CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES: THE CASE OF SLOVENIA

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1. Introduction

The corporate governance problem has been gaining importance in transition economies. Economic growth in these countries has turned out to lower than expected. Privatisation does not seem to have brought about the anticipated improvements in corporate efficiency. The state and ‘para-state’ institutions such as privatisation funds remain the largest shareholders of companies. Internal owners dominate in many companies, while the external owners do not have enough voting power to control the companies and thereby to ensure themselves appropriate returns. The capital markets are under-developed and do not facilitate the inflow of new capital as intended. Further, market transactions are often based on the abuse of inside information.

Slovenia is no exception here. Compared to other transition countries, it does show some better results, probably due to its relatively effective mix of macroeconomic policies (soft-landing) and traditionally export-oriented companies. In any case, the capital and labour markets are still underdeveloped, as is the financial system (Ribnikar, 1999). Bank financing represents only a small part of all the corporate financing, while the capital market’s importance in company financing is even smaller. A company’s investment activity depends mainly on its ability to provide internal funds (Prasnikar, Svejnar, 2000), which also involves high transaction costs (Domadenik, Prasnikar, Svejnar, 2000).

The Slovenian privatisation model applied has led to privatisation investment funds, state funds and insiders (workers, managers, retired employees, etc.)[1] being the largest shareholders of the nation’s companies. Most companies opted for the internal method of privatisation and chose the legal form of a joint-stock company. Those companies fulfilling the conditions for listing were given the opportunity to appear on the official stock market, while others stayed unlisted or have joined when the conditions are met. Due to the particular privatisation model chosen, the secondary capital market was the first to appear in Slovenia. As it was created artificially, there was no room for a primary market to develop. Further, it is obvious that the secondary market does not function, as it should. The main players in the

[1] The 1992 Privatisation Law allocated 20 percent of a firm’s shares to insiders (workers), 20 percent to the Development Fund that auctioned the shares to investment funds, 10 percent to the National Pension Fund, and 10 percent to the Restitution Fund. In addition, in each enterprise the workers' council or board of directors (if one existed) was empowered to allocate the remaining 40% of company shares for sales to insiders (workers) or outsiders (through a public tender). Based on the decision on the allocation of this remaining 40 percent of

secondary market, especially the privatisation investment funds and state funds that resulted from privatisation make agreements in order to prevent the establishment of any market-clearing price for shares in demand. Most trading thus takes places away from the official market. First, large investors often exchange blocks of shares among themselves in order to increase their ownership concentration without influencing the share price. Second, institutional investors exchange shares in one company that has been taken over (the target company) for shares in the take-over company and thereby facilitate the take-over activity. Third, individuals (workers) exchange their shares in the so-called internal market within their companies. Fourth, there are also institutional investors that buy shares from individuals in order to consolidate their stakes.

Slovenian corporate governance is even more complicated due to the Law on Workers' Co-Determination (1993). Pursuant to this Law, in companies with up to 500 employees at least one-third, while in companies with over 1,000 employees at least one-half, of Supervisory Board members must be workers' representatives[2]. Due to the Supervisory Board's important role in supervision of a company's affairs and elections of a company's management, monitoring by outsiders is relatively limited. In fact, different interest groups fight for power in Slovenia's companies: the employees as internal owners and through participation in the company's governance structures on one hand, and the institutional investors as external owners on the other. They both act with the aim of protecting their rents (rent-seeking behaviour) rather than to maximise the value of their companies (Prašnikar, Gregorič, 1999). Monitoring of management is hence insufficient and often driven by the wrong incentives.

The aim of this paper is to introduce the problem of corporate governance into the discussion on the transition and restructuring of Slovenian companies. Moreover, given that other transition countries face the same problem they would also benefit from the Slovenian experience. The main questions arising out of the corporate governance literature are

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shares, firms can be classified as being privatised to insiders (the internal method) or outsiders (the external method).

[2] The Slovenian Companies Act (1993) introduces a two-tier governance structure with the Supervisory Board as the intermediate body between the management and the Shareholders' Assembly. The adoption of the two-tier system is mandatory for companies with a capital stock of at least SIT 300 million, the average annual number of employees exceeding 500, for companies with successive founding, for companies listed on the stock exchange and for companies whose number of registered shareholders exceeds 1000.

presented in the second section of our paper. The distribution of the major shareholders' voting rights in Slovenian companies is analysed in the third section. A discussion of the capital market and the requisite actions to improve its liquidity and provide Slovenian companies with motivated owners is presented in the fourth section. Conclusions are drawn in the fifth section.

2. Corporate governance problem in the economic literature

The corporate governance problem was first referred to by Berle and Means (1932) as the problem arising out of the separation of ownership and control in large corporations. Given their discretionary power, company managers may use company resources to their own advantage. Investors therefore cannot take their returns of cash flow from the company's projects for granted.[3] There is no such problem in companies with concentrated ownership as large shareholders have both the incentive to be actively involved in monitoring management and to bear the costs, as they reap most of the benefits. However, ownership concentration also reduces capital market liquidity and hence investors' willingness to provide funds to companies in the market.

Dispersed ownership and liquid capital markets can be found in both the United States and the United Kingdom. On the other hand, most European Countries have highly concentrated ownership and relatively illiquid capital markets[4]. La Porta et al. (1997,1998,1999) explain these differences by the differences in investors' legal protection. The legal protection that investors receive determines their readiness to finance companies. The strong legal protection of creditors in German law for example explains the prevailing role of banks in company financing. Highly developed equity and debt markets in the United Kingdom are the result of the strong legal protection of British shareholders and creditors.

3 This so-called agency problem represents the heart of the Jensen, Meckling and Coase contractual view of the firm. Hart, Grossman and Moore explain this problem by focusing squarely on the investors' power relative to the insiders. By distinguishing between the contractual and residual control rights that investors have, the authors explain the incapability of the latter to write complete contracts that could determine all the actions and limit the discretion of the managers, also in unpredictable future circumstances.

[4]Thus, there are different systems of corporate governance. Most authors refer to the so-called outsider (USA, UK) and insider (Germany, Japan, Continental Europe) systems of corporate governance.

Conversely, the underdeveloped equity and debt markets in France, Belgium and Italy arise from the low protection of both creditors and shareholders alike.

