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Corporate Control in Poland

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# Evolution of Ownership Change and Corporate Control in Poland

## 1 Introduction

At the beginning of the 1990s Polish enterprises began to move from the social to the private domain. Privatization was one of the main issues of the famous *Balcerowicz Plan*, which was a programme for transforming Poland into a market economy. Already earlier, some state enterprises had been turned into joint-stock companies owned by their directors. This early phase of privatization was called *Nomenclature privatization*. From a legal and moral point of view it was highly questionable.<sup>1</sup> But it also did the change irreversible. The need to create an effective legislative framework for ownership then became necessary, and the former state enterprise managers were "bribed" into not trying to hinder the reform process.

At the turn of the decade Poland was the star among former communistic countries. It started the economic transition first, and its experiences were followed with great interest. After five years of transition Poland has been overshadowed by the others, notably by its southern neighbour the Czech Republic. In the light of Czech privatization, where the privatization was carried out by using the voucher scheme, Polish privatization seems modest indeed. Of the 8441 state enterprises in Poland in 1990 (not including those privatized through "small privatization") 4722 were transformed or were in the transformation process at the end of 1994, but in 3378 of these the state was still the owner.<sup>2</sup> Also budget revenues from privatization have been disappointingly small.

In discussions in the late 1980s the options discussed were citizen ownership versus employee ownership; but in practice the Government turned to favouring public offerings in the model of Great Britain. This approach was not successful, and a new solution was found in promoting employee ownership through leasing. Plans for citizen ownership have not as yet been realized.

Another way to privatize has been the sale of corporatized companies<sup>3</sup>. Corporatization was originally understood as a preparatory procedure for privatization. However, the new law on privatization, which was adopted by the parliament on 30 June but has not been implemented, makes corporatization

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<sup>1</sup> For a description of *Nomenclature Privatization*, see Lewandowski and Szomburg (1989).

<sup>2</sup> GUS (1995). Of the transformed state-owned enterprises, 1647 were agricultural units owned by a special agency of state treasury.

<sup>3</sup> State-owned joint-stock companies are often called also *commercialized companies*. In this text we use the term *corporatized companies* and refer only to corporatized companies owned by state treasury.

possible even without the intention to privatize. If the law, which we discuss more in detail later, goes into effect, it will mean a fundamental change in the transformation process.

Another essential change will be the introduction of the Mass Privatization Programme. This programme will implement the idea of citizen ownership. It is based on 15 investment funds, which hold the shares of slightly more than 400 Polish enterprises. The shareholders of investment funds are Polish citizens, who have bought share certificates. The present author is not willing to speculate on how this system, which combines the concept of the strategic investor (each fund will hold 33 % of shares of 30 companies) with highly dispersed ownership of investment funds, is going to work in practice. The share certificates are slated to be distributed to the citizens in October 1995.

This paper will evaluate the ownership structures that have emerged for three types of transformed companies: corporatized companies, corporatized companies which have been privatized and leased companies. Common to all these groups is that the enterprises involved were generally in relatively good financial condition when transformed.<sup>4</sup> The conditions for the company to be transformed are, of course, that its financial standing be good and that it be able to attract private capital.<sup>5</sup> In focusing solely on such groups, it will not be possible to provide a picture of Polish enterprises in general. This study pays no attention to the new, emerging private sector, which has recently been significant for Poland's economic growth.<sup>6</sup>

This paper studies the forms of transformation, the initiators of privatization, those who control the transformed enterprises and the effects of the financial structure. The empirical evidence in this survey is from secondary sources, mainly from Polish studies of enterprise behaviour. The author has tried to use as up-to-date material as possible, but it should be mentioned that also the most recent material treats mainly firms, that have been transformed in the early stage of economic change, which could introduce some bias into the study.

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<sup>4</sup> The way to transform an enterprise in poor financial condition is liquidate it by declaration of bankruptcy. This has been understood in Poland as a means of privatization. Often there is a private successor company, which continues the operations of the dissolved state enterprise after the bad assets have been removed.

<sup>5</sup> Of course, there is variation in the performance of individual firms inside the groups. A comprehensive survey of the financial standing of transformed enterprises is given in Dąbrowski *et al.* (1993).

<sup>6</sup> Błaszczuk (1995), p.1.

