Corporate Governance Transformation in Transition Economies: Evidence from Bulgaria*

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Summary

The paper presents study of corporate governance evolution in Bulgaria and its convergence to EU structures. The author discusses the traditional approach to separation of ownership and control in transition economies and modern ideas about the need for changing corporate governance paradigm. The study analyses main ownership and control structures in the Bulgarian industry and specific property-rights structures in corporatized state-owned firms, privatized firms and established de novo private enterprises. The research reveals the main constraints on corporate governance convergence to European structures in Bulgaria as the emerging enterprise sector duality and inefficient property-rights structures based on the state-owned firms transformation. The study analyses different paths for corporate governance and country development in the short run.

1. Introduction

This paper aimes at describing the evolution of ownership and control structures in Bulgaria and their convergence to (or divergence away from?) the developed market economies. Section 2 discusses methodological issues of separation of ownership and control in a transition context. Section 3 describes emerging ownership and control structures in the Bulgarian industry. Sections 4 analyses specific ownership structures in corporatized state-owned firms, privatized firms and established *de novo* private enterprises. Section 5 reveals the basic constraints on corporate governance convergence to the Western structures in Bulgaria and different perspectives for country development in the short run.

2. Separation of Ownership and Control in Transition Economies: Methodological Issues

The conventional approach to ownership and control structures and their effects on firm performance encounter difficulties to explain the real business behaviour in transition economies. This approach is based on some basic assumptions. The main hypothesis is that state-owned firms would perform less efficiently than private firms (property rights hypothesis). Four basic types of firms by ownership structure were observed in transition conditions: traditional state-owned enterprises (SOE), corporatized state-owned enterprises (CE) in the state sector, privatized enterprises (PRE), and private enterprises established *de novo* in the private sector. The basic assumptions are that state firms (SOE and CE) are less efficient than privatized firms (PRE), and privatized firms are less efficient than private firms established *de novo* (POE).

The main hypothesis about control types in the private sector is that interests of managers and owners diverge and management-controlled firms are less efficient than owner-controlled firms (Berle-Means thesis). In the transition economies, the dichotomy of insider-controlled and outsider-controlled firms is used as a basic discinction. In

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the group of insiders, manager-controlled and worker-controlled firms are studied; in the ousider-controlled group, domestic investor-controlled firms and firms under foreign investor control. Basic assumptions about firm performance by control types are that insider-controlled firms are less efficient than outsider-controlled firms, worker-controlled firms are less efficient than manager-controlled firms, and domestic investor-controlled firms are less efficient than foreign investor-controlled firms (see for example, EBRD, 1995).

There is a wealth of literature on the effects of ownership structures on firm performance in transition economies. However, the results of empirical studies are mixed concerning any significant difference in performance of *state and privatized firms.*[1] Many studies support hypotheses that *private firms established de novo* are more efficient than both state and privatized firms (for survey see Bilsen, Konnings, 1998). However, these studies using conventional state-private firms dichotomy cannot explain the basic relationship between traditional state-owned and new established enterprises under conditions of primary accumulation of capital in transition economies. There is no simple correlation between private sector share and either national economic performance or progress in transition (Estrin, 2000). There is also no significant evidence that *insider-controlled* firms underperform *outsider-controlled* firms.[2]

Attempts for a deeper understanding of ownership evolution and output decline in transition are based on studies of U-shape of industrial output. A number of papers explain the decline in output with supply side distortions, as disorganization in historical links of production (Blanchard, 1997), labor market frictions (Atkeson, Kehoe, 1996), credit constraints (Marin, Schnitzer, 1999), and demand shocks (Repkin, Walsh, 1999).

In southeastern Europe the evolution of the GDP during 1990–95 corresponds with the hypothesis of the U-shaped response of output to transformation shocks (Blanchard, 1997). In Bulgaria after the fall in GDP during 1990–93 (1991: –11.7%, 1992: –7.3%, 1993: –1.5%), there followed a recovery in 1994-95 (1994: –1.8%, 1995: –2.1%). Similar trends have been outlined in Romania and Albania. However, the optimistic visions about 1996 and the following years proved unrealistic (EBRD, 1995). In 1996, GDP fell sharply by 10.9% in Bulgaria. A similar, *second* sharp fall in GDP since the beginning of the transition was also observed in Romania (1997: –6.6%) and Albania (1997: –7%). The optimistic theoretical expectations underestimated the fundamental reasons for further instability that were still existing and worsening. Under transitional conditions the processes of reallocation and restructuring shaped specific ownership and control patterns and corporate governance structures.

It is known that there is no theoretical model of development of the economies in transition yet and the new science Economics in Transition is still to be developed. However, a specific economic system, non-planned and non-market, *emerges,* and underestimating this trivial fact may lead to serious misunderstandings and failure of policy-makers and potential investors. In the process of data collection of our studies some of the Bulgarian managers who took part in the questionnaire survey stated that 100% of the Bulgarian economy was gray economy and one could not do business without taking part in this shadow, back side kind of the economy. In Romania, the reorganization of state-owned enterprises in autonomous state enterprises and commercial state-owned enterprises was surprisingly similar to the process of corporatisation of state-owned enterprises in Bulgaria with its multiple unfavorable consequences for the enterprises and the entire economy. In Albania, we were startled by the discrepancy between the optimistic 1996 report of the representatives of the World Bank about the macroeconomic indicators of the country which could be an example for the other countries and the data collected by us on the enterprise level revealing their deplorable condition. These and many other facts and contradictions, which we observed, made us reconsider not only the economic issues in the transitional economies but also the approaches to it. Some of these methodological observations are presented below.