Appropriate legal protection of investors prevents their rights from being expropriated by managers and is therefore one of the ways of solving the agency problem. In countries with poor legal protection, as is generally the case of continental European countries, investors seek out alternative ways to overcome management. The concentration of ownership and the resulting concentration of voting rights is, according to the proponents of the legal perspective of corporate governance, one example of large investors exercising their power (LaPorta et al., 1999).

In companies with concentrated ownership the agency problem takes on a new dimension in the sense of the expropriation of the rights of minority shareholders by the large shareholders. The large shareholders can make managers act in their interests and at the expense of the company's value, the minority shareholders and other stakeholders in the company. The fear of such expropriation by large shareholders reduces the willingness of the minority shareholders to invest funds in companies and thus has a negative impact on the capital market (LaPorta et al., 1996; Perotti, Modigliani, 1998). This could be the main reason underlying the relatively small capital markets in continental European countries and thus the non-active markets for take-overs (Lannoo, 1998). However, the capital markets in the Netherlands, Sweden and Switzerland are an exception.

Different legal frameworks are also the key factor behind differences in the concentration of voting rights in European countries[5] (Becht, 1999). For example, German law permits the use of many legal devices such as preference shares, proxy voting, golden shares, voting trusts etc. that allow shareholders to concentrate their voting rights without concentrating ownership. Consequently, the concentration of ownership in German companies is lower than the concentration of voting power[6]. The same applies to the

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[5]The United Kingdom is an exception as in most companies the ownership is dispersed. Half of the analysed companies in the UK, for example, do not have an owner holding more than 9.9 percent of the voting rights. One of the reasons for that dispersion could be the British Law on Take-overs which requires any shareholder acquiring 30 (or more) percent of shares to make a take-over bid (Becht, Roell, 1999). Roe (1994) claims that the main reason for the low dispersion of ownership rights in the USA lies in the financial institutions' regulations that prevents financial institutions holding large ownership stakes in companies.

[6] Becht (1999) found that the higher voting power concentration in Germany and Belgium resulted in lower liquidity of the companies' stock. On the other hand, this is not the case of the 30 largest German companies forming the DAX that represent 60-70% of the market capitalisation and turnover in shares on German stock markets. The voting right concentration in these companies is not linked to ownership concentration but is

Netherlands where the concentration of voting rights mainly takes place through so-called administrative offices (De Jong, Kabir, Marra, Roell, 1998). The administrative office holds original shares and votes of the company-issuer and issues non-voting certificates that can be listed on the Stock Exchange. The voting rights are thus concentrated in the hands of the insiders, while ownership remains dispersed. On the other hand, the concentration of voting rights in Belgium mainly takes place through pyramiding. The latter does not necessarily lead to more concentrated ownership, but allows income redistribution and creates the wrong incentives for monitoring.

Debate continues on the most efficient corporate governance system in continental Europe[7]. There probably should be no pyramid structures as they provide the owners with the wrong incentives and reduce the liquidity of capital markets. The latter in fact results from any increase in ownership concentration. The introduction of a mandatory take-over bid once a certain shareholder gains a determined threshold of a company's shares could reduce the direct control by large shareholders. The introduction of the one-share-one-vote principle could reduce the percentage of non-voting shares in a company's stock and cut the liquidity of the capital market. The trade-off between liquidity and control is thus yet to be found.

3. Concentration of voting power in Slovenian companies

3.1. Legal types of companies in Slovenia

The Companies Act[8] introduces two main forms of commercial companies: 1) a partnership (general partnership, limited partnership and silent partnership); 2) companies with share capital (limited liability company, joint-stock company and limited partnership);

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obtained through different legal devices. It assures both the appropriate control over management and liquidity of the capital market. Further, the monitor-holders of substantial voting blocks have the right incentive to increase the value of the company they own.

[7] As in the UK and the USA where there is weak control over management due to dispersed ownership.

[8] The Companies Act as the main law governing companies in Slovenia was modelled on the German regulation of commercial companies and adopted in 1993. Further amendments to the Act came in 1994, 1998 and 1999.

as well as two types of hybrid companies (double partnership and limited partnership with share capital)[9].

As seen from Table 1, the limited liability company is the prevailing legal form in Slovenia. In fact, at the end of 1999 there were 48,742 limited liability companies operating in Slovenia compared to only 1,365 joint-stock companies[10] out of a total of 80,166 legal entities.

Table 1: Legal entities by legal organisational form as at 31.12.1999

Legal organisational form	**Number**
General partnership	3696
Limited partnership	954
Limited liability company	48742
Joint-stock company	1365
Proposed title	4
Commercial association of interest	87
Holding company	14
Co-operative society (limited liability)	500
Co-operative society	28
Lawyers' firm (general partnership)	9
Enterprise for employment of the disabled	100
Principal subsidiary of a foreign business entity	246
Social enterprise	303
Central Bank	1
Bank (joint-stock company)	31
Savings bank and other financial organisations	108
Management company (joint-stock company)	23
Management company (limited liability company)	27
Investment company (joint-stock company)	45
Stock exchange (joint-stock company)	2
Stockbrokers' company	19
Agency	2
Insurance company (joint-stock company)	12
Public enterprise	48
Old legal organisational forms not yet harmonised with the new legislation	107
Other institutions, bodies and organisations	23693
TOTAL	**80166**

Source: Statistical Yearbook of the Republic of Slovenia, 2000

[9] See Table 1-A in the Appendix and the description of the main characteristics of different types of companies.
[10] There were 789 shares registered by the Clearing Deposit House at the end of 1999. These shares represented 57.8% of Slovenian GDP.

A joint-stock company can be established by at least 5 shareholders with a minimum capital of SIT 4,100,000 (approximately DEM 40,000). The majority of the stock companies (over 700) is represented by companies that had been privatised under the 1993 Privatisation Law. These remain the largest and most important Slovenian companies.

3.2. Legal rules governing ownership concentration and voting power concentration in Slovenian joint-stock companies

Voting procedure

Pursuant to the Companies Act, Slovenian joint-stock companies can issue both ordinary shares and preference shares. Each share shall carry one vote and only preference shares can be shares that do not attract voting rights[11]. The latter shall not constitute more than half of the capital stock. In any event, Article 305 permits a special law to provide for the issue of non-voting ordinary shares. The issuing of shares of the same nominal value but carrying a different number of votes (multiple shares) is strictly prohibited. The Articles of Association may limit the voting rights of an individual shareholder whereby their votes with respect to the number of shares shall not exceed a defined number or percentage.