## 2 Ways to Privatize

### 2.1 Methods of privatization

Privatization methods in Poland can be divided into two indirect and direct methods. When a state enterprise is to be indirectly privatized, it is first corporatized and brought under the commercial code. Then, within two years, it should be privatized, either through public offer or sale to strategic investor(s). In direct privatization, the state enterprise is liquidated and its assets are sold, contributed or leased to other (private) companies. Most of these companies were established to succeed the former state enterprises. Indirect privatization is the method used to privatize large state enterprises in good financial condition. Direct privatization is used for small- and medium-size enterprises.

### 2.2 Corporatization

The initiative for transforming a state enterprise into a joint-stock company owned by the state treasury belongs to the enterprise or to its *founding body*<sup>7</sup>. After a feasibility study is done by a consulting firm, opinions are sought from management, the worker's council, the worker's delegation and the founding body. If they accept the plans, the Ministry of Privatization decides on the transformation. After the enterprise has requested the transformation, its size, value, business possibilities, legal position etc. are evaluated by outside consultants. The ministry may deny the transformation within three months after the request has been lodged, the reasons being either the poor financial condition of the enterprise or the "national interest". Remarkably, the status of the enterprise usually cannot be changed without the consent of the employees.<sup>8</sup> Until the end of 1994, 844 state enterprises were corporatized, and 134 of them were privatized.<sup>9</sup>

After the transformation the company is owned solely by the State Treasury. After Ministry of Privatization has decided on the transformation, the supervisory board is selected. The Ministry of Privatization chooses two-thirds of the board members, who act as the owner's supervisors. One-third of the board members are selected by the employees. The supervisory board replaces the employees' council as a controlling organ in the enterprise. As a compensation, employees are entitled to buy company shares up to 15 per cent at preferred prices (usually half price) after the corporatization. The supervisory board has the right, among others, to hire and fire management, decide on profit allocations and investments, and sell

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<sup>7</sup> Until 1994 the founding body was usually the ministry overseeing the enterprise. From the beginning of 1994 the duties of the founding body were partly removed to the *Voivoidships*, i.e. administrative districts.

<sup>8</sup> In special cases the prime minister can order the transformation, even if the employees do not approve. Such cases have been rare and they have applied to enterprises included in the Mass Privatization Programme.

<sup>9</sup> GUS (1995).

or lease company's assets. The board consists of at least three persons but usually six.

An important phase in the transformation of enterprises is liquidation of employees' councils. Polish state enterprises since 1981 have been self-governed by their employees. The employees' council supervises the directors' performance, hires and fires directors, approves production plans and carries out other important functions. In practice, a state enterprise in the 1980s normally had three main groups (managers, trade unions, and employees' council) which were competing for power. To gain advantages, they were forced to form coalitions and make compromises. As long as there was no competitive environment, these structures were not under threat. After opening the market, the old structures of corporate control were seen as major hindrances for to efficiency, and getting rid of them was one of the main reasons to corporatize, as will be explained in section 3.<sup>10</sup>

### 2.3 Capital privatization

The Ministry of Privatization can order that a privatization be accomplished through a public offer or a selective trade sale. Prior to privatization an economic and financial evaluation should be completed. Originally, public offers were preferred by the Government, because of the anticipated budget revenues, but this method was not very successful. Only 21 enterprises had been privatized through public offering up to the end of 1994. There were at least two major reasons for this failure: first, evaluation of enterprises was more costly and difficult than expected, and secondly, expectations regarding public interest in these shares were overoptimistic. Some years later the reasons for this failure seem obvious: the Polish people could not have accumulated such large savings during the years of socialism that they could have bought significant amounts of national industry<sup>11</sup>, and large investors were more interested of trade sales, where they could achieve more favourable terms.

Apparently because trade sales give investors more ready access to controlling shareholdings, trade sales have been more successful. By the end of 1994, 109 companies had been privatized by trade sale.<sup>12</sup> Most often the buyer was a foreign company (or companies), which acquired a majority stake in a privatized company. It must be stressed that capital privatization is a viable method only for large companies in good financial condition. This may explain why there has been so little progress, in quantity terms, using this method. It is also a costly method, because of the evaluation and other preparatory measures involved. Still it has consistently been favoured by the Government, because trade sales raise budget revenues and give the company a strong owner. Various programs connected with

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<sup>10</sup> See Bieńkowski (1992) and Federowicz (1994, pp.65–69). Sometimes this triangular relationship and interdependence is called the "Bermuda Triangle". To complicate matters further, the enterprises usually had two competing trade unions, sometimes even three.

<sup>11</sup> One way to overcome this problem was proposed by Lech Wałęsa: he promised 10 000 USD for every adult Polish citizen during his presidential campaign in summer 1990. The money was meant for buying privatization coupons.

