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ENTERPRISE GOVERNANCE IN TRANSITION – A STAKEHOLDER PERSPECTIVE

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Mature market economies have thrived on very diverse systems of corporate governance. Transition economies in Central and Eastern Europe have entered the market economy with a special historical inheritance, and critical political decisions of key institutions that have a bearing on the new systems of governance evolving in the region. In this paper, I use an analytical stakeholder approach (different from a normative approach) to identify how the specific conditions in countries in transition have influenced the evolution of specific governance structures, and how this influences the workability of the system.

I employ a broad definition of *enterprise governance* that incorporates *fixed, residual* and *appropriated* rights among a broad range of different stakeholders. The governance system is a function of the markets that the firm operates in, by state regulation, and by other specific firm and stakeholder conditions. Based on this definition, I analyse some general determinants behind the governance structure in a market economy, focussing on the distribution of rights among stakeholders. Governance systems in Western countries are used as a benchmark to explore the specific conditions for governance structures in economies in transition.

Governance structures changed over different stages in the transition process, with privatisation being the single most important determining factor. Consequently, the role of different stakeholders varies across countries, and has evolved considerably over time. The specific conditions of the transition process have favoured insider ownership mostly in the form of management ownership, but in some cases, also broader employee ownership. However, the relative strength of insiders, especially employees, has declined considerably in later stages of the transition.

Keywords: corporate governance, transition, ownership structure, stakeholders, enterprise objectives

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1. INTRODUCTION AND OVERVIEW

Corporate governance and ownership structures vary considerably among mature market economies (Shleifer and Vishny, 1997; Berglöf, 1997; Mayer, 1998). In Central and Eastern Europe we observe even bigger variations, but also some common trends specific to the transitional economies. This paper gives some theoretical explanations of this variation and the fact that some structures, like insider ownership including broad employee ownership, have become much more widespread in Eastern Europe than in the West. This can be explained by a combination of historical inheritance and political decisions taken in the early 1990s concerning institutions for the new market economy. Most crucial have been the chosen methods of privatisation, but also other aspects of the rudimentary institutional framework, the high uncertainty and the nature of change in production structure influencing the new governance system.

To understand this development, it is necessary to employ a broad perspective on enterprise governance. I thus look beyond publicly traded corporations and the relation between investors and managers, which has been the focus of most prior literature. I include specific insider-owned enterprises and analyse a broad range of stakeholders involved in the production process. This stakeholder approach allows identifying how the specific conditions in countries in transition determine the development of specific governance structures. Moreover, external conditions influencing governance structure are considered, including markets, state regulation as well as specific firm and stakeholder conditions.

The framework thus developed is then employed to analyse the governance systems in different countries in transition, and possible future trends in the development of these systems. Governance structures changed over different stages in the transition process, with privatisation being the single most important determining factor. In consequence, the role of different stakeholders varies across countries, and has evolved considerably over time. The transition process has often favoured insider ownership in the form of management ownership, but in some cases also as broader employee ownership. However, the relative strength of insiders, and especially employees, has declined considerably in later stages of the transition.

The following section summarises different conceptual approaches to corporate governance. It introduces the stakeholder approach, noting the appropriation of rights from the owner by other stakeholders as a particular problem. Section 3 describes some general determinants of governance structures in a market economy, and section 4 analyses the distribution of rights among different stakeholders. Section 5 describes the link between institutional conditions and governance structures in selected Western countries, providing a benchmark for the

subsequent analysis. Section 6 describes the specific conditions for developing governance structures in economies in transition, considering the privatisation process, different markets, state regulation, enterprise level condition, and stakeholder-related conditions. The focus for the analysis is the role of different stakeholders in the governance structure. Section 7 gives a conclusion.

2. PRINCIPLES OF ENTERPRISE GOVERNANCE

There is no generally accepted definition of corporate governance. The narrow definition takes its starting point in Berle and Means (1932) and their focus on the conflict of interest between the manager and the owners. Later on Jensen and Meckling (1976) and Fama and Jensen (1983) explicitly using an agency approach developed the theory. Following this tradition, Shleifer and Vishny (1997) use this definition of corporate governance: *The ways in which suppliers of finance to corporations assure themselves of obtaining a return on their investment.*

Other authors use a very broad definition to include all the influences affecting the institutional processes determining corporate governance, see e.g. Turnbull (1997): *Corporate governance describes all the influences affecting the institutional processes, including those for appointing the controllers and/or regulators, involved in organising the production and sale of goods and services.*