Decisions of the assembly are valid if adopted in the presence of shareholders holding at least 15 percent of the capital stock represented. Unless provided differently by the Articles of Association, a majority of shareholders' votes cast (ordinary majority) is necessary for adoption of decisions of the assembly. The Act requires at least three-quarters of the votes cast for the adoption of special decisions, such as reducing the capital stock, liquidation of the company, changes to the Articles of Association, recalling of Supervisory Board members etc.

Shareholders accounting for at least ten percent of the share capital can, upon motion, request the court to recall the Supervisory Board (Article 267) and can also file a motion in court for the initiation of liquidation proceedings (Article 373). Shareholders accounting for at least five percent of the capital stock can require the assembly to be convened (Article 284) and can request an administrator for liquidation to be appointed by the court (Article 377).

Legal devices and voting rights' concentration

After depositing their authorisation in writing with the company, a proxy may exercise the voting right of another shareholder. The Companies Act does not define the nature of the relationship between the shareholder and their proxy. That is a matter for the two involved to define according to private contract. Proxy voting by an individual should be distinguished from the exercise of voting rights by a financial organisation or shareholders' association, both professionally involved in shareholders' representation.

According to Article 298, a financial organisation or other person may exercise or confer the exercise of a voting right for registered shares only with written authorisation to that effect. The shareholder may give such authorisation for a maximum period of 15 months and may withdraw it at any time. The financial organisation or other authorised persons exercising the voting rights for a shareholder needs to deposit a written authorisation with the company.[12]

If a financial organisation or shareholders' association exercises the voting right on behalf of another shareholder, the amount and class of shares for which they are authorised should be indicated in the list of participants at the assembly (Article 291). The list should be made available for inspection to all participants before voting.

The Act on the Privatisation of Legal Persons in the Ownership of the Slovenian Development Fund (Official Gazette of the Republic of Slovenia) refers to shareholders' participation through so-called authorised associations of workers (druzba pooblascenka). Pursuant to Article 17, the employees, former employees and other beneficiaries of an internal buy-out may constitute, for carrying out the internal buy-out, a special legal person to participate in the internal buy-out in its name but on behalf of its founders. Although the Companies Act does not refer to the authorised workers' association, it will probably represent one of the institutional representatives of shareholders. The shareholders create the association by contributing their own shares as the capital of the association with the only purpose to influence jointly, through a common representative, the management of their company (Bohinc,1996).

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[11] Companies Act, Article 179.

Regulation of joint-stock companies in the Slovenian capital market

The only stock market in Slovenia is the Ljubljana Stock Market, which is regulated by the Securities Market Act[13]. Securities on the Ljubljana Stock Exchange can be traded on the official market and the free market. The only differences between the two segments are the more relaxed reporting requirements for companies listed on the free market and the absence of the 10% daily limit on movements in securities' prices on the free market.

In order to be listed on the official market, an issuer must fulfil the following requirements (Article 233 of the Securities Market Act): 1) securities have to be fully paid up; 2) securities have to be freely transferable; 3) securities have to be issued in a dematerialised form; and 4) securities, given the operations of the issuer and characteristics of the issued securities, have to fulfil all the conditions stated by the Official Ljubljana Stock Exchange Rules (see table below).

Table 2: Conditions to be met before securities may be listed on the official market

	QUOTATION
1. years of operating	3
2. veracity and objectivity of financial statements	Audited financial statements for the past three years
2. the value of the capital*	SIT 500 million USD 3 million
3. minimum value of the stock of a class (book or market value if previously on the organised market)	SIT 200 million USD 1.25 million
4. diversification of the stocks**	At least 25% (SIT 100 million or USD 600,000)
5. minimum number of stock owners	150

* The value of the shareholders' capital, surplus, reserves and undistributed profits
** Public stocks are considered all securities except those ones owned by the management of the issuer and securities owned by those holding more than 10 percent of a particular issue

Source: Ljubljana Stock Exchange, Official Ljubljana Stock Exchange Rules

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[12] The Companies Act does not refer specifically to the shareholders' association. In any event, it states that all provisions referring to financial organisations shall also apply in the case of a shareholders' association representing the shareholders.

13 More than 400 articles of the Securities Market Act determine the issuance and trading of securities, the role of the Stock Exchange, the Securities and Exchange Commission (SEC), the Central Securities Clearing Corporation (KDD), as well as other participants in the securities market. Further, on the basis of Article 227 of the Securities Market Act and the Articles of Association of the Ljubljana Stock Exchange, the Management Board of the latter has adopted its own Rules and Procedures.

The free market has been operating since January 1995. All securities not accepted for quotation on the Stock Exchange official market are listed on the free market.

Disclosure. When applying for listing, companies are required[14] to disclose all the information requested in Article 20 and the names of the holders of 10 % or larger stakes of the issued securities[15]. The securities issuer has to inform these 10% threshold owners about the application for approval for a public offering. The disclosure of information and reports for companies whose securities are listed are further defined by the Rules and Procedures of the Ljubljana Stock Exchange. Those companies whose securities are listed have to regularly notify the Stock Exchange and the public about their unaudited and audited financial statements. Besides, they are requested to notify the Stock Exchange and the public about all events and circumstances that could have a material impact on the price of their securities.

Transparency Directive. The provisions of the Large Holdings Directive are in a way implemented in Article 64 of the Take-overs Act (Official Gazette 47/97). The Act regulates the manner and conditions of the purchase of securities of an individual joint-stock company-issuer of securities, when a natural or legal person acquires or wants to acquire a proportion of securities that gives them more than 25 percent of the voting rights arising from those securities. Any person who acquires a proportion of shares in a joint-stock company which give, together with securities previously acquired, at least 25 percent voting right has the obligation to make a public bid to purchase these shares according to the Take-overs Act (Article 4).

Further, any individual directly or indirectly acquiring 5% of the issuers' voting securities or any further 5% of these securities (referred to as a qualified holding) is required to give notice about the acquisition to the issuer of these securities and the SEC (Article 64, Take-overs Act).

[14] Securities Market Act, Article 55.
[15] Those companies whose securities are listed on the official stock market have to notify the Stock Exchange of the names of the ten biggest security holders, the total number of security holders, as well as the percentage of shares held by the company's management board.