<sup>12</sup> This figure is from the information of Ministry of Privatization, 29 March, 1995.

the restructuring of state enterprises have been linked to the capital privatization programme.

## 2.4 Privatization Through Liquidation

The preparatory procedures for direct privatization are much the same as described before in the case of indirect privatization. The enterprise or founding body initiates the procedure, approval of employees is required, evaluation and other preparatory measures are taken, and the approval of Ministry of Privatization is required. After the approval of the ministry, the state enterprise will not be transformed through corporatization but *liquidated*, and its assets will be sold, contributed or leased to private company(s). For direct privatization, leasing has been the most popular method.<sup>13</sup> In total, 913 enterprises were privatized via direct privatization until the end of 1994.<sup>14</sup>

The preconditions of leasing are, that the lease must be made to a company in which more than half of the employees of the former state enterprise are shareholders, and the new company must be capitalized at least to the extent of 20 % of the book value of liquidated enterprise, before the lease takes effect.<sup>15</sup> The leasing contract is made with the founding body of the state enterprise. The contract will be for a period of 5–10 years, and after all payments have been made, the ownership rights will be transferred to the new company.

The lessee pays according to the value of leased assets divided by the length of the agreement plus interest on the unpaid portion of leased capital. The value of the assets is determined prior to leasing. Altering the asset valuation during the lease is a complicated process. The lessee pays, after the first year, one-third of the interest payments due, and after the second year one-half, with the remainder to be paid in the third year. This has caused a heavy financial burden for many companies in their third year of operations.

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<sup>13</sup> On the basis of the leasing arrangement, the state still owns the assets the enterprise leases, and the ownership rights are (in most cases) transferred at the end of the contract. Nevertheless, full control rights are transferred to the lessee at the very beginning, and that is why leasing can be treated as a form of privatization. See Gomułka and Jasiński (1994, p.225 n 21).

<sup>14</sup> GUS (1995).

<sup>15</sup> In this section we discuss only the most popular leasing arrangement, the so called "lease and sale". For a description of other kinds of leasing arrangements which will not automatically lead to the transfer of ownership rights, see Frydman *et al.* (1993, pp.188–190).

## 3 Initiators of a transformation

### 3.1 The Players

The initiation of the transformation process requires the approval of managers, employees and state representatives (Ministry of Privatization and founding body). The role of the state is usually to merely approve the decisions. Relatively seldom does the Ministry of Privatization refuse to privatize, generally only in cases where the prospects for finding private capital are poor. The founding body seldom initiates the privatization, most often it does so in cases of bankruptcy liquidation.<sup>16</sup> The initiative for privatization thus belongs to management and employees. By initiating the transformation process, they face a trade-off between economic profit and economic risk. The profit is the opportunity for higher wages; the risk is the higher probability of losing one's job. Both managers and employees try to reduce risk by contracting. Some of the tactics used will be mentioned below.

In the vast majority of the cases the initiators of transformation were the managers, irrespective of the method of privatization. Also the employees' councils were active in initiating transformation, which may seem peculiar because after transformation the employees' council was liquidated.<sup>17</sup> The participation of trade unions has been less impressive, but in the early privatization phase they at least refrained from blocking the process.<sup>18</sup>

### 3.2 The Managers

First, the managers saw privatization as the only possible road to growth for the enterprise. In the beginning of 1990s the environment for enterprises was restrictive: fiscal and monetary policy were tight, the state was drastically cutting subsidies to enterprises, interest rates were so high that companies could not afford to take bank loans, and Government introduced a new tax for enterprises, the excess wage tax, "*popiwiek*". The managers saw that only privatization could guarantee sufficient financing for restructuring the enterprise. An additional stimulus for corporatization and privatization was that transformed enterprises were exempted from the excess wage tax.

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<sup>16</sup> The passivity of the founding body is not surprising. It would not be expected that state bureaucrats would actively try to give up their control rights. Another constraint the state faces is connected with its financial interests. If we consider cash flow, the state gains from privatization. Selling a state enterprise is economically profitable only in cases where the sale price is at least as high as the net present value of the enterprise. The net present value of an enterprise is very difficult to estimate in transition economies.

<sup>17</sup> One possible explanation for this odd phenomenon might be that middle management was strongly represented in the employees' councils (Federowicz 1994, p.63), and this group could expect to be gainers from the transformation (Dąbrowski *et al.* 1993, p.101).

<sup>18</sup> Dąbrowski *et al.* (1992, pp.21–24) and Bednarski and Wratny (1995, pp.18–20).