However, such a definition is too broad to be operational. Isaksson (1999) uses a functional approach: *The system for mobilising, allocating and monitoring resources for production in the enterprise.* This definition is primarily oriented towards the capital inputs. It can be used for showing how a well-functioning institutional system with high transparency can give the best guarantees for both credit capital and equity. In this way, capital can be mobilised in the cheapest way, allocated efficiently in the firm and between the firms and the return effectively monitored. However, it can also be applied to other inputs such as labour, intermediary goods, contracts for sale of outputs etc. In this way, it opens up for a wider stakeholder approach, and can be applied to evaluate different types of corporate governance systems.

By applying the stakeholder perspective, I shall distinguish between the normative and the analytical approach. The normative approach emphasises that stakeholders other than capital-investors should participate in the rights in relation to the enterprise (Donaldson and Preston, 1995). The analytical theory as expressed by Hill and Jones (1992) includes a broader range of stakeholders to give a more comprehensive analysis of the way enterprises are governed. Managers are considered as the only group of stakeholders who enter into a contractual relation-

ship with all the other stakeholders. Hill and Jones formulate a stakeholder-agency theory with the manager as the agent. But why appoint one of the stakeholders as the agent? Instead, the game around the enterprise shall be understood as performed by different stakeholders who in relation to each other have a varying degree of conflicting interests.

A *governance structure* for an enterprise here is defined as the distribution among stakeholders of both the formal rights and the appropriated rights concerning: 1) control, 2) income flow, 3) assets and liabilities, and 4) information of the enterprise. The *governance system* consists of the formal and informal institutions that determine the governance structure.

A *stakeholder* in the enterprise is an individual, a group or a legal entity who:

- has *interests* in relation to the enterprise,
- contributes *resources*: capital, technical skills, management skills, governance skills,
- holds *rights and obligations* in relation to the enterprise.

The enterprise is characterised by a given technology and set of products. A production function describes the relations between capital, labour and other inputs needed to produce a specific combination of outputs. The enterprise can thus be characterised by the number of employees, needed capital equipment, capital intensity, and the specificity of capital and labour (i.e. to what extent capital and labour can be used in another production unit without loosing value).

Some of the rights (and obligations) related to the governance structure are *fixed* in contracts between the stakeholder and the enterprise. These rights are normally enforceable, provided that the transaction costs for negotiating, writing and enforcing the contract are low. Examples of fixed rights include interest on loan capital, tax to the state, wage-contracts for employees, etc. Some of these rights and obligations are determined on the markets for products, labour and debt and/or they are determined by state regulation.

However, because of lack of information, uncertainty about the future, etc., contracts are incomplete. Only parts of the rights are fixed in contracts. The *residual rights* and obligations are connected to the owner (Grossman and Hart, 1986). If these *ownership rights* are clearly defined, they can be exchanged with external agents or institutions and traded on equity markets. These institutions and markets are part of the governance system. This is illustrated in *Figure 1*.

Rights are either fixed or residual. However, not all the fixed rights can be enforced, and not all the residual rights can be assumed by the owner. Therefore a third type of rights emerges: *rights appropriated* by other stakeholders. The owners have the right to the residual, the surplus, but a stakeholder may appropriate part of this – e.g. shirking by workers, transfer pricing, managers tunneling values out of the firm. This appropriation of rights by the manager or by other stake-