Regulation of institutional investors

Privatisation investment funds (PIFs). Privatisation investment funds[16] are regarded as a special form of investment companies established for the purpose of collecting ownership certificates from the public and investing them in corporate shares, issued according to the Law on Ownership Transformation. Besides some exceptional provisions[17], the same rules as those for normal investment companies apply to privatisation investment funds: 1) an investment company, mutual fund, or PIF shall not hold more than 10 percent of its portfolio in the securities of foreign issuers and only in the securities listed on stock exchanges selected by the Slovenian SEC; 2) an investment company, mutual fund or PIF can hold up to 70 percent of its portfolio in securities issued and guaranteed by the Republic of Slovenia if those securities have been issued in at least five different issues (each issue can involve a maximum 35% of the PIF's or investment company's portfolio); 3) an investment company of a PIF shall not, unless authorised by the SEC, hold any shares in other investment companies (or PIFs), in banks authorised to perform payments for the investment fund, the Central Securities Clearing Corporation that has been authorised for saving the funds' securities, an authorised stockbroking company as well as in stakes exceeding 10 percent in other legal entities that directly or indirectly own more than 10 percent of the capital of the management company that runs the investment company.

Further, privatisation investment funds are subject to the same portfolio diversification rules as ordinary investment funds (mutual funds and investment companies), except for the following: 1) a PIF shall not hold more than 10 percent of its assets in the shares of a single company or group of companies (for other investment funds, investment companies and mutual funds, the percentages are lower); 2) a PIF shall hold not more than 20 percent of its assets invested in the fixed assets sold by the Slovenian Development Fund; 3) a PIF shall not hold ownership stakes above 20 percent in legal entities that have any business connections

[16] Law on Investment Funds and Management Companies, Article 126.

[17] For example, the minimum capital required for a PIF is SIT 100 million (SIT 200 million for other investment companies), the maximum being SIT 10 billion; the shares of the PIF can be paid up with money or ownership certificates; unlike for the other investment companies (unlimited transferability of shares), up until the PIF is listed on the Stock Exchange the PIFs' shares can are not transferable by the legal contracts between their owners etc.

with legal entities holding more than 10 percent share in the capital of the management company managing the PIF.

The management company[18] is the only entity authorised to establish and run a mutual fund, investment company or privatisation investment fund. While not allowed to directly or indirectly own any claims in the mutual fund that it manages, the management company should subscribe and fully pay up shares of a total value of at least SIT 1 million when establishing an investment fund. Once the fund is established, the funds' management company cannot acquire or dispose of any shares. The management company should not directly or indirectly own shares or business stakes in other management companies, in banks authorised to perform payments for the investment fund, the Central Securities Clearing Corporation that has been authorised for saving the funds' securities, the authorised stockbroking company and its own shareholders.

Capital fund. The Capital Fund is a joint-stock company founded by the Republic of Slovenia with the aim to provide additional funds for pension insurance by managing funds gathered in the ownership transformation process and by managing other pension funds.

Restitution fund. The Slovenian Restitution Fund was founded as a joint-stock company in 1993 (The Law on the Restitution Fund) by the Republic of Slovenia for the purpose of compensating all those who suffered loss through nationalisation according to the Law on De-nationalization and other laws.

3.3. Voting rights[19] of the largest shareholders in Slovenia's listed and unlisted companies

[18] The management company can be established both as a joint-stock company (with registered shares of one class only) or a limited liability company (d.o.o.).

[19] The analysis of voting rights is based on the analysis of ownership stakes. Except for authorised associations of workers, firms are not obliged to report voting blocks, which may be the result of proxy voting.

Our empirical analysis involves 136 Slovenian companies (banks, insurance companies and privatisation investment funds and mutual funds excluded) listed on the official and free markets of the Ljubljana Stock Exchange, as well as 578 unlisted companies. In order to get the best possible estimate of the voting rights held by any individual shareholder, only ordinary shares were taken into account.

The frequency distribution of the 136 Slovenian listed companies according to the percentage of voting rights held by the largest shareholder is shown in Table 3 and Figure 1.

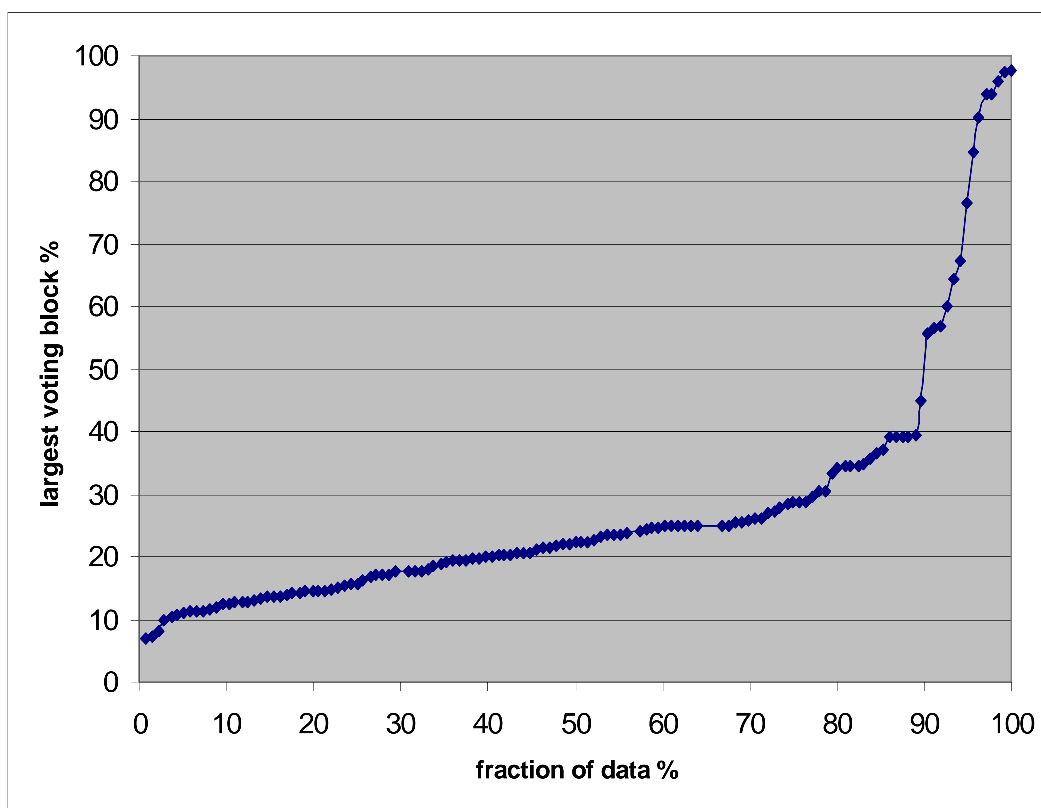
Table 3: Frequency distribution of 136 listed companies, by share of voting rights of largest shareholder