Moreover, the managers saw in privatization a means of getting free of their hierarchical subordination to the employee's council. In workers-controlled enterprises, managers' salaries had risen only very slowly. In transformation, they saw the opportunity to substantially raise their own salaries.

The fear of losing job, which the managers experienced, was connected especially to capital privatization; in that sense insider privatization and corporatization were much safer alternatives. Sometimes the advantages of corporatization were so great that even if there would have been substantial expected benefits from privatization *for the firm*, the managers did not try to find a buyer because of their personal risk.<sup>19</sup>

In the case of transformation into an employee-leased company the management was even more active than in the case of corporatization.<sup>20</sup> This observation sounds very plausible and indicates that the management probably already before transformation had a strategy to gain control in these enterprises (see section 4).

### 3.3 The Workers

The main reason for workers to support privatization was the expectation of higher wages. The workers believed that the abolition of the excess wage tax would allow substantial wage increases, and that was the decisive argument for the employees' councils and general meetings to launch the transformation.<sup>21</sup>

Also the workers would get some privileges. As mentioned above, in corporatized companies they get their representatives on the supervisory board, and moreover the privatization law guaranteed them the possibility to buy company shares at preferred prices. In employee-leased companies, the majority of employees became shareholders by definition.

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<sup>19</sup> Chełmiński and Czynczyk (1991, pp.20–21).

<sup>20</sup> Bednarski and Wratny (1995, p.19).

<sup>21</sup> Dąbrowski *et al.* (1992, p.23).

## 4 Ownership Structure and Corporate Control

### 4.1 Theoretical Framework

Polish privatization has been exceptionally rich in introducing different patterns of ownership and control, and it provides a lot of empirical evidence for studying the linkages between ownership and control. One approach to this issue is the so-called principal-agent theory. Applying this framework the owners of the firm are the principals, who transfer some of the control rights to their agents (the directors). Some of main assumptions are the following: 1) The information possessed by principal and agent is incomplete and asymmetric, and usually the agent has more information than the principal. 2) The agent's objective is to maximize his own welfare, and the decisions he makes on this basis do not always maximize the welfare of the principal. 3) Monitoring the activities of the agent is costly for the principal.<sup>22</sup>

Using this framework, we can now analyze the Polish economy. In the three types of companies described above, the principals (owners) are, the state, outside investors and insiders (employees and management). The relationship between directors and employees can also be described using principal-agent theory, where the agents are the employees.<sup>23</sup>

### 4.2 The State as Owner

Ministry of Privatization has supervisory rights over corporatized state enterprises. It nominates the state representatives to the supervisory boards. Candidates for the corporate supervisory boards have to complete special training for this task, which is provided by the ministry.

It is interesting to note that two ministries, Ministry of Privatization and Ministry of Finance, have somewhat contradictory incentives. The task of the Ministry of Privatization is to locate private capital, whereas the Ministry of Finance is concerned about fiscal revenues. Evidence suggests that concern about fiscal revenues has slowed the pace of privatization.<sup>24</sup> It is evident also that the State Treasury as owner is under the influence of the politicians, and the interests of politicians differ from these of private owners; for example, the politicians favour continued excess employment.<sup>25</sup> One thing which should be kept in mind is that the Ministry of Privatization is overloaded, and it does not have the resources to carry out all its tasks effectively. This means that more power is

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<sup>22</sup> The original developers of the principal-agent theory were Jensen and Meckling (1976). The sketch presented here is consistent with their description.

<sup>23</sup> Except for traditional Polish state enterprises, in which employees had controlling power over managers.

<sup>24</sup> Chelmiński and Czynczyk (1991, p.23).

<sup>25</sup> Shleifer and Vishny (1994, p.999).

transferred to members of supervisory boards and local authorities, bodies which are exposed to pressure and corruption by managers and politicians.

Most of the evidence points to the passivity of supervisory boards.<sup>26</sup> This is accounted by the lack of incentives among supervisory boards to monitor management, the bureaucratization of boards and controlling state bodies and the boards' incompetence in business. According to this evidence, control rights have shifted largely to the management. They benefited from the liquidation of employees' councils. The former directors and managers for the most part maintained their positions. They have the advantage of superior information compared to the supervisory board, and the supervisory board seldom interferes in their decision making.