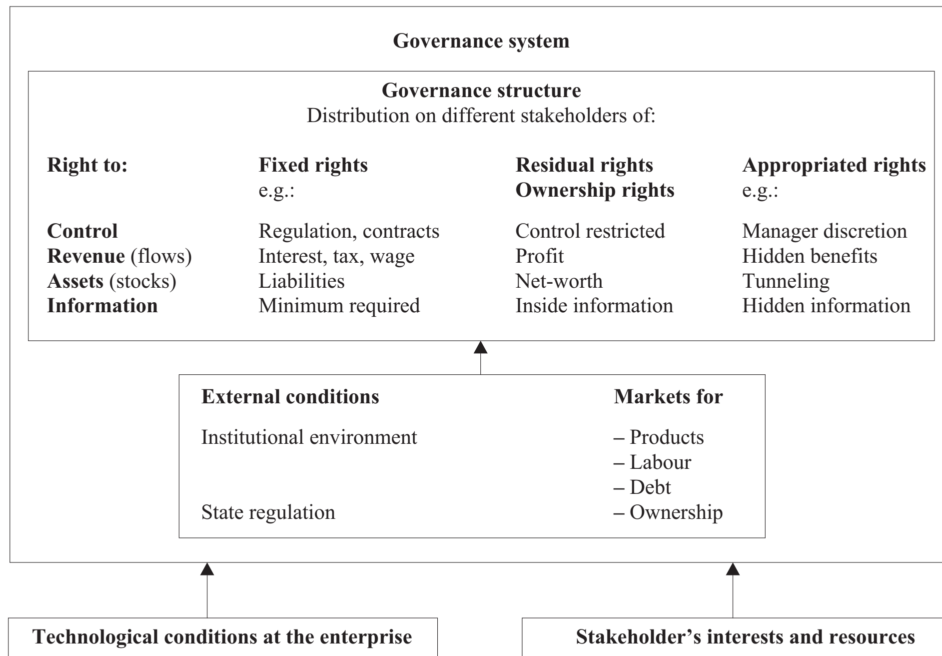

Figure 1. The elements of enterprise governance

holders is the core of the *governance problem*. In the narrow definition of corporate governance it is related to the manager appropriating rights from the owners. It could also be a majority owner appropriating a higher share of the surplus through transfer pricing on the expense of minority owners. This appropriation does not need to be illegal. It depends on the legislation and it can simply be based on bounded rationality by the owners, who do not know their rights or do not have enough skills to perform these rights – e.g. a paternalistic culture could be a way for managers to appropriate rights from employee owners.

The distinction between ex ante fixed rights, residual rights or ownership rights, and appropriated rights are summarised in *Figure 1. Control rights* may be fixed, defined in market contracts or by state regulation restricting the scope of action of the company – e.g. environmental regulation, regulation of working conditions, etc. The residual control rights accrue to the owner as ownership rights. If a manager takes over some of the control without being monitored by the owners, he appropriates some of these ownership rights. The *rights to the flow of revenue* can in the same way be divided between payments fixed in contracts: salary for employees, interest for debt finance, tax for the state, etc. Owners receive the re-

sidual profit, but the manager can appropriate part of this as hidden benefits. Moreover, a majority owner may appropriate part of the profit – e.g. by transfer pricing, to the detriment of minority owners. The *rights to the stock of capital* can be distinguished in a similar way: Liabilities are separate from the residual net worth belonging to the owners, which again can be diluted by asset stripping by a manager. Finally, the enterprise can be obliged to deliver certain *information* to its different stakeholders as stipulated in contractual agreements or through state regulation. The residual information can be kept by the owner or appropriated by other stakeholders, in most cases by the manager.

Any stakeholder can simultaneously possess fixed rights, ownership rights and appropriated rights. Yet, most groups of stakeholders have only fixed rights. The return on ownership does not only include the direct return on the risk capital used to buy the ownership rights, the equity, but also other types of returns to the stakeholders of the enterprise. A supplier may obtain a return on ownership by having the enterprise pay an additional price for the inputs. Employees may obtain higher wages or more secure jobs, etc. The return does not necessarily need to be paid directly. A manager can take over ownership to secure his power or status even if sale to an alternative owner could give him a higher monetary return. The *return on ownership* shall thus be understood as the total monetary and non-monetary return on ownership to the stakeholders. A majority owner on the expense of minority owners may appropriate part of these returns.

The state is a special kind of stakeholder in firms. In the command economy, the state held most fixed and residual rights, although many were appropriated by insider stakeholders. In a market economy, which is the focus of this paper, the state can obtain rights by direct regulation – e.g. by directly controlling some environmental matters or directly taking a certain part of the revenue as taxes. The authorities can also indirectly influence the governance structure by regulating different markets. Finally, the state can behave like an agent using fixed contracts on the markets buying different products and services, which is then delivered to the population.

3. DETERMINANTS OF GOVERNANCE STRUCTURES

Market economies have different institutional arrangements to settle the fundamental questions of enterprise governance: What determines the relative weight between fixed and residual rights? Which stakeholders obtain ownership rights? And to what extent will other stakeholders appropriate part of these rights?