2.1 Failures of the conventional approach

Theoretical base. The developed theory on separation of ownership and control is based only on the American experience and few other developed market economies as Germany, Japan, UK, France. There is a big gap between this practice and the reality of transitional economies. The direct application of the results of this theory in a completely different economic environment like the economies in transition would be dogmatic and fruitless.

Ownership and performance. The main issue is whether relationship between ownership structure and performance under transition conditions can be interpreted as causal. Firms, which are selected for privatization, are not selected randomly. There would be reverse causality from performance to privatization. The differences in privatization rules across regions and countries can determine foreign ownership structure and insider-outsider control structures in general.

[1] See for a survey of the literature, Megginson and Netter (1999), Boardman and Vining (1989) and Bevan et al. (1999).

[2] Among recent studies see Jones and Mygind (1999) for the Baltic States, Peev (1999a, b) for Bulgaria, Romania and Albania, Djankov (1999) for Georgia and Moldovia).

State sector – private sector dichotomy. The typical relationship between private firms established de novo (POE) and state owned enterprises (SOE) is based on 'input-output' price transfer scheme, where private firms, owned by state enterprise managers, are suppliers and customers of the same state enterprise. The consequences are that state enterprises bear all residual risk, private firms take the profit, and state enterprises decapitalize. In fact, relationships between state and private enterprises are rather between victim and vampire than between equal economic agents.

Privatized firms – state-owned firms' dichotomy. Some private owners are as inefficient as the former state owner after privatization. By definition privatization is a political process directed to efficient reallocation of resources. However, in many cases the privatization process only leads to national wealth re-distribution. Many privatized firms are run by kleptocrats with aiming actually at plundering the firms' assets and to transfer money abroad. Privatization is misleading concept. The real economic phenomenon is re-distribution with *random consequences* about efficient firm performance.

Insider control – outsider control dichotomy. The distinctions made between insiders and outsiders have rather artificial nature in a transitional context. Insiders and outsiders are usually described as groups with distinctive interests. But in fact, within these groups there are significant differences — between young and old workers, between top and other managers. Besides, there exist wheels within wheels type of interests of the top managers and outsiders which are informal and frequently mean evading the law. Therefore, they are difficult to detect. By definition enterprises privatized within the MEBO scheme are under insider control. In fact, the financial sources for privatization belong to groups of interest outside the enterprise. Managers are only their 'post boxes' and 'puppets'. The real control is held by outsiders.

Transitional institutions with transitional functions. New established private and state banks, corporatized state-owned companies, board of directors are new institutions and new instruments that should have aimed at increasing either competition or managerial incentives for restructuring. However, these new so-called 'market' institutions were designed and simply misused for state-enterprises with the effect of decapitalizing the population. Conventional market economy terminology leads to misunderstanding of emerging 'crony' capitalism.

Reallocation and restructuring. The basic observed facts of ownership evolution are rather prolonged state enterprises decapitalization than exit. There are two types of private firms established de novo, normal ones and 'crony' firms with close political connections. In fact, the process of reallocation is characterized by primary accumulation of capital from state firms to private ones. Important stages of state enterprises restructuring and ownership evolution are: 1) decapitalization; 2) *primary* privatization; 3) resale and *secondary* privatization; 4) restructuring, exit or nationalization. After primary accumulation of capital, private firms have met two options in middle term, either to restructure or to exit.

Economy of 'crony capitalism'. The optimistic theoretical expectations in 1995 for Bulgaria, Albania and Romania underestimated the emerging system of 'crony capitalism' with a main network among former communist nomenclature circles, weak state institutions and 'crony' firms. The typical motivation of the agents in this symbiosis has been to ransack national wealth. The industrial policy was directed towards slow privatization of the state-owned enterprises, which led to their asset stripping. The private sector existed mainly in the form of newly established domestic small firms, many of them 'crony' firms. The banks pumped resources from state institutions and state budget and transferred them as loans to 'crony private' firms and state loss-makers. The latter shifted financial resources through transfer pricing or other devices to 'crony' private firms with strong political connections. Some of the particular features of this economy that can be described as 'crony capitalism' are the following: first, lack of, or undeveloped institutional constraints such as property rights, governance structures, market institutions. Second, post-socialist rent-seeking culture. Third, economic agents are quasi-state officials, quasi-owners, and quasi-managers with a short-term existence. Fourth, the objectives of new owners of privatized enterprises are not profit maximizing. Fifth, winners in the specific transitional competition are those whose objectives were asset-stripping and export of capital.

2.2 Theoretical starting points for further analysis

Stake-holder approaches. In the transition literature, there are attempts for more correct approaches reflecting both specific transition reality and modern theories of the firm.[3] These studies focus on all the firm stakeholders and define corporate governance as the set of mechanisms that translate signals from product markets and factor markets into firm behaviour.

Property rights literature may also give useful insights stressing on the firm as a set of contracts with different stakeholders where the so-called 'firm owners' are only owners of financial assets and nothing more, and the so-called 'firm privatization' means only financial assets transfer (see Alchian, Demsetz, 1972). The significant

[3] See for example recent articles by Mygind (1999); Berglof and Thadden (1999).

difference in the existing basic structures of ownership in transitional economies can be found in their different origin. The difference in the origin of the studied enterprises presupposes a difference in their starting positions, and not so much in their behaviour, which in a short term may show similar features because of the common market environment.