Management salaries rose considerably, and often the rise was even not tied to performance. Management was very active in purchasing shares of the enterprise at preferred prices.<sup>27</sup> Significant shareholdings can give managers an incentive to develop the enterprise in a rational way. But there is the danger, that management is not willing to look for outside investors, because of the concern of their own advantageous position. In the worst case, corporatization may even hinder restructuring. In corporatized enterprises management often takes a wait-and-see attitude, and so the needed restructuring measures are not taken.

There is also empirical evidence, that the aim of the supervisory board and management is to avoid possible conflicts and lay-offs. Indeed, in the corporatized enterprises there appeared to be more concern for maintaining employment than in the other types of transformed enterprises. Despite this, in corporatized enterprises there was more discord than in the others. The price the workers have to pay for greater job security was a slower rise in wages.<sup>28</sup>

Employee participation is channelled through their representation on supervisory boards and the possibility of buying company's shares at a discount. The duty of the employees' representatives (elected by employees) is to maintain contacts with management and employees and to inform employees about decisions. However, it happened that this dialogue either does not exist or is informal. The trade unions have been totally excluded from decision making.<sup>29</sup>

### 4.3 Private owners

In considering capital privatization, we have to keep in mind the different ownership structures that follow capital privatization: public offers lead to dispersed ownership, whereas negotiations with potential investors usually lead to the concentration of shareholding in a single large investor.

The author has no detailed information on the shareholding structure of firms privatized through public offers. In other cases ownership is highly concentrated

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<sup>26</sup> Such a viewpoint can be found eg in Chełmiński and Czynczyk (1991, pp.14–16), Federowicz (1993) and Rada (1995, p.16). For an opposing view, see Belka *et al.* (1995, p.26).

<sup>27</sup> Chełmiński and Czynczyk (1991, p.9, 19 and 22).

<sup>28</sup> Bednarski (undated, pp.15–17).

<sup>29</sup> Bednarski and Wratny (1995), p.28–29.

in the hands of a single investor. This one investor usually holds a majority stake in the companies. At the end of 1994 there were 109 companies that had been privatized by selling to outside investors, and in 84 of these a single outside investor hold more than half of the shares, and in 57 cases the outside investor was a foreign company.<sup>30</sup> Banks do not have significant amount of equity holdings.

What might be slightly surprising is that even after privatization the former management usually maintained or even strengthened its position. Western economists have generally doubted the competence of managers of former state enterprises, and so one might ask why western enterprises have not also doubted it? This might be because of the imperfectness of labour markets for managers or because of managers' knowledge of local markets and suppliers, but it may also be because the managers negotiated on privatization with potential investors and then on work contracts for themselves as well. On the other hand, there were usually major changes in the composition of the supervisory board. The state representatives lost their position, but in many cases the workers maintained their representative on the board, although for this there was not any more any legal obligation. The employees' shareholdings in enterprises is diminishing and the share ownership is concentrating in the hands of major owners and management.<sup>31</sup>

#### 4.4 Employee ownership

Generally, we can distinguish two types of employee participation in enterprises: First, management is controlled by the employees, but the employees do not own the enterprise. An example of this kind of participation is the traditional Polish state enterprises. The second type is share ownership, where the employees are entitled to control rights based on their shareholdings, as in typical capitalistic enterprises. Polish leasing companies fall into the second category. Corporatized and privatized companies have elements of both types of participation, but only to limited extent. The question of which form of participation is better and how much decision-making power the employees should be given, is outside the scope of this paper. Regarding the pros and cons of employee participation, there is a mounting literature and opinions differ widely.<sup>32</sup>

As noted earlier, both the employees and managers were worried about their job security in the context of transformation. Establishing a employee-owned company was seen as a convenient way to put the fate of the enterprise and one's own job into one's own hands. Loyalty to one's "own" enterprise has appeared to be an important factor in establishing these companies.<sup>33</sup>

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<sup>30</sup> These figures are taken from Ministry of Privatization data, 29 March 1995.

<sup>31</sup> Szomburg *et al.* (1995, pp.25 and 27).

<sup>32</sup> The reader is referred to Bonin *et al.* (1993), which has a comprehensive survey of the literature on employee participation, both of empirical and theoretical works.

<sup>33</sup> Szostkiewicz (1994).

