumptions, discussed in the previous section, this form of control is exclusive majority control, when the leading shareholder (in our case a group of two related shareholders) is not threatened by the existence (appearance) of another shareholder, with whom he would be compelled to negotiate the actual control over the enterprise.

Table 6 presents all cases, when after the end of the third round of mass privatisation, two funds are in a position to control a mutual majority package of shares, meeting these conditions.

1. Here are included primarily enterprises in which the actually privatised share exceeds two-thirds of the total capital. It means that shareholders are not threatened by the emergence of a large shareholder after an eventual sale of the remaining package of shares by some form of cash privatisation. In the worst case, the residual package would be approximately 23% as out of the remaining 33%, the law has reserved 10% for eventual restitution claims. As it can be seen from Table 6, the average privatised shares are even higher. This automatically reduces the possible size of the packages for cash privatisation.

2. This form of control includes enterprises, where either there is no other institutional investor, or his stake is insufficient to organise a second group which may have demands for the control of the enterprise, even if he controls the maximum residual share of the capital, which in any case will be below 30%.

3. The small number of such enterprises (approximately 30), where the total voting power of the institutional investors outside the controlling group exceeds 10% (but not more than 20%) have the following features: a very high share of their capital if privatised (over 90%); the second fund in „the pair“ has a substantial share in the capital; a large number of individual investors who hold the rest of the privatised capital. The general patterns in the behaviour of small shareholders suggest that they can not form an autonomous voting block, and most frequently their votes are in fact distributed in favour of the largest shareholder.

This group includes a substantial number of enterprises – almost a quarter of all enterprise are controlled in this way. These are small enterprises as their average size is below the average size of the entire set of 1,040 enterprises, and their distribution is skewed to the right – the median is almost half of the mean of their capital. The majority of enterprises have a size which is smaller than the average for the group. At the same time, their capital is largely privatised – the unsold shares, distributed after the auctions, amount on average to 1%, while the free shares, distributed among employees amount to 7%. As noted above, outside the controlling group there are practically no other institutional investors – the average size of the shares of the third, the fourth and the fifth fund is only 3.87%. An indirect indication for the correctness of the analysis is the fact that two of the most frequently encountered funds, in 28 cases have been bidding for one and the same enterprises as first and second largest investors.

**Table 6**

**Characteristics of Enterprises from the Group with Exclusive Majority Control**

| ***Enterprises in the group*** | | ***Capital of the group (thousand BGL)*** | | | ***Average size of the privatised share per enterprise (%)*** | | |
|---|---|---|---|---|---|---|---|
| Number | Share in all 1,040 privatised enterprises (%) | Total amount of capital | Average amount of capital in one enterprise | Median | At the auctions | After distributing unsold shares | After distributing free shares |
| 267 | 26 | 19,574,018 | 73,311 | 43,764 | 69.95 | 70.19 | 78.05 |
| ***Average share of majority shareholders in the total capital of the enterprise (%)*** | | | | | ***Average share of minority shareholders in the total capital of the enterprise (%)*** | | |
| Share of the two funds, participating in the „pair“ | Share of the leading (first largest) funds | Share of the second largest funds | Most frequently encountered leading fund | Most frequently encountered second largest fund | Share of the third largest fund | Total share of the third, fourth and fifth largest funds | Total share of individual investors |
| 59.00 | 33.48 | 25.53 | „Doverie“ Fund | „Petrol“ Fund | 3.54 | 3.87 | 15.18 |

*Source: Calculations of the author, based on data from the Center for Mass Privatisation.*

Another very important specificity is that the share of the controlling package is not very large, amounting on average to 59%. Only in 45 cases there is a total control of over two-thirds of the votes. These figures point to the considerable interest of minority shareholders, which should receive adequate legal regulation.

## Shared majority control

The most typical feature of this group is that, in spite of the presence of a majority shareholder (or a group of related shareholders), there are also other important shareholders who can intervene to one or another extent in the control of the privatised company. The specificity of the Bulgarian mass privatisation scheme is that it kept large non-privatised packages of shares in a considerable number of enterprises. Thus, in many cases majority owners faced threats for transfer of a substantial residual package of shares to a single actor, either through cash privatisation or through MEBOs. This would alter the position of the majority shareholder. Certainly, the situation is much more complicated – in many cases, the residual packages are acquired by the majority shareholders, who thereby can secure exclusive control.