Voting rights (%)	Number of companies	Percentage of companies %	Cumulative percentage %
0–5	0	0	0
5–10*	4	2.9	2.9
10–15	26	19.2	22.1
15–20	25	18.3	40.4
20–25	36	26.5	66.9
25–30	14	10.3	77.2
30–35	8	5.9	83.1
35–40	8	5.9	89.0
40–45	1	0.7	89.7
45–50	0	0	89.7
50–55	0	0	89.7
55–60	4	2.9	92.6
60–65	1	0.7	93.4
65–70	1	0.7	94.1
70–75	0	0	94.1
75–80	1	0.7	94.9
80–85	1	0.7	95.6
85–90	0	0	95.6
90–95	3	2.1	97.8
95–100	3	2.1	100
TOTAL	136	100	

*Above 5 to 10 (included)

Source: Own analysis on the basis of CDD data holders as at July 6, 2000.

Figure 1: Voting rights of largest shareholder in 136 selected Slovenian companies listed on the official and free markets of the Ljubljana Stock Exchange



Source: Own analysis on the basis of CDD data as at July 6, 2000.

In half of all companies the largest shareholder holds at least 23 percent of the voting rights, while the average voting stake held by the largest shareholder is 27.4 percent. In 10 percent of companies, the largest shareholder owns the majority of voting rights, while there are only 5 percent of companies that have a shareholder holding 75 percent of the voting rights. Most frequent among these block-holders are the privatisation investment funds (they are the largest shareholder in 37.5 percent of all the companies), followed by other non-financial companies (20.1 percent), the Capital Fund (in 15.4 percent of companies), private individuals (8 percent), the Restitution Fund and foreigners (5 percent). Banks are the largest shareholders in four companies. An authorised association of workers, representing the beneficiaries of internal distribution, is the main shareholder in one company.

Table 4: Ownership stakes of the largest shareholder, by identity of the shareholder

Type of shareholder	No. of companies	% of companies
Individuals	11	8.1
Foreigners	7	5.1
Republic of Slovenia	4	2.9
Non-financial companies*	28	20.6
Banks	4	2.9
Insurance comps.	0	0
Capital funds	21	15.4
Restitution Fund	8	5.9
Privatisation Investment Funds	51	37.5
First Pension Fund	0	0
Authorised workers' association	1	0.8
Development Fund	1	0.8
Total	136	100.0

*Includes companies that are not banks, insurance nor investment funds.

Source: Own analysis on the basis of CDD data as at July 6, 2000.

In half of all the selected companies, the second largest shareholder holds about 13 percent of the voting rights, while the third largest shareholder has only four percent less. These figures evidence the relatively strong competition among the largest shareholders of Slovenian companies. Without a consensus, none of them can exercise any substantial influence at the Shareholders' Assembly.

Table 5: Ownership stakes of the first, second and third largest shareholders

Share	Min.	Max.	Average	Median
First largest	**7.07**	**97.72**	**27.44**	**22.3**
Second largest	**0.08**	**33.33**	**13.35**	**12.13**
Third largest	**0.05**	**25.00**	**9.2**	**9.48**

Source: Own analysis on the basis of CDD data as at July 6, 2000.

The ownership structure of Slovenian listed companies is thus the result of the privatisation model chosen - mass privatisation through the free distribution of vouchers, the mandatory transfer of certain percentages of capital to state funds and a free choice as to the distribution of the remaining 40 percent to insiders or outsiders. The ownership of Slovenian

listed companies is dispersed among privatisation investment funds, state funds, other non-financial enterprises, employees, former employees and retired people.

By contrast, as seen in Table 6 and Figure 2, the ownership structure of unlisted joint-stock companies is more concentrated.

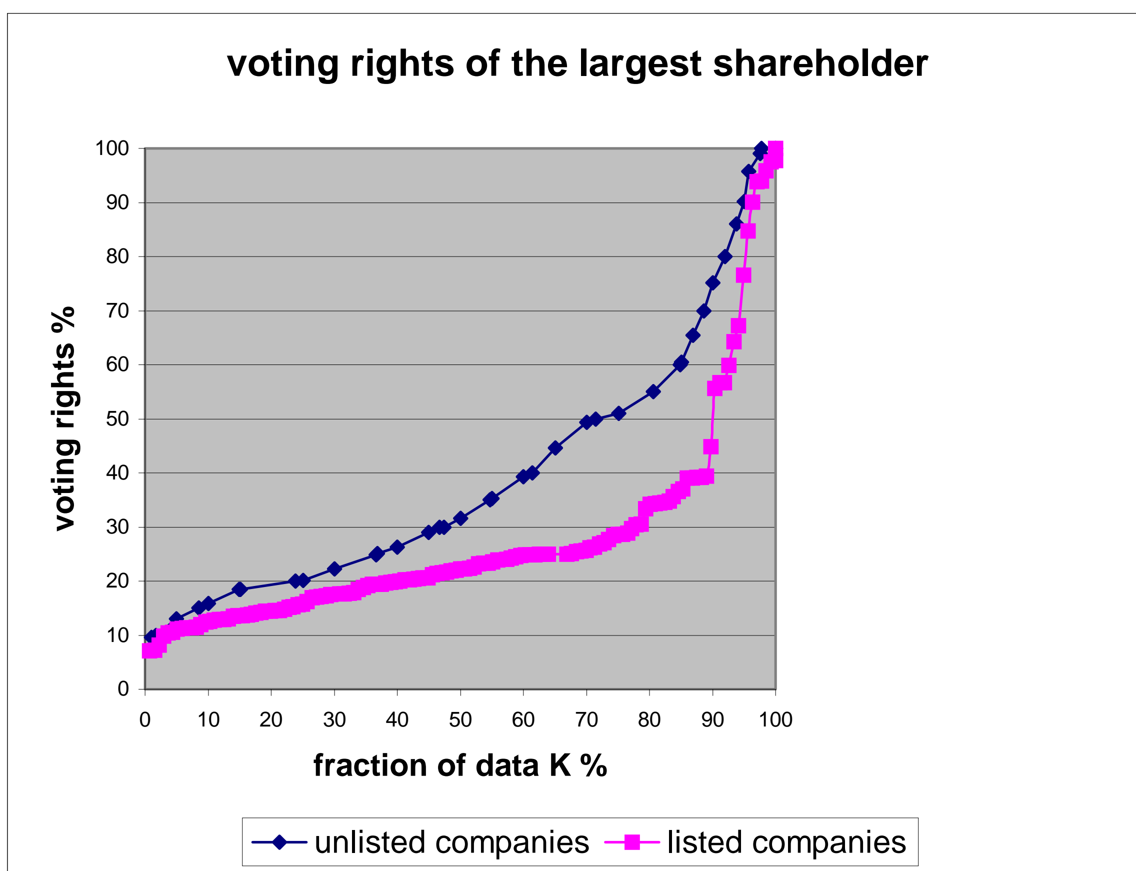
Table 6: Frequency distribution of 578 unlisted companies, by share of voting rights of the largest shareholder