According to the classical criterion, corporations may be classified by the following types of control: 1) private control — one party-individual, family, financial group, etc., owns 50–80% of shares; 2) majority control — one party owns 50–80% of shares; 3) minority control — one party owns 20–50% of shares; 4) control by legal device; 5) managerial control — if there is no base for external control (Bearle, Means 1932). Other scholars use this classification in order to provide a basis for studying the evolution of control structures in a mixed economy. It also serves as a starting point for creating a corresponding classification of types of control in a transition economy. A dominant ownership stake by some individual or group is presumed to yield effective control of the firm. The basic deficiency of this approach is that the formal ownership of a block of company shares is only one of the relevant indicators and does not automatically determine who has real decision-making authority in a given company. The more important criteria for the type of control in enterprises in the transition economies are qualitative ones. The property rights approach, considering such problems of ownership and control structures as who owns company assets, who is the bearer of the residual risk, who is the decision-maker, who nominates the members of the Board of Directors, etc., and the idea of managerial discretion in relation to different types of control provide some useful points for further analysis.

Transition environment approach. The conventional approach to corporate governance in transition economy overestimates the importance of property rights reform and private ownership for transforming the totalitarian state and economy. It underestimates other main factors for firm performance, such as corrupt government and anti-national government policy, high discretion of foreign institutions as IMF and EU into internal affairs in transition economies, country-specific initial conditions, nationalist attitudes, emerging underground economy. The key features of the new transition environment approach are based on the following assumptions and empirical agenda.

Macroeconomic indicators are not enough. Traditional macroeconomic indicators do not capture business sector efficiency, and a more important pointer is stabilization of market institutions (see WIIW, 1999).

Corruption issues. The survey by the World Bank and the EBRD, published as part of the EBRD's annual Transition Report, concludes that bribery and corruption remain widespread due in part to the continued reliance of companies on direct ties to government officials (EBRD, 1999).

Shadow economy. Some authors estimate that the underground economy accounts for more than 40% of total GDP in Azerbaijan, Georgia, Russia, and Ukraine, and 20% or more in many other economies. What drives firms underground, they suggest, was not high taxes but excessive regulatory discretion, weak rule of law, and corruption (Johnson, Kauffman, 1999).

Changing policy of international organizations. The new EU policy to enlargement is based on country-specific development. The World Bank's new approach to development is stressing on both economic and social development dimensions. The next step of development of this approach is implementing nationalism, anti-nationalist indicators in ownership and control transformation analysis.

The common research framework of the study was based on an integral theoretical approach. We used the property rights approach in the study of ownership and control structures of business organisations, and the literature dedicated to the empirical study of the relationship between ownership and performance in the study of the relationship between ownership, control and business behaviour. The core of our analysis of business behaviour does not focus on the profit maximisation but the *utility-maximisation hypothesis* (De Alessi, 1983). In economies in transition, the specific semi-market environment, characterised by high political uncertainty, macroeconomic instability, strong fluctuation of input and output prices and financial performance measures influences managerial behaviour. The inefficient behaviour of owners (observed in the mixed economy, too) is much more typical of transitional economies because of the particularities of the primary accumulation of capital. The utility-maximisation hypothesis about individual choices, made by managers, workers and owners under transitional institutional constraints has been accepted as a main connecting behavioural hypothesis.

The present survey uses information collected from the Bulgarian Central Statistical office (1990–99) and empirical studies of industrial enterprises during 1992–96. The last empirical study was carried out during the period August–December 1996. A detailed description of the methodology of this study is presented in Peev (1999). A summary of the basic results of the survey is presented below.

3. Ownership and Control Transformation in Bulgarian Industry

3.1 Ownership structures

The Bulgarian industry is characterized by four major groups of firms, classified according to the type of ownership: traditional state-owned (non-transformed), corporatized state-owned, former state-owned firms which have been privatized, and private firms established *de novo*.

Private sector. The main factor contributing to the development of the private sector in Bulgaria during 1992–96 was the creation of new private enterprises. The share of privatised state-owned enterprises was insignificant. Privatisation has made a little progress and up to now it has been applied mainly to small and medium-sized enterprises. Only 2,396 enterprises have been privatised for the whole period (1992–96), the major part of them is municipal property or parts of enterprises. Substantial progress in privatisation was observed in 1997–98 connected with the finalization of a number of large-scale deals as well as the completion of the mass privatisation. About 1,000 enterprises were privatised — entirely or part of them — through vouchers. In the period 1992–97 about 20% of total enterprise assets were privatized. In 1997 there was acceleration of this process, e.g. about 4% of assets were privatized through cash sales with proceeds of 421.4 mill. US-$. However, the preliminary data for 1998 show only 145.8 mill. US-$ privatization proceeds. The main reason for slow progress is the continuing fight for corporate control between different groups of interest and new 'crony firms'. By the end of 1997, the private sector accounted for nearly 58,8% of value added in the whole economy, i.e. 97,6% in agriculture and forestry, 42,7% in industry, and 62,8% in services.