Thus, two types of enterprises belong to this group:

• Enterprises where the process of privatisation has led to the presence of a second institutional shareholder (in some cases, there are even more than one minority institutional shareholder);

• Enterprises which had or still have a substantial non-privatised package of share, allowing in principle the advent of a new and powerful controlling agent. The characteristics of the group of enterprises, defined in this way, are illustrated in Table 7.

**Table 7**

**Characteristics of Enterprises from the Group with Shared Majority Control**

| *Enterprises in the Group* | | *Capital of the Group (thousand BGL)* | | | *Average Size of the Privatised Share per enterprise (%)* | | |
|---|---|---|---|---|---|---|---|
| Number | Share in all 1,040 Privatised Enterprises (%) | Total Amount of Capital | Average Amount of Capital in One Enterprise | Median | At the Auctions | After Distributing Unsold Shares | After Distributing Free Shares |
| 143 | 13.75 | 21,509,043 | 150,413 | 65,296 | 63.05 | 63.38 | 70.57 |
| *Average Share of Majority Shareholders in the Total Capital of the Enterprise (%)* | | | | | *Average Share of Minority Shareholders in the total Capital of the Enterprise (%)* | | |
| Share of the Two Funds, Participating in the „Pair“ | Share of the Leading (First Largest) Funds | Share of the Second Largest Funds | Most Frequently Encountered Leading Fund | Most Frequently Encountered Second Largest Fund | Share of the Third Largest Fund | Total Share of the Third, Fourth and Fifth Largest Funds | Total Share of Individual Investors |
| 52.32 | 32.94 | 19.38 | „Doverie“ Fund | „Doverie“ Fund | 5.12 | 6.00 | 12.25 |

*Source: Calculations of the author, based on data from the Center for Mass Privatisation.*

The group of these enterprises is almost two times smaller, but it includes larger companies. However, the distribution is again asymmetrical and the number of enterprises with less capital than the average for the group prevails. At the same time, the group has considerably lower average share of privatised capital and increased role of the second largest institutional shareholders. Here the figures for the average share of the third largest fund, and the total share of the third, fourth and fifth largest funds are misleading, because they include two groups of enterprises with heterogeneous characteristics. These groups are represented almost evenly – on the one hand, these are enterprises with a higher participation of the third, fourth, etc. largest privatisation funds, and on the other hand, there are enterprises with a zero (or close to it) participation of such shareholders, but with a substantial residual package of shares. These are enterprises with a ***potentially*** second group of control. In realty, these cases are exactly the opposite and balance each other in the calculated average figures.

If, however, the shares of minority institutional investors for these groups are calculated separately, the results are quite indicative – for the enterprises in which more than two-thirds of the capital was privatised, this share is 14.74%. Cumulatively with the third and the fourth largest funds, the share reaches 17.79%. At the same time, the average non-privatised share of the remaining enterprises is 34%.

The average share in the capital of individual investors is close to the one of the preceding group. It means that their shares cannot be of any serious interest to institutional investors in the process of redistribution of corporate control. It seems that the most essential peculiarity of this group is the contraction of the average share in the capital of the second largest fund in the leading „pair" to below 20%, which reduces the average size of the controlling package to 52.32%. This figure suggests another possible scenario in the group – some of the minority shareholders could aggressively attack the controlling „pair", particularly in cases when the mutual transfer of shares between the two leading shareholders has not been completed.

The frequent presence of „Doverie" Privatisation Fund as first and second largest shareholder is explained by its rather big and very dispersed investment portfolio and, on the other hand, by the fact that its partners were relatively small investors. As a matter of fact, „Doverie" participated with 14 different funds in a total of 34 „pairs" in the group and build 18 „pairs" (more than half) with only three of these funds. Undoubtedly, this is additional evidence in support of the argument for the joint construction of controlling packages.

If „Doverie" Privatisation Fund is taken out from the group, the result is also interesting. Then the greatest frequency as a leading fund is displayed by „Melinvest" Privatisation Fund, while „Bulgaria" Privatisation Fund is the second largest fund – this is another „pair" of the funds shown in Table 4, which aggregates 37 cases of joint participation.