Employee ownership in Poland is not to be understood as a development wherein the control rights of an enterprise are automatically turned over to the insiders: the employees usually paid the required 20 per cent of the book value of their own savings.<sup>34</sup> Requirements of a high level of capital and leasing payments are a heavy financial burden for the enterprise. In some other countries (eg in USA and Germany) the legislation is more favourable to employee ownership than in Poland.<sup>35</sup>

As explained, one requirement for establishing an employee-owned company was that at least half of the employees be shareholders of the company. The employees were very active in purchasing shares. According to one study, almost 90 per cent of employees of these companies owned shares at the end of 1991.<sup>36</sup> The trend is clear: According to the same study, in June 1994 only 72 % of the employees were shareholders. The managers have strengthened their position. It would not be a bad guess to say that management in initiating the privatization had a clear strategy to gain control in these companies and they certainly have no need to be disappointed.<sup>37</sup>

It is interesting that the outside ownership share is growing the fastest, although there are considerable barriers to the entry of outside investors. In 72 per cent of the leased companies there were obstacles to entry for outsiders.<sup>38</sup> Entry usually requires the consent of both the company insiders and the Ministry of Privatization. Opening the enterprise to outside investors is sometimes the last means to avoiding bankruptcy.<sup>39</sup> If the company does reasonable well, there is usually not much incentive open it to outsiders.

The employees, despite their share ownership, do not practice decision-making power in the enterprises.<sup>40</sup> Perhaps considering these enterprises as employee-owned is misleading: it might be closer to the truth to say, that managers consider establishing the company as a way of securing their own domination in the enterprises, and they use the employees to finance the operation. But it should be added that the formation of leasing-companies had the support of the workforce. Even after the enterprise has experienced financial difficulties, which is not unusual for these companies, the employees remain loyal to the company. These companies experience less discord than other companies. This may be correlated with the size of the enterprise: these enterprises are small- and medium-sized. According to Polish researchers, in small enterprises, where the articulation

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<sup>34</sup> Gardawski (1994, p. 96).

<sup>35</sup> Błaszczuk (1993, pp.27–29).

<sup>36</sup> Gardawski (1995, p.68). Pietrewicz (1994, p.50) presents a considerably lower figure.

<sup>37</sup> Gardawski (1995, pp.61–64) also reports that the former management has usually maintained its position, and their wages have risen faster than those of the employees.

<sup>38</sup> *ibid.*, p.68.

<sup>39</sup> Szomburg *et al.* (1994, pp.67–68).

<sup>40</sup> Gardawski (1995, p.64).

of interest representation is less institutionalized than in large enterprises, emerging forms of representation may be more satisfying.<sup>41</sup>

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<sup>41</sup> Szostkiewicz and Kozarzewski (1995, p.100–103). Empirical evidence seems to confirm this hypothesis. See Bednarski and Wratny (1995).

## 5 Notes on the Financial Development of Enterprises

### 5.1 Lack of Capital

The curse of all types of Polish enterprises has been poor access to capital. High interest rates have prevailed since the beginning of the decade, making it impossible for many enterprises to borrow. Also, the banks have often been reluctant to lend; either they have not been willing to take the risk or they simply have not had the means of financing the enterprise.

The Government opted for the rapid development of capital markets. It was thought, that equity financing would play an important role in creating a capitalistic environment.<sup>42</sup> A broader, sociological purpose was to create a strong middle-class via shareholding. These hopes soon proved to be illusory. Still it took a rather long time before other methods were introduced. The emphasis from the beginning was put on privatization and private capital. Proposals for state-led industrial policy were rejected as post-communistic doubletalk.<sup>43</sup> An irony of history is that now again there are proposals for strong state intervention, backed by a "post-communistic" Government. These are discussed in section 6.

Law on Financial Restructuring of Enterprises and Banks, which was a significant step towards improving commercial banking in Poland, was introduced in March 1993, quite late, if compared to the introducing of Warsaw Stock Exchange in April 1991. Equity financing has been of minor importance so far and commercial banking is the alternative now recommended for transition economies by many western economists.<sup>44</sup> According to the study by Belka *et al.* (1995), bank debt holding in Poland is increasing rapidly, especially in the private sector; similar conclusions were drawn by Szomburg *et al.* (1994). An interesting finding of the latter study was that among the indirectly privatized enterprises bank debt grew most slowly and investment was the greatest in the group of enterprises with large foreign shareholders. This is explained by strong internal financing in these enterprises, but it implicates, that the Polish commercial banks will be excluded from the healthiest part of Polish former state enterprises.

### 5.2 Explanations for Low Level of Investment

Both corporatized companies and employee-owned companies are reported to be very hesitant to investment.<sup>45</sup> There are probably different reasons for this. For corporatized companies, there has been a general lack for any clear strategy for company growth. The design of investment policy is the responsibility of the

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<sup>42</sup> The bases for this kind of thinking are given in Kawalec (1989).