The total percentage of the privatized assets since the beginning of the privatization process on 1 January 1993 till the end of November 1999 is 46.3%, which is more than 70% of the state assets due to be privatized in the mid-term. Between 1 January 1993 and 31 December 1999 the total privatization effect is 6,501.663 mill. US-$. The distribution of concluded transactions by sectors is as follows: industry –30,2%, trade –24,5%, agriculture –13,8%, tourism –11,1%, others –20,5%. Privatization of the basic part of the companies in *manufacturing* has finished. Some of the big privatized companies are: 'Balkan Airlines, 'Neftochim', 'Petrol', 'Agropolichim', 'Himko', 'Antibiotic' — Razgrad, 'Yambolen', 'OtK' — Kardjali, 'Kremikovtsi', 'Promet' — Burgas, 'Asarel-Medet', 'DZU' — Stara Zagora, 'Alumina', 'Arsenal', 'Beta-Cherven Bryag'. *Energy utilities* privatization has barely started. The privatization process of the *Telecommunication Company* is ongoing. In the *financial sector,* the United Bulgarian Bank (July 1997); the Bulgarian Post Bank (the end of 1998); in 1999 Society General bought TB Express and Reagent Pacific — Hebros Bank have been privatized.

The government plans to conclude privatization of the most important enterprises in manufacturing and telecommunications by the end of 2000 by selling via privatization intermediaries and consultants, including the privatization of 'Bulgarian Telecommunications Company', of the holding companies 'Bulgartabak', 'Incoms Telecom' and 'Balkancar', and by issuing a licence for a second GSM-operator. All state-owned minority packages of shares of the enterprises which were privatized by the end of 1999 are expected to be offered for sale. The privatization of companies in the sphere of *agriculture, forests, and transport* are expected to be concluded. Restructuring and preparation for privatization of the big monopolists in the *energy sector:* the National Electric Company and 'Bulgargas' as well as the central heating companies is starting. In the *finance sector*, it is expected that the strategy for privatization of Bulgarian banks in 2000 will be fulfilled, including the sale of all state shares in TB 'Biochim' by the end of June 2000 to a strategic buyer, and the sale of at least 67% of the capital of 'Bulbank' to a strategic foreign investor. In order to develop an efficient capital market, there is a plan to decrease state participation in 'Bulgarian Stock Exchange — Sofia' from 49% to 37%.

Corporatized state-owned firms. The main changes in state-owned enterprises are related to their transformation (corporatization). This was a process transforming former state enterprises into companies with 100% state participation. In general, this process has taken place mainly in 1991–92 and has developed at a considerably lower pace in the following years. After 1993, non-transformed state-owned and municipal firms decreased twice in number. This was due to two main reasons: first, the continuing process of corporatization and, second, the privatisation of non-transformed state-owned enterprises.

As a result of the progress made in privatization and enterprise restructuring, the non-private sector has decreased its share to 36.3% of gross value added and 43.3% of output, according to preliminary data of the Bulgarian Statistical Institute for 1998. Respectively, the share of the public sector in industrial production is 55.8% of gross value added and 56.2% of industrial output. Employees in the public sector are about 40–55% of the total employment in the Bulgarian economy, according to different estimations. There has been no official data for public sector assets for 1998, but it can be expected that their share has continued to be high.

3.2 Control types

Private and majority control. The prevailing types of control of private *de novo* and privatised companies are private and majority control. One group of the companies under private control is characterised by a dominant outsider stake of company assets. These outside institutional shareholders are: 1) firms owned by the company managers and 2) firms with managerial participation in ownership. Another group of firms under private control has a dominant workers' stake. But these firms are not as important as the former ones.

The companies under majority control are characterised by two groups of enterprises as well. Some of them

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show a dominant outsider stake especially when the large shareholder is a private firm. An essential feature of these enterprises is managerial participation in the company assets and the board of directors. The other companies show a dominant managerial stake of their assets. One party, usually a private firm owned by company managers, is the large shareholder in these firms.

These control structures are characterised by some key features: first, close relations between owners and managers; second, the large shareholder has formal effective control of the managerial behaviour through nominating the members of the board of directors, obtaining real company information, hiring and firing of managers. This control type diminishes the transaction costs for the monitoring of managers. These costs become lower than the ones of companies with dispersed ownership between many small shareholders; third, the large shareholder bears a higher risk and has stronger motivation to compel managers to adopt strategies maximising the shareholders' wealth.

Control based on enestablished property rights and interest groups. Despite 100% state participation in their ownership, the corporatized state-owned companies are mainly under managerial control and interest group control. These types of control are based on unestablished property rights and informal influence by groups other than the nominal owner, the State. This peculiar transition kind of control is implicit and unstable. Unestablished property rights are property right structures which fail to determine clearly who owns company assets, who is a bearer of residual risk, who is a decision-maker, who nominates members of the board of directors. In this ownership structure, however, there are different degrees of managerial discretion. Another key feature of the control structure of the corporatized state-owned companies is the influence of interest groups other than the State. In the Bulgarian state-owned companies these interest groups are trade unions, political forces, finance groups and other unattached individuals as non-formal leaders, for example. In the distinct companies they have different degrees of influence on management.

The key features of the control structures during 1992–96 were the following: first, in the private sector, private and privatised firms, there is strong owner type of control that is the base for constraining potential discretionary managerial behaviour; second, in the private companies managers participate closely in company ownership, they have stakes in private firms that are large owners of company assets, directly own companies and occupy seats on the board of directors; third, contrary to the conventional view that 100% state ownership means strong government control as well, the state-owned enterprises are characterised by separation of ownership from control and scope for managerial discretion.

Managerial control and minority control. After the mass privatisation in 1996–97 many companies, especially large firms, acquired a dispersed ownership structure. Their shareholders control insignificant property stakes and managerial and minority types of control emerged. There is separation of ownership and control and, thus, potential for inefficient managerial behaviour. A stage in the evolution of ownership structures which began at the beginning of 1998 is the fight between minority owners after the mass privatisation and outside participants for the acquisition of efficient control over the enterprises. This process will objectively lead to a concentration of ownership (though not necessarily to higher efficiency). Because of insufficient development of capital markets, both the stock exchange and OTC markets, the basic way to compete for corporate control are proxy fights.