## Exclusive minority control

According to the already discussed theoretical models, there is exclusive minority control when the stake of the leading shareholder is at least 10% and the next top 19 shareholders are not able to accumulate a larger share of the capital. The reality of the Bulgarian environment requires substantial modification of this criterion, in order to take into account the logic for differentiating the group of enterprises, in which corporate control is based on exclusive minority. This specificity could be summarised in the following way: the leading group of owners consists of two funds; the monitoring of the next largest shareholders would be meaningless, if individual investors are included, because the size of their packages is very small and not comparable to those of the funds. On the other hand, the cases of five funds participating in the privatisation of a single enterprise are very few. The other specific feature is that in all cases, at least 10% of the capital was not privatised. This questions the exclusive control of the leading group, if the size of its package drops below the 10% level.

These peculiarities determined the following changes in the criteria of differentiating the group:

1. Because of the possible emergence of new owners when the residual package of shares is sold, the group included only enterprises in which more than two-thirds of the capital is privatised.

2. The classic threshold of 20% was adopted as the lower level for the ownership of the leading group of funds.

3. The summarised data on the third, fourth and fifth largest funds was monitored, taking into account the requirement that their share should not exceed 10% (not just be smaller than the share of the leading shareholders). There is a possibility that some of the smaller funds could establish an alliance with potential new shareholders, who have acquired shares through cash privatisation and restitution claims. In some cases, they could ally even with the second largest fund, which would force the leading shareholder to exercise shared, rather than exclusive minority control.

4. In addition, enterprises which met the above criteria but there was no evidence for connections between the first two funds or connections between one of them and the third, the fourth or the fifth fund, were also not included.

The characteristics of this group are illustrated in Table 8. The group is relatively large, with a high share of privatised capital, but with a very low average size of the capital of one enterprise. This probably suggests why the interest of the funds was lower and why the individual investors were very well represented. In spite of their large share, individual investors do not create possibilities for redistribution of the voting power at the general meetings of privatised companies. It can be assumed that their votes will be distributed evenly in the decision-making or, even if they sell their stock, this will increase proportionally the shares of other shareholders.

**Table 8**

**Characteristics of Enterprises from the Group with Exclusive Minority Control**

| *Enterprises in the group* | | *Capital of the group (thousand BGL)* | | | *Average size of the privatised share per enterprise (%)* | | |
|---|---|---|---|---|---|---|---|
| Number | Share in all 1,040 privatised enterprises (%) | Total amount of capital | Average amount of capital in one enterprise | Median | At the auctions | After distributing unsold shares | After distributing free shares |
| 159 | 15 | 11,448,649 | 72,004.08 | 37,319 | 65.93 | 66.20 | 73.55 |
| Average share of majority shareholders in the total capital of the enterprise (%) | | | | | Average share of minority shareholders in the total capital of the enterprise (%) | | |
| Share of the two funds, participating in the „pair“ | Share of the leading (first largest) funds | Share of the second largest funds | Most frequently encountered leading fund | Most frequently encountered second largest fund | Share of the third largest fund | Total share of the third, fourth and fifth largest funds | Total share of individual investors |
| 41.36 | 31.22 | 8.58 | „Doverie“ Fund | „Doverie“ Fund | 1.57 | 1.84 | 31.91 |

*Source: Calculations of the author, based on data from the Center for Mass Privatisation.*

The substantial share of highly dispersed ownership, together with the unsold residual packages of shares, ranging from 17% to 27% of the capital, if not regarded as creating some instability, at least develop preconditions for increased activity of the controlling shareholders in buying out the stock of individual investors. In this connection, the relatively high share of the controlling group of shareholders (41.36%) is another characteristic feature. It means that with some efforts, this group will be able to secure the needed share of more than 50% of the ownership in order to have majority control in the privatised companies. The very low participation of the second largest funds in the group is striking, bearing in mind that the share of the largest funds is close to the possible maximum. Strictly speaking, the criteria of including funds in this group allowed variations in the ratios of the share of capital, controlled by the first and the second largest funds, from 34:16 to 25:25, and sometimes to 20:0. In fact, this is another indication for the high degree of co-ordination between institutional investors in bidding at the privatisation auctions. In practical terms, the „pair“ alliances of funds are needed only for establishing majority control. In cases where this was not set as an objective, the emergence of a second powerful shareholder was, in fact, undesirable. The 8.58% share of the capital, hold by the second largest shareholder, was a result of the failure to establish majority control, rather than a result of pursued real objective. The re-emergence of „Doverie“Privatisation Fund as most frequently encountered fund is a result of the large amount of accumulated investment vouchers. The second most frequently encountered leading fund is „Albenainvest“ (see Table 4) and it has joint participation with „Doverie“ Privatisation Fund in a total of 26 cases.