Agency theory shows that in a situation with perfect information and no externalities, a set of complete market contracts can distribute all the rights and obliga-

tions in relation to the activities and assets of an enterprise. There would be no room for ownership rights or for appropriated rights as everything can be determined ex ante (Hart, 1995). However, in the real world, uncertainty, lack of information, non-perfect capital market, and externalities limit the possibility of writing complete contracts. This is due to transaction costs of collecting information, negotiating and writing the contract and monitoring the contract. The costs vary between different contracts and different groups of stakeholders. Stakeholder specific returns on residual rights and their possibilities for appropriating rights from other stakeholders also vary. The determinants of the governance structure are the interests and resources of the stakeholders, the internal conditions in the enterprise and constraints imposed by external markets and state regulation.

The opportunities for writing contracts depend on the stability and transparency of the respective market. In unstable markets, high uncertainty and lack of information raises transaction costs and inhibits many contracts. Well-designed state regulation can help to overcome some of these problems, but regulation may also be a barrier for a well-functioning market. For example, contracting on the product market can be hampered by high unpredictable inflation, by lack of clear legislative rules for contract enforcement, and by state regulation directly restricting the possibility of making market contracts in certain areas. Such conditions are typical for transition economies.

On the *product markets* the enterprise contracts with customers and suppliers. These contracts are determined by the relative strength of the agents on the market. Customers, suppliers and competitors are all important stakeholders in the enterprise. If the market works smoothly with a high degree of competition it can be expected that most of the transactions will be determined by contracting on the product market without involving the stakeholders directly in the governance of the enterprise. This requires not only macroeconomic stability but also a stable regulatory framework securing competition, including openness to the world market, and clear legislation for contract enforcement. If some of these conditions are not fulfilled, stakeholders may seek more direct control in the enterprise by acquiring ownership rights. In some situations, specific conditions for cooperation can be put into a contract – e.g. creating a long run trading relationship – without involving residual ownership rights. In other cases some form of horizontal or vertical integration in the form of cross ownership may be preferred. An acquisition or merger with a competing enterprise may exploit economies of scale and/or increase the market power position.

Labour markets are decisive for the role of the employees. If there is a high degree of mobility and if the employees are in a strong position, perhaps supported by strong unions, they may be able to negotiate such fixed market contracts in which residual ownership rights would bring no extra benefits. On the other hand,

there may be high unemployment in general or locally combined with limited mobility. Such a situation in combination with high specificity of human capital may give the employees a strong incentive to obtain ownership rights to secure their jobs. The lower are the level of unemployment benefits, the higher are the stakes for employees to secure their jobs. Employees may be willing to trade job security for lower wages. Strong unions can oppose such market flexibility, and unions may oppose a situation where the employees take over the ownership to secure their jobs, but by taking over a higher income risk. In some situations it will pay off for the owners to establish closer links with employees to bond the specific human capital investment. Qualified employees may be in high demand on the market, and high fixed wages may not be enough to keep them in the company. Ownership rights can create stronger links to these employees.

Markets for debt capital, which are remunerated independently from the residual profit of the company, are governed by different mechanisms than equity markets. Normally, loans from banks or commercial bonds are low-risk capital based on a fixed interest contract with collateral in the form of enterprise assets with low firm specificity. This limits investment risk, yet the risk also depends largely on the situation of the other markets, especially the product market. A breakdown of the product market may depreciate assets that before could have been used in many alternative processes. Markets for debt always have an element of rationing. The state regulates banks by restricting their loans. The interest rate and the possibility for obtaining loans are important determinants for how much high risk capital with residual rights are needed for the company. In this way the debt market influences the governance structure. If the loan-contract is not fulfilled by the enterprise, the bank will normally, through bankruptcy procedures, be entitled to ownership rights. This gives banks an important role, both as monitors of the loan contract, and as potential owners in case of default.

Stock markets – the markets for ownership rights – are an important part of the governance structure in a market system. Ownership is allocated to those owners who can obtain the highest monetary and non-monetary returns on the assets. The supplier of high risk capital is included as a stakeholder. Often the equity owner has other stakes in the enterprise (as employee, manager, supplier, etc.) beyond their ownership of equity.

The *state* both at the national and the local level can be considered to have stakeholder interest in the enterprise, ideally representing the interests of the majority of the population on the national or the local level. In reality many different interest groups influence the state, and the already mentioned stakeholders may try to support their interests by directly influencing the state.