In Bulgaria exists a corporate culture of post-totalitarian primary accumulation of capital. The share of the grey economy is assessed to be about 40% of GDP. In our study 70% of the firms in the sample estimate the share of the underground economy at over 50%. Corruption determines an unhealthy business climate. All these factors predetermine more specific owner objectives, which in the future may not be directed to development of the enterprises but rather to their decapitalisation and short-term use.

4. Emerging Property Rights Structures

The property rights approach examines ownership structure in different kinds of business organizations. The study uses this approach in an investigation of the ownership structure of corporatized state-owned, former state-owned firms that have been privatized, and private firms established *de novo* in the Bulgarian industry.

4.1 Corporatized state-owned firms

Property rights structure. Corporatised enterprises prevail in the state sector. Untransformed traditional state enterprises have an insignificant share and are actually of no importance for the development of the national economy. The property-rights structure of the corporatized state-owned company is characterized as follows: 1) state ownership of assets, 2) the state owns the right of residual risk, 3) the government appoints a board of directors, the latter manages and represents the company and designates managers, 4) the state has the right to sell its rights of central status and residual risk bearer. The state-owned company is a transition form of business organization between the self-managed socialist enterprise and the modern corporation. There is an essential difference between a state-owned company and a self-managed socialist enterprise. Here the employees are not agents of property rights. This is a peculiarity of the state-owned company in Bulgaria. In Hungary and Poland the workers' councils continued to exist after the commercialization of enterprises. The essential similarity between a state-owned company and self-managed socialist enterprise is the preserving of state ownership of assets.

The main agents of property rights in a state-owned company are the government as an owner and the managers. The function of risk bearing, according to property rights theory, is taken on by state officials and the function of management — by managers. However, the state officials are risk-bearers not because of their higher motivation for risk bearing, but because of their status. Who is the actual bearer of the residual risk after the collapse of CMEA and the shock stabilization programme in Bulgaria at the beginning of the 90s? While a given enterprise is in state ownership the government, as owner, is the economic agent which, according to the property rights theory, must bear the residual consequences from the shocks. The managers and the workers of particular enterprise have no liability with respect to the external difficulties felt by the enterprise. In practice, however, the state officials shift all the liabilities of the transition onto the enterprise. The state-owned company obtains the so-called 'autonomy', a hypothetical promise of freedom in the field of products, markets and investments. In fact, however, this is only quasi-autonomy because: first, the state remains the owner of the assets and shifts only the risk- bearing of the economic reform to the companies; second, the risk is again with the management, the employees, or the enterprise at large.

Business behaviour. Corporatised state-owned enterprises are characterised by an unestablished property rights structure. The only nominal owner is the government. The control rights are to be exercised by the Board of Directors, but the survey shows that the managers have the most active influence on decision-making. Ownership and control are separated in a specific 'transitional' scheme. This is due to the inefficient behaviour of the state in transition that withdraws from the control of enterprises, gives great managerial discretion and allows post-totalitarian accumulation of capital at the expense of the enterprises. The Board of Directors cannot fulfil its functions as a disciplining mechanism to managerial behaviour because it consists of people (including representatives of the private business) who have interests definitely different from the interests of the enterprises. Corporatised state-owned enterprises show passive managerial strategies to restructuring in all spheres of economic activity. These enterprises have the lowest performance indicators measured in profit/sales ratio and productivity in comparison to the firms with the other types of ownership structure. Their turnover and size of the workforce is the highest because the prevailing part of them is large-sized firms. A feature of corporatised state-owned enterprises is a very old structure of equipment.

The programs of the government for liquidation of state-owned loss-makers and 'isolation' and privatization or liquidation of other losing enterprises were being carried out slowly. The 'isolation' combined restructuring with limits on further borrowing. As as consequence of the 'isolation' of loss-makers their production decreased, hence decreasing their material costs. However, the biggest loss-makers continue to exist. In 1998 ten enterprises only are responsible for about half of inter-enterprises arrears. According to some estimation the size of total arrears is about 8% of GDP. In 1998 the government remained passive regarding restructuring, but its task will become more difficult in the first half of 1999, when in accordance with the IMF Policy Memorandum the isolation programme must be completed.

4.2 Privatized firms

Property rights structures. The typical property rights structure of the enterprises after their privatization is characterized as follows: 1) one party- private firm, personnel, managerial team, etc., owns a big stake of assets, 2) all the shareholders own the right of residual risk, 3) this party has the formal and factual right to appoint a board of directors, 4) all the shareholders have the right to sell their rights by public offering. This structure is similar to the ownership structure of the private companies established *de novo*. Both show a have concentration of the company assets in the hands of a large owner.

The ownership structure of the enterprises after the 'mass privatization' is different. Their key feature is dispersion of the ownership between many small shareholders, privatization funds, financial institutions, etc. The main peculiarities of this property rights structure are: 1) many owners of assets and no agent has real power based on his shareholding or strategic position, 2) all the shareholders own the right of residual risk, 3) formal right to appoint a board of directors, 4) all the shareholders have the right to sell their rights by public offering. This ownership structure is similar to the structure of the so-called 'managerial firms'. This will create problems of separation of ownership and control between small shareholders and managers.