### Shared minority control

Some of the specific criteria for this group are based on criteria used in the previous group, such as the requirement for at least 20%[14] participation of the leading, however, there are some differences. First of all, these are enterprises in which there is also a second seriously interested institutional investor. As it has been already noted, this could be also a potential investor, who may acquire the remaining non-privatised capital.

What is specific here, is that this group includes enterprises which in principle meet the criteria for the previous group, but there is no evidence of connections between the first two leading funds. Thus, here the autonomy of institutional investors is one of the underlying assumptions. Therefore, in the first place, the group includes those enterprises which were dropped from the previous group only because of such connection. Besides, the group incorporates enterprises with lower total share of privatised capital (up to 40%), i.e. enterprises in which, after further cash privatisation, new minority shareholders may emerge. The residual package of unsold shares may vary from 40% to 60%, i.e. the new owner may immediately become a majority shareholder. The 40% ceiling for the lower level of the unsold share of the enterprise was picked because of the requirement to reserve 10% of the capital for restitution claims. Even if these 10% are not entirely utilised, they still cannot be included in the package for cash privatisation. The new shareholder will not be able to secure *ex ante* majority control. Therefore, these enterprises could be regarded as controlled by shared minority interests. Table 9 provides the characteristics of the enterprises defined in accordance with these criteria.

**Table 9**

**Characteristics of Enterprises from the Group with Shared Minority Control**

| *Enterprises in the group* | | *Capital of the group (thousand BGL)* | | | *Average size of the privatised share per enterprise (%)* | | |
|---|---|---|---|---|---|---|---|
| Number | Share in all 1,040 privatised enterprises (%) | Total amount of capital | Average amount of capital in one enterprise | Median | At the auctions | After distributing unsold shares | After distributing free shares |
| 131 | 12.6 | 22,467,420 | 171,507 | 95,400 | 53.42 | 53.50 | 60.10 |

| *Average share of majority shareholders in the total capital of the enterprise (%)* | | | | | *Average share of minority shareholders in the total capital of the enterprise (%)* | | |
|---|---|---|---|---|---|---|---|
| Share of the two funds, participating in the „pair“ | Share of the leading (first largest) funds | Share of the second largest funds | Most frequently encountered leading fund | Most frequently encountered second largest fund | Share of the third largest fund | Total share of the third, fourth and fifth largest funds | Total share of individual investors |
| – | 29.41 | 10.99 | „Doverie“ Fund | „Bulgaria“ Fund | 5.86 | 7.36 | 12.30 |

*Source: Calculations of the author, based on data from the Center for Mass Privatisation.*

[14] The possibility for the emergence of a powerful minority stockholder in the subsequent cash sale is the reason for including in this group some enterprises with shares which are close to those of the leading fund but are lower than 20%.

In this group, several points are worth noting. Most of all, it is the high average size of the privatised enterprises in which this form of corporate control is implemented. The average share of the privatised capital is lower because of the level of this classification criteria is lower for the group. At the same time, the reduction of the number of individual investors is also interesting, which because of the specific features of mass privatisation is an independent variable.

The higher participation of the third largest funds is also characteristic for this group. Although, once again, the size of the third largest funds is considerably smaller than that of the second largest, the gap is much more narrow, compared to the gap in the previous classification groups. In fact, here the picture is distorted by the inclusion of enterprises with low shares of the third largest funds, but with potential for the emergence of a new shareholder after the privatisation of the residual package of shares. Recalculated for the enterprises in which at least two-thirds of the capital is privatised, the share of the third largest funds increases twice, up to 10.75%, the share of the second largest funds increases by only 15%, while the share of the leading funds is practically unchanged. For the first time, a wider representation of funds following the third largest is observed – the total participation of the fourth and the fifth largest funds is within the range of 1.5%, whereas in the previous classification groups it is quite lower.