The *specific conditions of the production process* at the enterprise level can play an important role in determining the governance structure. There are differ-

ent possibilities for different stakeholders for acquiring ownership rights in a small labour-intensive enterprise compared with a large capital-intensive enterprise. Knowledge-intensive production often favours ownership by key employees, if the knowledge is embedded and performance is hard to observe. Thus, also the specificity of human and fixed capital influences the resulting governance structure.

The *stakeholder-related conditions* are the interests and the resources controlled by the stakeholders. The value system determines the *interests* that a stakeholder may associate with a specific stake. For instance, employees may be more or less oriented toward individual goals (Mygind, 1992). The *resources* controlled by stakeholders include their access to capital, information and governance skills. The stakeholders access to capital and the amount of required high risk capital has a crucial role for the stakeholders' ability to become owners. If markets for debt are underdeveloped, the required risk capital may be prohibitively expensive. Access to information is also crucial for owners. Before acquiring ownership it is important to assess the possible return on investment. Reliable information is required to execute ownership rights because it involves monitoring a manager, who may try to appropriate rights from the owner. The ability to limit appropriation of rights by monitoring the managers and by defining and implementing the objective of the enterprise is an essential aspect of the governance skills needed to be an efficient owner. Lack of this ability may explain why some stakeholders do not acquire ownership.

4. FACTORS FAVOURING OWNERSHIP BY DIFFERENT STAKEHOLDERS

Every agent faces choices over the use of her resources in pursuit of her *interests.* She can sell them on the market using fixed contracts (specifying some rights to control, income, assets and information from the enterprise), or she can obtain ownership rights. The optimal solution depends partly on her *resources* and how these resources can be exploited by combining them with ownership rights. Can the owner limit other stakeholders' appropriation of rights? How do the specific conditions on the markets and the state regulation influence the governance structure?

Figure 2 illustrates factors behind the governance structure by specifying which interests, which resources and which market conditions and regulation favour ownership by specific stakeholders. The first column specifies the stakeholder group. The second column shows under what conditions a stakeholder group would aspire for ownership rights. This depends on enterprise and stake-

holder-specific factors. In the third column, the resources available to the stakeholder group and possible constraints are reported. These resources include access to capital, governance skills for negotiating and monitoring, and access to information. The fourth column reviews how state regulation and market conditions may limit the possibilities for fixed market contracts and thus favour ownership rights by the stakeholder group.

Stakeholder	**Ownership interest**	**Ownership resources**	**External conditions**
	Stakeholder objectives Firm-specific conditions	Access to capital Governance skills Information	State regulation Market conditions for fixed contracts
Employees	high cost of losing job high specific human capital high unemployment low mobility low unemployment benefit desire for self-governance (high risk aversion)	lack of capital difficult to obtain loans =>low capital intensity highly educated have best access to information governance easiest when small, homogeneous group experience of participation	labour market: non transparent high transaction costs difficult to monitor contracts unions for or against?
Managers	high specific human capital desire for self-governance continue as manager	lack of capital => low capital inputs needed asymmetric information direct governance => no agency problem	unstable markets low development of market for managers and equity markets
Risk capital **Venture** **Portfolio** – funds – individuals	hunting potential profits in under-performing firms following signals from capital market	access to high-risk capital professional governance economies of information usually passive ownership diversified, free riding	dependent on: transparent and effective capital market legislative efficiency on shareholders' rights
Debt capital **banks**	takeover to secure loans or build holdings: FIGs	access to high-risk capital often lower risk segment high information demand professional governance	good bankruptcy rules legislative efficiency on creditors rights unstable markets – FIGs
Strategic **Investor** supplier/ customer, parallel firm	target enterprise trade with supplier/customer high/low price input/output scale-economy/specialisation or market takeover	access to high risk capital mainly foreigners some information barriers especially for foreigners professional governance	ownership alternative to market contract when low product market competition and/or high transaction costs weak contract legislation
Government local/ central	important externalities and/or political defined: "strategic" for society	access to high-risk capital information problem governance problem: incentives for bureaucrats	ownership alternative to market contract when low product competition market and/or high transaction costs

Figure 2. Factors favouring ownership by different stakeholders

Under what conditions will *employees* (other than managers) aspire to ownership rights? As shown at the top of *Figure 2,* they may have a specific interest in governing themselves. Since they are active participants in the production process they may also demand a share of the control rights (Mygind, 1992). To obtain control, employees must assume the risk connected to the residual rights to income/loss and assets/liabilities. Employee-owners are exposed to the double risk of both losing the job and the ownership stakes (Meade, 1972). On the other hand, the risk of losing the job may exactly be the factor motivating employees to take over their enterprise. This is especially the case if the cost of losing the job is very high – in a situation of high unemployment, low mobility of labour and low unemployment benefit. The cost of losing a job is also high when employees possess a highly specific human capital – skills, which are developed in close connection to the specific production process in their enterprise and cannot be moved to another type of production.