Voting rights (%)	Number of companies	Percentage of companies %	Cumulative percentage %
0–5	0	0	0
5–10*	10	1.7	1.7
10–15	39	6.8	8.5
15–20	89	15.4	23.9
20–25	74	12.8	36.7
25–30	62	10.7	47.4
30–35	42	7.3	54.7
35–40	39	6.7	61.4
40–45	23	3.8	65.2
45–50	36	6.3	71.5
50–55	53	9.1	80.6
55–60	25	4.3	84.9
60–65	10	1.8	86.7
65–70	11	1.9	88.6
70–75	7	1.2	89.8
75–80	13	2.2	92
80–85	9	1.6	93.6
85–90	7	1.2	94.8
90–95	4	0.7	95.5
95–100	26	4.5	100
TOTAL	578	100	

*Above 5 to 10 (included)

Source: Own analysis on the basis of CDD data as at July 6, 2000

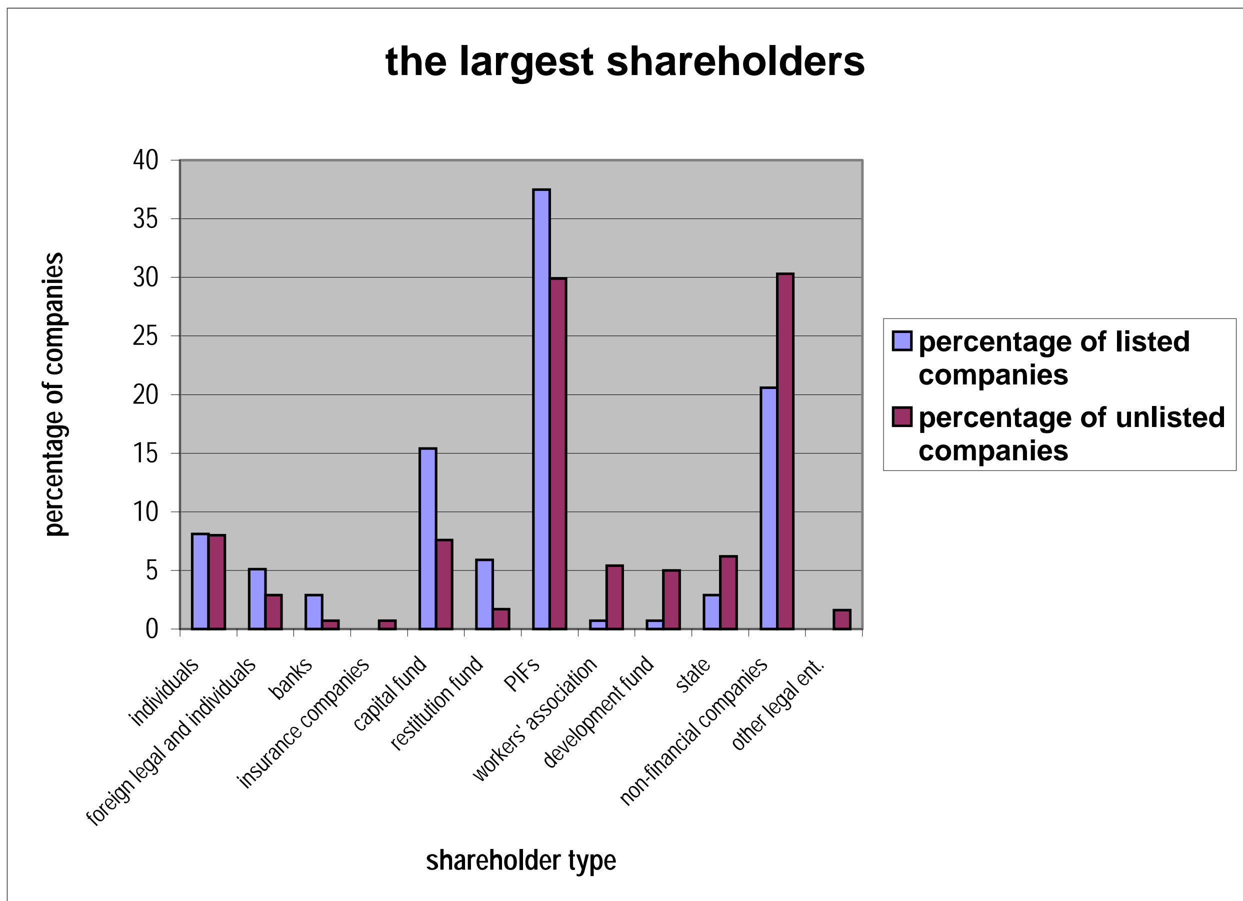
Figure 2: The voting rights of the largest shareholder in 136 listed Slovenian companies and 579 unlisted companies



Source: Own analysis on the basis of CDD data on July 6th, 2000

The largest shareholder in unlisted companies on average holds 38.84% of voting rights. In half of the companies, the voting stake of the largest shareholder exceeds 31.65%. The frequency distribution of the listed and unlisted companies by the identity of the largest shareholder is shown in Figure 3. Foreigners, banks and institutional investors are less common among the largest shareholders of the unlisted companies with respect to those listed on the official or free markets. On the other hand, non-financial companies, the state, the Slovenian Development Fund and authorised workers' associations are more common.