It is also noticeable that the amount of the capital, controlled by the leading fund, remained quite high. The differences in the ratio between the shares of the first two largest funds are not significant. It should not be forgotten that as a rule the criteria for this group exclude linkages between the first two largest funds, which makes the picture of shareholders participation much more diversified. In this classification group there is again a total domination of „Doverie" Privatisation Fund as the most frequently encountered leading fund. It is notable that „Bulgaria" Privatisation Fund is the most frequently encountered among the second largest funds, however, there is no data that it has participated in a „pair". The same situation arises after filtering out these two funds – the next most frequently encountered are „Troud and Capital" and „Orel Invest" Funds, for which there is no evidence of joint participation.

### Limited minority control

The distinction of this group is relatively easier in comparison with some of the previous classification groups. Here are included enterprises with shares of the leading shareholder below 20% and above 10%, which is the upper level for the last classification group. Three companies, with shares of the leading fund below 10% make an exception, as they have no other institutional participation and at the same time the degree of privatisation of their capital is very high, nearly 90%. Thus, in their case the control functions of the leading minority shareholder cannot be blocked.

At the same time, classifying them in last group seems unjustified, as this group suggests a complex set of a number of relatively equal interests, as it is difficult to assume that individual investors will be able to oppose efficiently institutional shareholders in order to protect their own interests.

The group is quite small in terms of number of enterprises, and from this point of view is of marginal significance within the classification structure of newly emerging forms of corporate control. On the other hand, the average amount of the capital of these enterprises, although smaller than the average size of all privatised companies, ranks this classification group somewhere in the middle, compared to the other groups. In terms of degree of privatisation, the group is also of interest, because on average more than two-thirds of the capital of the companies has been privatised, and according to the formal criteria, the privatisation process is completed.

**Table 10**

**Characteristics of Enterprises from the Group with Limited Minority Control**

| *Enterprises in the group* | | *Capital of the group (thousand BGL)* | | | *Average size of the privatised share per enterprise (%)* | | |
|---|---|---|---|---|---|---|---|
| Number | Share in all 1,040 privatised enterprises (%) | Total amount of capital | Average amount of capital in one enterprise | Median | At the auctions | After distributing unsold shares | After distributing free shares |
| 27 | 2.6 | 2,788,176 | 103,266 | 51,897 | 62.48 | 62.60 | 69.67 |
| Average share of majority shareholders in the total capital of the enterprise (%) | | | | | Average share of minority shareholders in the total capital of the enterprise (%) | | |
| Share of the two funds, participating in the „pair“ | Share of the leading (first largest) funds | Share of the second largest funds | Most frequently encountered leading fund | Most frequently encountered second largest fund | Share of the third largest fund | Total share of the third, fourth and fifth largest funds | Total share of individual investors |
| – | 14.51 | 9.23 | Bulgarian-Dutch Fund | „Bulgaria“ Fund | 5.55 | 9.46 | 36.15 |

*Source: Calculations of the author, based on data from the Center for Mass Privatisation.*

Compared to all other classification groups, this group differs significantly in terms of the structure of shareholders participation. For the first time, the combined shares of the second and the third largest funds can outvote the leading fund. On the other hand, the fourth and fifth largest funds are really represented shareholders with an average share of almost 4%. Together with the third largest fund, they can oust out the second largest fund from controlling positions. In practice, under this structure of ownership the shares of all institutional investors are equally important for the effective control of the enterprise. It preconditions the increased interest of institutional investors in this kind of stock.

At the same time, the relatively high instability of such structure of corporate control is obvious, which actually is the reason for defining it as limited minority control. The indirect test, made by the comparison of the two most frequently encountered privatisation funds as first and second largest shareholders is again positive. Table 10 indicates that there is no evidence for joint participation of the two largest funds, which supports the previously made assumptions.

**Constellation of interests**

This is the last type of corporate control, which followed from the implementation of the mass privatisation scheme. It is obvious that the application of slightly modified criteria in defining the previous classification group, where the few[15] enterprise in which the leading fund had a share below 10% were placed in the group of limited minority control, will also influence the definition of this group. The constellation of interests group consists primarily of enterprises in which there is a complete absence of participation of institutional shareholders in the ownership[16]. Nevertheless, this type of control preserves as leading characteristics the equal footing and interdependence of the shareholders in determining their place in the system of corporate control in privatised enterprises.