The main agents of property rights in the privatized companies are the shareholders as owners and the managers. The function of risk bearing, according to property rights theory, is taken on by shareholders and the function of management — by managers. However, the owners have high-risk aversion, typically the large shareholders are both shareholders and managers. Who is the actual bearer of the residual risk after the privatization? While a given enterprise is in private ownership, the shareholders as owners, are the economic agents that, according to the property rights theory, must bear the residual consequences from managerial decisions. In practice, the large shareholders of the firm have very close connection with the managers. They consist of other firms owned by managers, outside firms with managerial ownership stake, etc. The privatized company obtains a specific autonomy: first, the owner of the assets is the risk-bearer as well; second, the risk- bearer is personal — a private firm or a private person; third, the government shifts the risk-bearing of the macroeconomic financial reform to the companies, and they become hostages of the potential government voluntarism.

Enterprise behaviour. Till 1995, the privatisation rate in Bulgaria was low. The privatised enterprises are small and medium-sized and are characterised by a variety of ownership structures. Enterprises with a highly concentrated ownership structure are most frequent. From the point of view of control structure, the enterprises under outsider control are prevailing over the ones under insider control. The institution of the Board of Directors in privatized enterprises is characterised by the most active behaviour in comparison to the behaviour of the Board of Directors in enterprises with other forms of ownership. On the whole, in privatised enterprises the managers have the highest influence in decision-making in the spheres of production and personnel, while in the spheres of managerial employment and compensation and the financial sphere — the Board of Directors is in charge. A specific case of coincidence between the dominant nominal owner and the real decision-maker in the firm are enterprises under the control of a foreign investor. In these enterprises there is no separation of ownership and control. On the contrary, we observe a very strong owner control and owner participation in the management of the enterprises typical of property rights structures in the so-called 'classical' capitalist firm.

Privatised enterprises are characterised by efficient managerial strategies to restructuring, the most active being the enterprises under foreign owner control. Privatised enterprises have better performance (profitability, productivity, and age of capital) in comparison to state-owned enterprises. However, such kinds of conclusions are doubtful because in many cases it is not ownership structure which determines performance, but the other way round. The privatization programmes select enterprises with better short-term prospects and there are specific firm characteristics determining whether firms are privatized.

After the *mass privatisation* in 1997–98 about 1,000 new enterprises were privatised. The typical ownership structure formed was dispersed ownership with managerial or minority owner control exercised by the new holding companies (former privatisation funds). Here separation of ownership and control emerges. A stage in the evolution of property rights structures that began at the beginning of 1998, is the fight between minority owners after the mass privatisation and outside participants for the acquisition of efficient control over the enterprises. This process will objectively lead to concentration of ownership (though not necessarily to higher efficiency). Because of insufficient development of capital markets, both the stock exchange and OTC markets, the basic way to compete for corporate control are proxy fights.

The problems with post-privatization restructuring of the already privatized enterprises will be on the agenda very soon. In 1998–99, the basic task of the government is the privatization of state enterprises and the liquidation of the unprivatised state-owned loss-makers. The main reason for slow progress in the privatization is the continuing fight for corporate control between different groups of interest and 'crony firms'. In 1998 the government preferred insider privatization, because of close connections between policy makers and managers. A large part of privatisation took the form of worker-manager privatization (MEBO).

4.3 Private firms *de novo*

Property rights structure. The ownership structure of the private firms established *de novo* has two main peculiarities. First, many firms are proprietorships, and very often their owners and managers are one and the same person. These firms have a similar ownership structure as the 'classical' capitalist firm known from the literature. Second, few private enterprises are companies. Their ownership structure is characterized as follows: 1) high concentration of the assets in the hands of one party — private firm, private firm coalitions, etc., 2) all the shareholders own the right of residual risk, 3) the large shareholder has a seat in the board of directors and appoints the other members of the board, 4) the shareholders have the right to sell their shares by public offering. The key feature of the ownership structure described here is that the large owners bring more risk, and their personal welfare is closely connected with the viability of the firm. Their motivation adheres to the motivation of the owner-entrepreneur of the 'classical' capitalist firm who is the sole bearer of residual risk and managerial initiative.

Enterprise behaviour. Private firms de novo have a more concentrated ownership structure than privatised firms. The dominant owner has a majority (50–80% of assets) or private control (over 80%). A typical dominant owner is the manager-owner, which is typical of the property rights structure in the 'classical' capitalist firm in the capitalism of the 19th century. In this ownership structure there is no separation of ownership and control, and a most efficient managerial behaviour is expected. The newly founded private firms show passive strategies to enterprise restructuring, which is explainable taking into consideration their origin. Private firms de novo show the best performance (profitability, productivity, and age of capital) compared to all the other firms. This indicates that in spite of the unfavourable semi-market environment, their ownership structure creates life-giving incentives of adaptation.

4.4 'Crony' private firms

The existence of 'crony' private firms is a specific case. During 1992–96 the system of 'crony capitalism' emerged with a main network among former communist nomenclature circles, weak state institutions and the criminal world. The industrial policy was directed towards slow privatization of the state-owned enterprises, which led to asset stripping. The private sector existed mainly in the form of newly established domestic firms with two characteristics: 'crony firms' and 'non-crony firms'. The Bulgarian banks pumped resources from state institutions and state budget and transferred them as loans to 'crony private' firms and state loss-makers. The latter shifted financial resources through transfer pricing or other devices to 'crony private' firms with strong political connections (OECD, 1997).