Ownership may, however, not be realised if the employees do not possess the necessary resources of capital, governance skills and information. Lack of capital has been identified as the most serious problem for potential employee owners. They often have low savings, or their savings are reserved for pensions and the risk should be diversified over a wide range of different assets (Putterman, 1993). They may also have special barriers for obtaining loans from banks because the banks consider their interests to diverge from profit maximisation indicating a higher risk of default. Therefore, the employees are more likely to be able to take over a company when capital requirements per worker are low. There is a special problem concerning the distribution of ownership among the employees. It is easier to organise an employee takeover when each employee can invest approximately the same capital. This makes it easier to have the group acting as a block behind their stakeholder interests (Mygind, 1992). An egalitarian distribution may require that the employees who can invest the lowest amount of capital determine the investment per employee.

The homogeneity of the group of employees is important for their ability to effectively govern the enterprise (Hansmann, 1988). It is misleading to take employees as one group of stakeholders because they often have different interests. A homogeneous group of employees is in a stronger position defining the strategy of the company and monitoring the manager. A smaller number of employees can more easily govern themselves than in the case of a large company. The possibility of free riding is lower and mutual monitoring is more feasible in smaller enterprises.

Employees working in the top administration and highly educated employees have easier access and better understanding of the information about the enterprise. This group can be expected to hold a higher share of ownership than

blue-collar workers do. If transparency is low, the informed employees have an advantage compared to outsiders. These insiders may be the best to monitor the managers. State regulation can support employee ownership by special advantages, e.g. on taxation (the US ESOP-system), or discourage this type (unemployment benefit in Denmark). A well-developed debt market can to some extent overcome the employee's lack of capital. A well-functioning labour market may encourage employees to seek market contracts instead of seeking ownership rights. If transaction costs on the labour market are high, employees are more likely to seek ownership. Unions can both work in favour and against this development. Strong unions can enforce a high share of fixed rights of control and income to the employees leaving only weak incentives for employees also to acquire residual rights. On the other hand, especially, company-based unions can organise employees for local takeovers of enterprises.

In conclusion, we find different conditions favouring employee ownership. On the one hand, employees may take over the ownership of enterprises in a defensive move to preempt the loss of their jobs. The takeover price per worker would often be low, because of the crisis of the company. On the other hand there can be a strong tendency for employee ownership in profitable enterprises with high specific human capital, often with core owners among a group of highly educated employees who are crucial for the competitiveness of the enterprise – e.g. in e-business.

The case for *manager ownership* follows to some extent the arguments for employees. Managers have some specific human capital connected to the specific technical and market conditions of the enterprise. Managers are often driven by a high desire for self-governance – i.e. they do not want to follow orders. They are prepared to defend their position even at the sacrifice of some monetary rewards. Access to capital is also an important constraint for managers. However, they are more concerned with the absolute level of needed capital input, not of capital intensity. Managers have direct access to information of the enterprise. The degree of asymmetry in relation to outsiders is important for the choice between management and outside ownership. Is it possible for an outside investor to obtain the relevant information to monitor the managers? The manager–owner conflict disappears with direct governance by the managers. In comparison with employees the manager is also in a strong position concerning governance skills. The problem of size and homogeneity disappears with only one person or a small group of managers. On the other hand the manager may not be able to see his own lack of skills in relation to the needs of the enterprise. A strong outside owner would be able to identify the problem and influence or change the manager. An entrepreneur with an innovative idea to start a new enterprise may not have strong intentions of being the owner of the new enterprise. Capital is needed to start and develop produc-

tion. The risk is too high for ordinary debt capital to fill the gap. There is thus a strong demand for outside owner capital, but asymmetry of information and limited possibility for the outside owner to monitor the entrepreneur/manager may limit access to outside capital.

The development of manager ownership critically depends on the alternative possibilities for non-ownership market contracts that fulfill the interests of the manager and/or contracts giving outside or employee-owners enough monitoring abilities in relation to the manager. Outside ownership depends on the development of the stock market and the market for management skills. When these markets are not developed there will be less outside and more management ownership.