Data on this group is limited, and for this reason it is not presented in a table. The enterprises in this group are 48, or 4.6% of all enterprises designated for mass privatisation. The total amount of their capital is (non redenominated) BGL 830,798 thousand and the average for one enterprise – BGL 17,308 thousand. The median is BGL 10,157 thousand, suggesting an even smaller amount of the capital of most enterprises. The average participation of privatisation funds is 0.02%, and of individual investors – 82.42%, which is practically the average size of the privatised share of these enterprises.

What is striking here is not so much the lack of interest of the privatisation funds, but the enormous interest of individual investors. It is possible that these may be cases of undervalued enterprises, the employees of which have combined the investment vouchers of their families with the distributed free shares in an effort, if at all possible, to secure their jobs.

In fact, this form of corporate control, in the absence of developed market for securities, in practical terms means a lack of corporate control.

**Group of enterprises, for which mass privatisation did not lead to a specific form of corporate control**

In a number of enterprises, the Bulgarian mass privatisation scheme initially offered very low shares of the capital for privatisation. There was a substantial number of cases (264 or 25% of all enterprises, privatised through mass privatisation) when enterprises were excluded from one or more of the privatisation auctions. The share of their capital, privatised under the mass privatisation scheme, was so low that they cannot be classified

[15] In reality, the number of such enterprises is quite high, however, most of them have a very low share of privatised capital. This required to place them in special untypical group, which is discussed below.
[16] Several enterprises make an exception. They have less than half percent participation of privatisation funds, substantial share (over two-thirds) of their capital is privatised, and they have a significant number of individual shareholders. These enterprises cannot be placed in the group of limited minority control as, at least theoretically, their structure of ownership does not allow such form of corporate control.

in any of the discussed above groups of corporate control. The reason is that it is not possible to project exactly in what way they will be privatised, and hence what forms of control will emerge.

Nevertheless, the share of these enterprises is substantial and it is worth noting some characteristics of the group. The total amount of the capital of these enterprises is BGL 153,610,012 thousand, or approximately three quarters of the capital offered for privatisation. The average size of one enterprise is BGL 581,856 thousand, or two times more than the average for the entire set of enterprises, offered for mass privatisation. In fact, this group includes almost all of the large enterprises. The average part of privatised capital amounts to only 19.94%, after the distribution of free shares to employees and the administrative redistribution of the remaining shares, which were not sold at the auctions. The actually privatised share of the capital is approximately 16%, while the largest shares of privatised capital amount to approximately 30-35%[17]. The average participation in the capital of the privatised company is 8.14% for the leading fund, 1.33% for the second largest fund and 10% for individual investors. At the same time, although their shares are insignificant, there are third, fourth, and fifth funds. The most frequent encountered leading privatisation fund is „Multigroupelit“.

Certainly, the situation is much more complicated – some of these enterprises were already privatised by a majority owner, for others there were negotiations and in some cases large shares were privatised after the end of mass privatisation. There are also some cases, where the leading funds hold more than 30% of the capital. Although as a whole mass privatisation led to more dispersed ownership of large enterprises, eventually they proved to be with quite concentrated corporate control, even if it has been achieved by other privatisation techniques.

## 2.3. Summary of the results

The objective of this analysis was to examine the newly emerging structures of various forms of corporate control ***as a result of mass privatisation***. In order to present the whole picture, it is necessary to eliminate the enterprises with undefined forms of corporate control. Thus, as a final summarised result, the share of enterprises with the most „concentrated“ form of corporate control – *exclusive majority control*, amounts to 34.49% of the cases included in this group; the share of the enterprises with *shared majority control* is 18.53%, respectively. *Exclusive minority control* is observed in 20.46% of the cases, *shared minority control* – in 16.86% of the cases; *limited minority control* – in 3.47% of the cases; and finally corporate control exercised through a „constellation of interests“ – in 6.18% of the cases.

[17] There were three exceptions of enterprises in which the share of privatised capital was around or a little over 50%. The non-privatised share does not allow their classification in the group of constellation of interests, in spite of the fact that the distribution of shareholders ownership meets temporarily its criteria.