Figure 3: Histogram of Slovenian listed and unlisted companies –percentage of companies by identity of the largest shareholder



The state is mainly involved in those companies that transformed from state-owned to joint-stock companies (infrastructure companies, companies with special importance for the state etc.). These companies generally do not fulfil the listing conditions. On the other hand, companies with the Slovenian Development Fund as the largest shareholder are part of its portfolio and have adopted the legal form of a joint-stock company. It is generally believed that the role of the state and the Slovenian Development Fund in Slovenian companies should be limited.

More interesting (see table below) is the role of non-financial companies and the authorised workers' associations as the main shareholders of unlisted companies. They are not only more frequent, but on average hold larger stakes with respect to the listed companies. The average voting rights' stake of non-financial companies in unlisted

companies in fact exceeds 50 percent, and is slightly below 50 percent in the case of authorised workers' associations.

In 50 percent of companies with a non-financial company as the largest shareholder the voting rights' share of the latter exceeds 50 percent. The median percentage held by the largest shareholder shrinks to 30 percent in those companies where the largest shareholder is a privatisation investment fund.

Table 7: Average stake (%) of different groups of the largest shareholders in listed and unlisted Slovenian companies

Shareholder type	Number of companies listed	Mean stake %	Number of companies unlisted	Mean stake %	Difference Sign (two-tailed)
Individuals	11	21.3	46	27.1	0.41
Foreign legal and individuals	7	38.3	17	49.2	0.28
Banks	4	32.57	4	71.85	0.12
Capital Fund	**21**	**17.42**	**44**	**22.23**	**0.00**
Restitution Fund	8	15.74	10	15.71	0.99
PIF	**51**	**25.03**	**173**	**30.22**	**0.01**
Non-financial Companies	**28**	**40.37**	**175**	**50.6**	**0.10**
Workers' organisation	**1**	**39.10**	**31**	**45.6**	-
State	4	24.28	36	47.22	0.01
Development F.	1	64.3	29	43.23	-
Insurance co.	0	0	4	41.24	
Other legal ents.*	0	0	9	30.67	-

* Associations and clubs.

The stronger voting rights' concentration seen in unlisted companies is probably the result of a higher number of subsidiary undertakings (dependent companies) among the unlisted companies. Some of these undertakings were already part of the present company groups at the time of privatisation, others have resulted from the take-over activity taking place in Slovenia since privatisation (Lahovnik, 1999). The most common take-over targets are companies with the same owners or whose owners belong to the same type (privatisation investment funds, state funds etc.) than those of the company that is doing the taking over. In

this case, the owners of the target company simply exchange their shares for shares in the company that has been doing the taking-over. That is probably why the average ownership share of privatisation investment funds and the Capital Fund as the main shareholders in unlisted companies is significantly larger than that for listed companies[20].

Slovenian companies mainly merge or take-over other companies to benefit from the synergy arising from the integration of activities, the diversification of activities and to gain access to foreign markets. The replacement of inefficient management, therefore a solution to the agency problem, was not stated as one of the most important reasons for take-overs (Lahovnik, 1999). In fact, the proponents of take-overs are often the managers of both companies involved in a take-over.

An agreement between the main institutional investors of the target company seems to be the necessary condition for a take-over to occur. As they individually hold relatively small voting blocks, only co-operation between these owners and the managers guarantee the success of a take-over. This is the case of so-called trading in blocks. This trading lacks transparency as it usually takes place away from the official markets without any notification of the exchange being made to the public[21]. The relatively substantial increase of authorised workers' associations and their average voting rights' stake can be explained as a defensive strategy of the target companies, initiated by their managers to prevent institutional investors acting in their own interest.

4. Capital market liquidity and free trading of ownership rights

Market capitalisation as a proportion of Slovenian GDP amounted to 16.5 percent at the end of 1999. This figure puts Slovenia at the level of Austria and Italy, both countries with high ownership concentration and small capital markets. Further, the so-called secondary capital market in Slovenia lacks liquidity[22] and does not function as intended. Share prices have been declining recently and an individual firm's performance has almost no

[20] In 25 percent of unlisted companies with a non-financial company as the largest shareholder, a listed company represents the latter.
[21] The CDD only reports changes in ownership, but not the price at which ownership was transferred.
[22] Liquidity has been on a decline since 1993. The average turnover ratio at the end of the 1998 reached the value of 0.29.

influence on its shares' price level. Share prices increase only when a serious potential buyer appears in the market.

Moreover, unlike the German system bank financing is relatively underdeveloped. Although banks are the main providers of external finance to Slovenian companies, these external sources represent only a small part of corporate financing. Monitoring by external shareholders is relatively weak, and membership on a company's Supervisory Board can be obtained on the basis of relatively small ownership stakes (Pahor, Ferligoj, Prasnikar, 2000).

Since the secondary capital market was created artificially there was no room for a primary[23] capital market to develop. An efficient and liquid capital market is a necessary condition for the development of a primary capital market that allows fresh funding to get to the companies. Given the size of Slovenia's capital market, the current corporate governance system and efficiency of Slovenian companies, no huge investments in the emission of new securities will probably take place. In any case, there is probably no sense to develop this market now and therefore there is no need for the secondary capital market to be liquid.

Capital market liquidity in a small country such as Slovenia will increase as soon as Slovenia becomes completely financially open. In order to make this happen, we have to rectify all the obstacles or inefficiencies in the secondary capital market that could prevent the development of an ownership structure that would lead to an increase in the efficiency of Slovenian companies. One of the main questions is, whether the shares of enterprises are on the capital market and whether they can be obtained by those wanting to be actively involved in corporate governance. If there were no obstacles or bizarre behaviour of investors in the secondary capital market, this market could lead to an ownership structure that would ceteris paribus allow Slovenian enterprises' increased efficiency. Therefore, the secondary capital market is important and it is necessary to rectify all inefficiencies that could limit its performance.

The main actors in the secondary capital markets are the management companies of the privatisation investment funds acting directly or indirectly via their privatisation investment funds. These companies are allowed to buy shares in companies as well as to be

[23] In the last six years, for example, there were only 23 new share issues. 75% of these shares were banks' shares, while only 10 percent belonged to other companies.

shareholders of the privatisation investment funds they manage[24]. They manage the assets of their privatisation investment funds without any strong supervision[25]. Other important actors in the Slovenian capital market are the brokerage companies acting on their behalf and on behalf of their clients. The brokerage firms are connected with management companies and privatisation investment funds formally, on a capital basis, but also informally. Then there are state funds, whose involvement in the ownership of Slovenian companies can lead to a direct political influence on their investment portfolio. The latter can in fact also result from any co-operation between the state funds and the three or four largest management companies. The group that bears the negative consequence of this influence is the public itself that ends up seeing its shares as worthless, as well as any external investors, including foreigners, that want to buy or sell Slovenian shares.