During 1997–98 the currency board together with the new government have reduced the possibilities for rent seeking 'crony private firms'. However, the road to the end of 'wild crony capitalism' turned out to be long. In 1997 about 29% of state-owned enterprises were still losing. In 1998 loss-makers are 40% of the state enterprises. They survive due to the growing inter-enterprises arrears, the lack of effective adoption of bankruptcy legislation and new 'crony firms'. There is a risky tendency of growth of the liabilities of the state enterprises in comparison to 1997 tolerated by the government. The large part of the losses (about 74%), and liabilities (about 63%) are concentrated in 26 big enterprises. Despite the limitations sets to the budget by the currency board, the 'black financial holes' keep on sucking in fiscal revenue and transfer state assets to private 'crony' firms.

5. Corporate Governance and Economic System Convergence to the Western Structures

5.1 Dual enterprise sector

The most important aspect of the enterprise sector in the Bulgarian industry during 1992–98 is its duality. There are simultaneously two types of enterprises and two types of corporate culture in the Bulgarian economy: normal and 'transitional'. The first type shows a clear structure of ownership (newly founded private firms and privatized firms with market motivated owners). The others are corporatized state-owned enterprises (including the biggest state-owned loss-makers), state enterprises in process of privatization, newly founded private firms and privatized enterprises with owners oriented towards the expropriation of state assets and other 'wild capitalism' attitudes. The grey economy and the household production for own consumption belong to the second group.

The share of the private sector in the GDP is likely to reach about 65% of GDP in 1998. The total amount of foreign direct investments was 1,849 mill. US-$. between 1992 and 1998. Foreign enterprises are expected to introduce a new market-oriented style of management. For the time being, however, these enterprises show both types of corporate culture and behaviour. The existence of the second type of enterprises and its interaction with the first type gives rise to a dual economic culture. The same economic agents have to show market oriented behaviour with the market-oriented subjects and perverse behaviour on other occasions. The macroeconomic signals of the currency board are refracted through this culture. It is difficult for policy-makers to predict enterprise behaviour.

5.2 Firm ownership heterogeneity and its evolution

The research reveals that in a transitional context the specific feature of state and private firm owners are: a) disintegrated state institutions, which withdraw from control of enterprises and give them pseudo-autonomy and non-owners discretion (for example, corporatised state-owned enterprises); b) private owners with specific corporate culture, aiming not at developing, but at plundering the enterprises (for example, some privatised enterprises). With these 'wild crony capitalism' owner objectives, concentration or dispersion of ownership, majority owner control or managerial control, the board of directors and other internal governance mechanisms are not a reliable institutional basis of forecasts for business behaviour. There is specific firm heterogeneity based on state enterprise evolution. The main inefficient property rights structures in corporatized-state and privatized enterprises during 1992–98 and their positive evolution after 1998 are summarised below.

Corporatized-state enterprises. The owner — the government — has withdrawn from control, and managers and other non-owners have discretion to decapitalise the enterprises in their favour. The efficient evolution of these enterprises is from control based on unestablished property rights to fighting for explicit corporate control and *privatisation*.

Privatized enterprises with perverse behaviour. First, these are privatised enterprises with dispersed ownership. Inefficient behaviour is shown not only by managers but also by the new owners. They are not entrepreneurs and do not have an owner's market motivation. There is a trend towards ownership concentration and new objectives of owners. *Secondary privatisation* is stimulated through internal mechanisms or capital markets. Second, these are privatised enterprises, whose ownership is concentrated, but their owners stand for a post-totalitarian corporate culture and pursue asset-stripping strategies. The efficient development of these enterprises requires *secondary privatisation* (possibly also, through liquidation) and a change of owners.

Privatized enterprises with market-oriented behaviour. First, these are privatised enterprises with dispersed ownership whose inefficiency is due to a high degree of managerial discretion. Ownership concentration and introduction of *governance mechanisms* for disciplining managers, known in market economy,need to be introduced. Second, these are enterprises where the behaviour of large shareholders is in favour of their development. Here, the basic problem is not the contradiction between owners and managers, but rather that between large and small shareholders. *Governance mechanisms* for protection of small shareholders are to be developed.

5.3 'Crony' capitalism evolution in Bulgaria

We do not know where the different countries stand in their development towards the end of an emerging economy of 'crony capitalism'. The level of privatisation and private sector development cannot be a fully reliable indicator. This is shown for example, in the case of Albania, a country with the highest private sector share in GDP among transition economies in 1996. We only can forecast different scenarios of country evolution. The first scenario for Bulgaria in the short run is the preservation of the financial stability under the control of currency board, restructuring of state loss-making enterprises, quick privatization and social tensions due to restructuring and post-privatization perverse behaviour. The second, pessimistic scenario assumes replacing the fixed exchange rate and a delay of both enterprise restructuring and social tensions. It seems, however, unlikely that people will once more be taken in by socialist slogans as they did at the beginning of the 1990s, and at the end of 1994.

The start of the accession talks by Bulgaria in 2000 resembles the beginning of the transition to a market economy in the 90's. Now as well as at that time, there are tangible discrepancies between the expectations and the real outcome of the processes. The expectations then were that privatization meant a heavy blow against the monopoly state ownership and the communist nomenclature; liberalization — a blow against totalitarian planning and totalitarian state; stabilization — setting hard budget constraints. Now, ten years later, it could be ascertained that none of these expectations was achieved. What actually happened was redistribution and the destruction of national wealth (not privatization), persistent damage to the economy through unfair competition and export of national capital and a bureaucratic financial chaos. There is a positive (but not qualitative) change in the major participants then and now at the start in the talks with the EU. There are no new political forces, there is no exhaustive analysis of what happened during the past ten years, there are no sentenced criminals (except for some petty crimes) and there is no true market ideology. This leads to suspicions in the public about a new discrepancy between the announced advantages and disadvantages of joining the EU and the real outcome of it.