These results point out several trends. First of all, there is an explicit dominance of the „concentrated forms" of corporate control. Here it was also taken into account that because of the low share of privatised capital under the scheme of mass privatisation, quite a few of the companies have remained undefined, but nevertheless, they have acquired, or are acquiring such form of control. The „concentrated" form of control allows shareholders (or a group of shareholders) to exercise maximum control over the managers of privatised companies. In a similar line of observation, in a number of cases top managers of privatisation funds are directly involved in the management of privatised companies. This specificity is displayed both as dominance of majority over minority forms of control and as a dominance of exclusive over shared control.

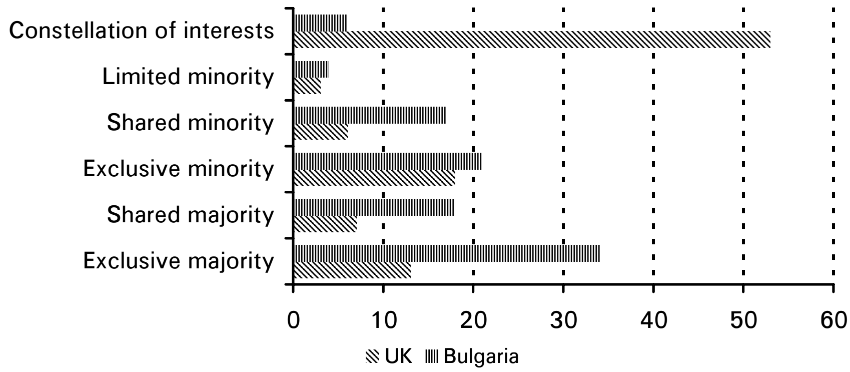
The weak presence of forms with dispersed shareholders ownership, where smaller shareholders play a real role in corporate control, is also noticeable. On the other hand, small shareholders are represented in all privatised companies. This relates not only to individual shareholders, but also to a great deal of funds with minority positions in the privatised companies.

At the same time, the „concentrated" forms of control as a rule are in smaller enterprises with shared forms of control. To a certain extent this is normal as it is easier to achieve concentration of ownership in smaller enterprises. On the other hand, however, it reflects the existing desire to avoid participation in enterprises in which there is a dominant interest. To some extent this desire can be explained by the insufficient provisions for legal protection of minority shareholders. However, it also reflects the dominant idea of the way of participating in corporate control of privatised companies – either everything or nothing.

An overall idea of the evolving specific features of corporate control in Bulgaria can be shaped by a comparison with similar forms of control in developed market economies. Figure 4 provides such a comparison by contrasting data from this study to data from Scott's study of 250 corporations in the UK to which we referred to in the theoretical analysis. The choice of this comparison is determined by the methodology of this study which follows, albeit with some specific modifications, the methodology of the UK study. These modifications are related to the differentiation of some forms of corporate control, unknown in Bulgaria or going beyond those forms, emerging as a result of mass privatisation. For this reason the UK data is recalculated only for those forms, common for the two countries. At the same time, in order to achieve better comparability, companies in which corporate control is not well defined were removed. Thus, Bulgarian data was reduced only to cases with clearly defined forms of corporate control. It should be noted that what is meant here is actually a juxtaposition and not so much a true comparison, as the latter is difficult to be made because of the radical differences of the two countries in terms of legal systems, development of stock markets and the like.

**Figure 4**

**Structure of Corporate Control in Samples of Companies from Bulgaria and UK (%)**




In spite of some similarity of the models, determined by the dominance of exclusive over shared forms of control, pointing to the identical preference for sharing the control in the least possible cases, the overall picture suggests a very important difference.

The most significant difference is in the share of the forms of corporate control, based on the complex interaction as is the case of constellation of interests. The substantial fragmentation of ownership, in which the largest shareholder does not control more than 10% of the capital of the company, can provide efficient control only in the presence of functioning and developed capital markets. In this case, the efficiency of the management is controlled by the trends in the prices of the stock of the respective company.

This form is practically absent in Bulgaria, which has a twofold significance. On the one hand, the underdeveloped capital market does not allow the presence of such form of corporate control. On the other hand, the lack of diversified ownership in joint stock companies does not encourage active trade in corporate securities.