Banks and other non-financial companies are also important, although their behaviour differs from that of the management companies of privatisation investment funds and state funds. For them, buying shares is mostly a way to place their excess liquidity. They thus trade mostly out of speculative reasons and find it very hard to resell the shares without capital losses. Therefore, they would greatly benefit from a more liquid secondary capital market.

We should, however, not determine in advance which ownership structure is the right one. It is clear that the correct structure is that which results from unlimited trading in shares on an efficient and liquid capital market. The result of such changes would clearly be a fall in the number of joint-stock companies in Slovenia and many of today's joint-stock companies would become limited liability companies. A balanced ownership structure will evolve over some time as will appropriate corporate governance mechanisms adjusted to the new ownership and organisational structure of Slovenian companies. For these changes to occur, a preliminary change in the secondary capital market is necessary.

[24] As already stated, except at the time of establishment when they had to invest a certain amount in investment funds, management companies were not allowed to buy shares of the investment funds they manage. However, the Law on Privatisation Investment Funds and Management Companies, Article 130, requires from management companies that at least 1/3 of the commission fee for managing investment funds is paid in shares of investment funds.

[25] The Law on Privatisation Investment Funds and Management Companies provides the main provisions governing a privatisation investment funds' Supervisory Board. The latter should consist of at least three outside members - independent experts not employed or in any other way connected to the management company. The members of the privatisation investment funds' Supervisory Boards are appointed by the founders - the management companies.

The transformation of privatisation investment funds into open-end funds, investment companies and financial holdings, due to take place by 2002, should resolve some of the present obstacles in Slovenia’s capital market. The open-end funds or investment companies managed by the same management company should not hold, together with the ownership share of the management company, more than 2 percent of the stock of a single domestic company. Moreover, this ownership stake should not exceed one percent of the total assets of the fund and its management company. This would ensure the dispersion of the portfolio of investment funds (investment companies and open-end funds) and would force them to invest mainly in foreign securities. There would thus be enough room for foreigners to buy shares in Slovenian companies. If privatisation investment funds are transformed into financial holdings, they should hold at least 50 percent of a single company’s voting rights in order to allow them to play an active role in the company’s decision-making. These would moreover prevent any diversion between direct and indirect ownership of the companies under the control of financial holdings.

The two state funds should withdraw from Slovenian companies. The same rules regarding portfolio dispersion as for management companies and their privatisation investment funds should apply. After the removal of all limits on foreign investment in Slovenia and on domestic institutions’ investments abroad, due to take place by February 1, 2003, these funds should not hold more than 10 percent of their assets in the securities of domestic issuers.

5 Conclusions

Dispersed ownership, established mainly by the Privatisation Act, and the illiquid capital market in Slovenia, do not fit comfortably together. Dispersed ownership together with the wrong initiatives result in a lack of prevailing monitoring of management and a fight between different interest groups for power. Restructuring is slower than it should be. There

is inefficiency in resource allocation and thus a loss in the social product. This is the main reason for Slovenian firms' change of ownership structure.

It is difficult to say who would be the best owner of Slovenian companies. What is obvious is that there is an excessive number of companies in the form of a joint-stock company, including those not meeting the minimum requirements that apply to this legal form. Moreover, it is clear that the correct ownership structure of Slovenian companies will evolve as soon as there are no constraints on share trading.

Capital market liquidity in a small country such as Slovenia will increase once Slovenia becomes completely financially open. In order to make this happen, some basic changes are called for, such as the transformation of privatisation investment funds into open-end funds, investment companies or financial holdings. The former two should be subject to a portfolio diversification rule, while the latter should hold at least the majority of voting rights in the companies they control.

The same portfolio diversification requirement should apply to the state funds. These funds should not invest more than 10 percent of their funds in domestic securities.

The requirements referred to above on the behaviour of privatisation investment funds and state funds would not be necessary if these funds could change autonomously and were not subject to political influence. As the latter does happen in practice, legal provisions are necessary. Financial stability and soundness will not take place without the financial integration of Slovenia's capital market with the European capital market. At that stage, there would be a liquidity problem in the Slovenian capital market only if there is a liquidity problem in the European capital market.

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1. APPENDIX

Table 1a: Main characteristics of the different types of companies

Legal Forms	**General Partnership**	**Limited Partnership**	**Double Partnership**	**Silent Partnership**	**Joint-stock Company**	**Limited P Share Capita**
Names of legal forms	družba z neomejeno odgovornostjo (d.n.o.)	komanditna družba (k.d.)	dvojna družba	tiha družba (t.d.)	delniška družba (d.d.)	komanditna (k.d.d.)
Main features	⇒ legal person ⇒ unlimited liability of partners with their share and their personal assets ⇒ suitable for family businesses	⇒ legal person ⇒ two types of partners: general partner has unlimited liability, special partner limited ⇒ provisions for general partnership apply to limited partnership unless otherwise determined	⇒ legal person ⇒ limited partnership in which all general partners are companies in which there are no personally liable partners **(e.g.?**	⇒ not a legal person (not registered) ⇒ silent partner invests assets in the company of the principal of the silent partnership and acquires the right to share in the profits	⇒ legal person ⇒ limited liability of shareholders (only liable to the limit of the value of unpaid shares)	⇒ legal pe ⇒ two ty genera unlimite stockho liability
Minimum capital	None	None	None	None	SIT 4,100,000	None
Min. no. of owners	2	1 + 1	1+ 1	exactly 2	5 (will be changed to no limit)	1 + 1
Lowest number of managers	⇒ all partners have the right to manage the business of the company ⇒ the partnership agreement can transfer the management to one or more partners or a third person ⇒ if several partners manage the business, usually each of them is entitled to do business unless the partnership agreement provides for joint management ⇒ it is possible to revoke or renounce the right to management	⇒ special partner(s) are not entitled to manage the company (if they do, they will be accountable as a general partner - unlimited liability) ⇒ regulation regarding management of general partner(s): same as General Partnership partners	⇒ same as Limited Partnership	⇒ same as the principal of the silent partnership (depends on what kind of company it is)	⇒ Executive management: one or more managers ⇒ if the management is organised as one-tier (no Supervisory Board) Executive management must have at least 3 members	⇒ for m provisio Partner as appr