<sup>43</sup> The rejection of state industrial policy, familiar from some Asian "industrial miracles", was strongly criticized in Amsden *et al.* (1994).

<sup>44</sup> See, eg, van Wijnbergen (1994) or Berglöf (1995).

<sup>45</sup> Dąbrowski *et al.* (1993, pp.64–66) and Szomburg *et al.* (1994, pp.53–58).

supervisory board, which casts doubts on the competence of board members. Also, the very idea of corporatization has been seen as a major hindrance to the development of the companies. As noted, they should be privatized within two years of corporatization. This creates a wait-and-see attitude: it is hoped that outside investors will bring sufficient financing and know-how for modernizing and restructuring the company. There has not been sufficient incentives to restructure prior to privatization.<sup>46</sup>

For employee-owned companies, the major barriers to investment have been heavy indebtedness and unclear property rights, as well as the impossibility of using the company's real estate as collateral for bank credit. These enterprises have problems not only with investments, but even with maintaining a sufficient level of working capital.<sup>47</sup> The enterprises do not have ownership rights to their physical assets, and they do not receive compensation if such assets are sold. Because especially after three years of operations the leasing payments become particularly burdensome<sup>48</sup>, many companies have fallen into major financial difficulties. Unable to raise more debt financing, the alternatives are to find private capital or go bankrupt. Even this is not that simple. As already noted, enterprises usually have barriers to entry for outside investor. As far as bankruptcy is concerned, this also is often not a viable option. The bankruptcy proceedings for these companies follow the procedures of the Law on State-owned Enterprises of 1981. Because the liquidation of state enterprises is understood in Poland as a method of privatization, the procedure is handled by the Ministry of Privatization. The ministry is overloaded with work, so it does not have the capacity handle these cases. Some enterprises use tax arrears as a means of maintain the necessary working capital, and the state has no alternative but to tolerate such behaviour.<sup>49</sup>

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<sup>46</sup> Federowicz (1993).

<sup>47</sup> Szomburg *et al.* (1994, p.52).

<sup>48</sup> See section 2.5.

<sup>49</sup> Pietrewicz (1995, p.44).



## 6 The State Revisited

Originally the word *komercjalizacja* (commercialization) was associated with the inducement of a state enterprise to behave like a private enterprise. Later it came to denote transformation into a joint-stock company (corporatization) and it was understood as an intermediary step to privatization.<sup>50</sup> However, the leftist Government which has been in power since autumn 1993 has tried to introduce commercialization in its original meaning. The pace of corporatization has accelerated during the tenure of this Government. In 1994 208 enterprises were corporatized compared to 156 a year earlier and 172 the year before that. Only in 1991, when the transformation was just beginning, were more enterprises transformed (250).<sup>51</sup> At the same time the Government has promoted the concept of mass corporatization, i.e. transforming all remaining state enterprises into state-owned joint-stock companies. This would inevitably lead to the rejection of the idea that corporatization is merely an intermediate phase on the way to privatization.

In mass corporatization, the Government announces that it aims to improve the efficiency of enterprises, opening them to private investors and clarifying the ownership structure.<sup>52</sup> Although openness to privatizing is still listed in the Government's top priorities, it is unclear if mass privatization will accelerate the privatization process, because the firms involved lose the possibility of direct privatization. In the author's opinion the other point mentioned deserves more attention: corporatization will lead to the liquidation of employee control and will shift more power to the public representatives; that is, the state is reasserting its ownership rights.

In the late June 1995 the Polish lower chamber of parliament, the *Sejm*, accepted a law proposal for changing the corporatization procedure. According to this proposal, corporatization no longer requires the consent of enterprise insiders. The enterprise's status can be changed at the request of the Prime Minister or the founding body (voivodships or ministries). The insiders would get 15 percent of the company's shares free of charge, instead of 20 percent at discounted prices. Mass corporatization was included in the bill submitted to the parliament, but the parliament removed it from the final version and added a provision making corporatization possible without the obligation to privatize. A law proposal similar to the one accepted now was rejected by the *Sejm* two years earlier.

The new law would mean a significant shift of decision-making power from enterprise level to state agents. It was already vetoed by the president who, confronting pressure from Solidarity supporters, rejected the law. However, the veto was overturned by two-thirds majority vote of the parliament. Later the president submitted it to Constitutional Tribune, which will decide on its constitutionality. The law has met criticism from others besides workers, namely from some

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<sup>50</sup> Błaszczuk (1995, p.8).