* * *

The mass privatisation scheme, implemented in Bulgaria, suggested two possible ways to develop efficient structures of corporate control. On the one hand, significant shares of the capital of a large number of relatively small and medium-sized enterprises were offered for privatisation, which developed preconditions for substantial privatisation of their assets within the framework of the mass privatisation. On the other hand, mass privatisation aimed at considerable diversification of ownership among a wide circle of investors. The attainment of this objective was facilitated by the relatively limited share of the capital of enterprises, offered for a voucher privatisation, by the regulations restricting the ownership of institutional investors in enterprises, designated for mass privatisation, as well as by the competitive mechanism for acquiring participation in the ownership. The legal framework in effect defined privatisation funds as investment intermediaries. This, to a great extent, replicated the Czech model and ultimately reflected the broader intentions of creating an active capital market, which is impossible without a wider diffusion of the trade with securities among the medium and small-sized investors. Finally, this was an orientation towards structures of corporate control, effected through the capital market.

At the same time, the possibility to transform privatisation funds at a certain stage of the process into holding companies was also envisaged. This is essentially an orientation towards forms of corporate control, in which the concentration of ownership in a small number of shareholders leads to consolidation of corporate control. This leaves the capital market aside, corporate control becomes more direct and in some cases shareholders can intervene in the management of the privatised company. This option probably reflected the underdevelopment of the capital market and the objective inability to trade many of the enterprises on the capital market.

The study has shown that privatisation funds used largely the second possibility and concentrated corporate control both by various preliminary agreements in the early stages of the privatisation process, and by transforming privatisation funds into holding companies. This conclusion is in a certain sense supported by the findings of the sociological survey, presented in the first report which, however, examines not only the case of mass privatisation.

However, this situation could be hardly attributed only to the underdeveloped capital market. Obviously, there are also other deeply rooted underlying reasons which are related to the generally underdeveloped market relations in the economies in transition. A similar process was observed in the Czech Republic as well, where after the initial boom on the stock exchange, the trade froze at a low level. This question can be examined from another perspective – the domination of concentrated forms of corporate control as a local repetition of global historical trends. Everywhere, the initial forms of corporate control are direct exclusive unity of ownership and control. The diversification of ownership among many agents, and along with that, the complication of its connection with control, come at a much later stage, when there are stable and durable relations between economic agents, and highly developed legal frameworks, allowing corporate control through the market.

In the overall evaluation, it is very tempting to attribute the adverse development to economic policy and to put on its record the discrepancy between envisaged corporate control and actually established structures. Such judgements would mean to ignore the interest of new owners to concentrate control in the least possible number of hands. A power policy contrary to this interest may induce withdrawal of investors from privatisation and could even delay it further. In our opinion, the objective analysis requires to recognise that the existing trend towards concentration of ownership and control corresponds to the current stage of development of market economy in Bulgaria.

At the same time, it should be taken into account that the outcome of the analysis contains a number of contradictions. On the one hand, the concentrated forms of corporate control prevail with their inherent approaches to management, dividend policy, and finally to smaller shareholders. On the other hand, there is an enormous number of public companies, which apart from being impossible to be traded on the market, pose quite different requirements for the relations between large and small owners, for the motivation of the latter and, ultimately, for the interest of smaller shareholders in the privatisation process.

The understanding of these contradictions, which make the positions not only of individual shareholders but also of institutional minority shareholders losing, found expression in a number of proposals for amendments in the legal regulation of the agents of mass privatisation. The concentrated presentation of these proposals is the Action Plan „*Policy for Corporate Governance Development in Joint-Stock Companies in Bulgaria*", developed within the framework of the Corporate Governance Initiative for Bulgaria. The proposals focus primarily on providing possibilities for small shareholders, who practically do not receive income from their equity in privatised enterprises, to sell it at a fair price. Probably in the end this will be one of the envisaged outcomes.

The important issue of the blocked capital market, however, remains open. If the attempt to expand the base of small shareholders and, hence, the number of small investors fails again, it is difficult to see how the stock exchange will become more active. The tendency in modern economies large strata of the population to participate directly or indirectly in the investment processes through pension and social funds, suggests that the capsulation of ownership within the hands of a small number of large shareholders cannot be regarded as an efficient solution of the problem.

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