In short, management ownership will be strong if managers have a high desire to exclude intervention by outside owners, if the need for risk capital is low, and if the access to outside capital is inhibited by asymmetric information, high cost of monitoring or underdeveloped markets for equity and management skills.

Among the *suppliers of capital* we distinguish between high risk capital and debt capital. Providers of debt capital typically obtain collateral in the assets of the enterprise (or other assets belonging to the owner). Their remuneration is fixed, not dependent on the actual performance of the enterprise, unless the collateral cannot cover the obligations in case of default. Risk capital is not backed by collateral and the remuneration is part of the residual ownership rights to income. In reality the two types cannot be clearly distinguished. There is a grey area – e.g. with risky high interest loans only partly covered by collateral.

An important source of *risk capital* are *venture capitalists* who screen the market for investment possibilities, assessing new and existing enterprises in need of fresh capital for restructuring or start of new projects. The outside investor brings the necessary risk capital and acquires a substantial part of ownership. This takeover can be hostile or friendly in relation to the existing management. The venture capitalists are hunting existing assets that are under-performing with the current ownership and management or it goes into realisation of new ideas/mobilising new assets. By definition this type of stakeholder has access to high risk capital. Their access to information is crucial, but venture capital firms are specialised in collecting and evaluating information on enterprise performance and future potential. They have developed professional skills in governance and they may also become directly involved in management. The venture capitalists normally depend on transparent and effective equity markets making it possible to acquire information about prices and performance and implementing the actual takeover. On the other hand, they may also have developed special knowledge about market deficiencies, which they can exploit.

While venture capitalists concentrate their capital in a small number of companies to take over control, *portfolio capitalists* normally spread their capital investment to diversify risk and they typically only own minority shares. Small shareholders can invest their personal capital individually or they can use pension funds or other types of investment funds to spread their risk and to administrate their investment. Normally they are passive owners. For an individual with only a fraction of the shares in a company, it is not profitable to invest time and effort to try to follow the performance of the company and monitor the managers. They tend to free ride on other groups of investors who monitor management. Therefore, more concentrated ownership is usually considered to be more efficient. However, high capital requirement is the reason why many large, capital-intensive enterprises are often owned by a diversified group of owners (Putterman, 1993). Investment funds may own such a big share that it is both possible and profitable to monitor actively, employing professional staff to perform these functions. Investment funds may take a more active position if they obtain information indicating that management ought to be corrected or changed. Thus they would shift their influence strategy from exit to voice.

Investors rely on the information from the equity market and they are thus heavily dependent on state regulation of these markets, especially concerning the legislative efficiency securing shareholders rights. In most cases, the transparency and quality of information will be the best for blue chip companies, due to "scale economies of information" (Putterman, 1993). These companies typically have a high share of portfolio investors as owners. For the whole economy, the share of portfolio ownership depends on the investment pattern of the population in general. State regulation has a crucial impact, notably via the regulation of pension schemes. Opportunity costs of investment are given by alternative investment possibilities such as bank-deposits, treasury bills, commercial bonds and real estate. Moreover, foreign portfolio capital may be invested if the national economy is attractive and open to global capital.

Another type of passive capital is *debt-capital* – short- and long-term loans by banks and commercial bonds sold on the capital market. Providers of loan capital are not owners, but in case of default, banks may take over the assets given as collateral and in this way acquire ownership rights. In some cases, the bank may be interested in acquiring direct ownership to improve the monitoring of the enterprise. At the same time the banks have professional expertise to collect and evaluate information from enterprises to monitor management. Therefore, loan and equity capital is often combined unless the legislation directly excludes the possibility of direct ownership by banks.

In an environment of uncertainty with a high-risk premium, the arms length relations of banks may be converted to a high degree of integration and cross owner-

ship in Financial Industrial Groups (FIGs). Within such groups improved flow of information and more stable business relations can limit the uncertainty and costs of information. At the same time FIGs especially in transition economies exploit economies of scale in building close relations to the state bureaucracy (Berglöf and von Thadden, 1999).

Strategic investors' interests as producers of a certain product determine their role as stakeholders – as a supplier, a customer or a competitor in relation to the analysed enterprise. The strategic investor can maximise returns on the relationship with the target enterprise: a supplier by maximising profits on sales and a customer by cutting the cost of inputs from the enterprise. A horizontally related firm can use the production facilities of the target company to exploit specialisation, or economies of scale in production, or to increase market power by closing down the target enterprise.