In the recent history of Bulgaria, there are several examples of gross lack of sincerity with disastrous consequences for the people. Besides the road to 'market economy' after 1989, these are 'the building of communism' (1960–1980), of the 'developed socialism' (1970–1990), of Bulgaria with a 'qualitative new growth' (1985–2005). Consequently, analogies with the new aspiration to 'accession' are to be expected. Positive expectations are connected with the *revival of efficient industrial structures in Bulgaria*, deformed after the Soviet invasion in 1944. This means priority development of tourism, agriculture and the food industry, as well as the light industry among the traditional branches, development of modern information technologies, and closing down or restructuring of the sectors unable to produce goods for European markets. The latest surveys show that the basic factor for the economic recovery of the country in 1989–95 was the export to the EU, whereas there is no redirecting of products sold on the former market of CMEA to the European markets. Our accession to the EU is conceived as a long-term objective, that is why there are no concrete expectations of the very accession but rather of the preparation for it, e.g. through *new laws normalizing the relations between employers and employees.* The expectations are not only for a high standard in industrial relations, but also for an *easier access to capital* and increase in employment. If the accession process developed normally, the *main loser* should be the second 'transitional' sector in the economy described above. Losers would be the peculiar network among political circles, 'crony' firms and criminal world, who flourished in Bulgaria in 1992–96 and is now experiencing fading functions (but ready for revenge in the next elections). State bureaucracy is in the middle position typical of the managers before privatization. It will win in the process, but lose from the result. The hopes of all retrograde forces ('crony capitalism' network, communists, Russian oriented parasites) are that the Bulgarian population will be incapable of creating a government which will govern independently of the bureaucratic whims in Brussels (such as the idea that gypsies in Bulgaria do not have the same rights as Bulgarians), and that economic advice a la Harvard Institute for International Development will lead to a handful of wealthy people and ruin the common citizen (like in Russia). The vague intentions and inefficiency of the IMF and the European clerks feed these hopes. According to Bulgarian nationalists these expectations coincide with interests of circles from the so-called Great Powers (the USA, Western Europe, Russia) which look upon Bulgaria as a dependent state (dominated formerly by Russia, currently by the IMF, and in the future by the European bureaucracy). This explains the skepticism of the Bulgarian intellectuals with respect to the real winners after the accession to the EU.

According to the most optimistic views on the accession of Bulgaria to the EU, it could happen in 2006, according to the most pessimistic, in 2080. In 1998, GDP per capita in Bulgaria was 28% of the EU-15 average. There even exists a considerable gap in income levels between Bulgaria and transition countries such as Poland, Hungary and the Czech Republic. According to various estimations, if Bulgaria grew on average by 2 percentage points faster than these countries by 2020, it would only reach 65% of their level of GDP per capita. Even if the average rate of growth of per capita income in Bulgaria exceeded that in the three transitional countries by 5 percentage points, Bulgaria would reach 90% of the average level of GDP per capita of these countries in 2020. The objective lag in Bulgaria at the beginning of the talks shows that it is necessary to have a fundamental change in the economic climate in the country.

The uncertainty is tremendous and it is hazardous to make predictions in this area. But even now it can be taken for granted that only a miracle could help Bulgaria to have the internal resources for a significant positive change to a higher growth path. If there were a change in the business climate (positive or negative) in the near future (the next 5 years), it would be a result of a political decision made outside of Bulgaria. In a more distant perspective (10–20 years), a positive development can be expected due to the natural change of generations.

In the short term (1–2 years) the preservation of the currency board will be the basic indicator of a positive development of financial stability in the country. Positive changes in the business climate of the country will be connected with the dismissal of corrupt people from governing positions (less probably). A basic debate in Bulgaria is that there is corruption at high levels of state administration, but nobody is being punished. Another significant indicator will be the results of the parliamentary elections (May 2001). Two short-term scenarios for Bulgaria can be envisaged: The first is associated with the preservation of the status quo (relatively probably). This means that the new government will keep the same line of action. The positive side is the preservation of the currency board and the orientation to European integration, the negative side is conservation of bureaucracy, the existing political class, and the bureaucratic business conditions in Bulgaria, which would be normalized slowly step by step. The second option (pessimistic) is the formation of a coalition government (relatively probably). It would have vague responsibilities and a populist policy, and there would be a revival of the 'crony' capitalism and a government in the style of 1990–96 postponing the actual reforms, cancellation of the currency board, and a new lack of business rules. The realistic optimistic approach to Bulgaria is to expect the second best, that is to say, the first scenario described above.

In Bulgaria after 1997, the currency board together with the new parliamentary majority excluding former communist parties has greatly increased stability in the country. The present government under Prime Minister Ivan Kostov is the first Bulgarian government since 1990 with a clear orientation towards EU accession and a market economy. However, the legacy of the wasted years remains. The dualistic enterprise sector and the three inefficient groups of enterprises in the Bulgarian economy analysed above will respond differently to the signals of economic policy. This means that policy-makers have to be ready to deal with both market-oriented and pervasive responses to one and the same macroeconomic policy decisions in the short run (about till 2003). One of the basic issues to be addressed by policy-makers in Bulgaria is how to establish corporate governance mechanisms that will curb simultaneously inefficient discretionary behaviour by managers and owner.

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