<sup>51</sup> GUS (1995).

<sup>52</sup> Rada (1995, pp.13–15).

leading economists. Janusz Lewandowski commented<sup>53</sup>, that the new law would lead to massive bureaucratization of state enterprises and would slow down privatization by promoting indirect privatization instead of direct privatization.

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<sup>53</sup> Gazeta Wyborcza 1 July 1995.

## 7 Concluding Remarks

One lesson to be drawn is that the ownership forms created tend to persist for better or worse. Already from 1991 on the emphasis has been on restructuring prior to privatization, but despite various programmes backed by the Ministry of Privatization and by international financial institutions, the results have been meager. The best parts of Polish industry were sold first, and in the case of the remaining possible successes, the tobacco industry and metal mines, the Government has been reluctant to privatize.<sup>54</sup> Despite the forthcoming Mass Privatization Programme, a significant acceleration of privatization is not to be expected. What could have been done? At the initial point of transition it is difficult, if not impossible, to foresee the situation. More flexibility later on would have helped, but political factors stood in the way.

Polish privatization has sometimes been characterized as eclectic; it could as well be described as inconsistent. Perhaps the various approaches complement each other only to a certain degree. In the Czech Republic the whole privatization process was carried out with vouchers. The Czech privatization has a sense of egalitarianism, no matter what can be said about its efficiency. Compared to this, Polish mass privatization, covering some five per cent of former state enterprises, looks like a poor second best. The lack of coherence in privatization policy is caused by continuous discord in state politics. In the 1993 parliamentary elections the socialistic and the peasant parties emerged victorious and formed a Government after effectively obstructing Government's policy in opposition two years. After 1993 the discord has existed in the relationship between the president and the Government.

Leasing privatization is now under threat. According to the tastes of the observer, this type of privatization has been considered as notorious insider privatization or a desirable form of employee participation. If this form of privatization is to be continued, some legislative changes are urgently needed concerning an enterprise's rights to its property. The present Government does not seem to favour this form of privatization. The number of companies taken into direct privatization dropped to 120 in 1994 from 203 a year earlier.<sup>55</sup> This is partly due to uncertainty concerning changes in legislation.<sup>56</sup> In any case, the Government's policy raises the question: Is the state trying to replace managerial control by bureaucratic control?

Foreign capital has provided the best growth opportunities for Polish enterprises.<sup>57</sup> Also, it has become clear that foreign investors are not as interested in Polish markets as was expected. The suspicion felt by Poles toward foreign

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<sup>54</sup> After a long fight in the parliament, the privatization of the tobacco industry is now moving forward. Five tobacco firms are expected to be sold this autumn (Reuters 9 August 1995).

<sup>55</sup> GUS (1995).

<sup>56</sup> According to Privatization Minister Wiesław Kaczmarek in an interview (*Życie Gospodarcze* 26 February 1995).

<sup>57</sup> Szomburg *et al.* (1994, p.29).

investors has become a further argument against this method.<sup>58</sup> Domestic sources of investment are so scarce, however, that give-aways would be the only means to achieve rapid privatization using domestic funds only. Commercial banks are developing, but it will probably take years before they can "take the lead in initiating restructuring and the design of (...) capital structure".<sup>59</sup>

Should we consider Polish privatization a failure? One is tempted to answer to the question thusly: "Perhaps the privatization of state-owned enterprises is not a success story, but it does not seem to matter." When one looks at the impressive growth rates for GDP and industrial production in Poland in the two latest years, it looks like as if the new private sector is powerful enough to provide sufficient impetus for the whole economy. The evolution of the new private sector, alongside the old state sector, despite some *a priori* doubts, has succeeded. But the basic questions still remain. The old state sector is too large to be ignored, and new small private firms are far too small in unit size to run the economy.

Poland's privatization is now at a crossroad. Recently, there has been a lot of legislative activity, concerning privatization in general, mass privatization, reprivatization and corporatization. The rules of the game are to be set anew. The state as rulemaker is in a crucial position. Is the state going to seek a more active role in the game or will it be satisfied with the role of distant regulator? The crucial questions will again be connected with corporate control and finance. The fate of Polish privatization will depend on Polish state itself, and most likely no clear picture of the situation will be forthcoming before the presidential elections this autumn. Economics and politics are hopelessly intermingled in Poland, and the state will not wither away, not even after socialism is gone.

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<sup>58</sup> See, eg, Gomułka and Jasiński (1994), p.240.

<sup>59</sup> van Wijnbergen (1994, p.23).

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