The strategic investor normally has good access to risk capital. In transitional economies it will often be foreign enterprises, and they have a high supply of risk capital compared to most domestic investors. However, foreigners have higher cost in obtaining reliable information about the enterprise both before and after the takeover. Although large multinational companies have access to high professional governance, cultural differences between foreign managers and local employees may imply some governance problems at lower levels in the company.

When does the acquiring enterprise prefer ownership to a fixed market contract with the target enterprise? This is the case when competition on the product market is limited and when high transaction costs make it difficult to define and monitor a market contract. This happens when there is high uncertainty/low stability on the product market and when market contract enforcement is weaker than legislation concerning direct ownership. Vertical integration is especially important if there is high lock in between the enterprises in the value chain (Williamson, 1985).

Central and local governments represent the interests of the people in the whole nation or in the local area. In a perfect market they do not need to interfere with the enterprise, but if there are strong externalities that cannot be internalised through contracting, they will have incentives for direct regulation. This regulation can be so detailed that no residual ownership rights are left for other stakeholders. Some sectors of the economy are in this way owned by the state or local municipalities. The degree of regulation and the number of activities and enterprises under public ownership depend on the political goals, the evaluation of the costs or benefits of externalities, the policy concerning distribution, etc. In the West there has been a tendency in the 1980s and 1990s to let private enterprises take over activities, which was earlier under public ownership. Important criteria

have been whether it was possible to create competition in relation to a certain activity, and whether this activity could be specified in a market contract.

State and local municipality usually do not face access to capital as a major barrier, although tight budget constraints may prevent acquisition of assets, or push their privatisation. Distorted incentives, information and monitoring, however, are major problems connected to state ownership, and the background for the transition from plan to market in the recent years. The incentives for the politicians and the bureaucrats to monitor the managers may be quite weak. There are important governance problems both in the relations between the manager of the enterprise and the state bureaucracy as well as inside the bureaucracy (Phelps et al., 1993).

An owner can combine more than one type of stakeholder interest in the enterprise. For instance, a bank can simultaneously be creditor, administrator of portfolio-shares of individual investors, and direct owner. In fact, direct ownership may increase the credibility of the bank seen from the point of view of individual investors who use the bank as administrator of their shares. The German universal banks are examples of such a combination of stakeholder interests. The earlier mentioned FIGs are also a way to combine different stakeholder interests and limit uncertainty.

If different groups of stakeholders have ownership of the enterprise, the combination of their ownership shares and other rights determines the sharing of actual control. If shares are widely dispersed among small shareholders, the manager can be in a strong position even without formal ownership rights. If ownership is diversified, however, a single owner with a substantial minority share may be able to effectively control the board of the enterprise and to monitor the manager.

If a stakeholder owns a smaller share of the enterprise than his stakeholder interest in the company, he will have an interest in transferring the returns away from the shares to stakeholder remuneration. If employees control the company, they could decide to pay out the profits in the form of higher wages leaving the other owners with no return on their shares (Nuti, 1995). The exploited shareholders may go into negotiations with the dominating owner to try to improve their situation. State regulation may give minority shareholders some rights to veto important decisions, see the recent discussion concerning protection of minority shareholders, e.g. OECD principles for good corporate governance (OECD, 1999). Minority shareholders may also have some power based on their role as stakeholders – e.g. a bank may threaten not to renew loans to the enterprise.

The interests of different stakeholders can be more or less conflicting or complementing each other. Managers and employees can make alliances on the continuation and growth of the company. Venture capital, banks and portfolio investors have a common interest in maximising profits. However, in some situations

the bank may choose to support the security of the loans instead of maximising the value of the equity. Strategic investors will in pricing decisions often be in conflict with the other stakeholders. When there are conflicting interests between the stakeholders, there will probably be a quite complicated game between them. To avoid Nuti's stakeholder problem the resulting ownership structure can concentrate a large majority to one single stakeholder. Ultimately, one stakeholder holds all the residual rights while the rest are remunerated through fixed contracts.

A minority shareholding can be offered to other stakeholders to align their interests with the owners. This is especially used for managers, but also for giving incentives to other employees – such insider minority shares have become more widespread in recent years in the Western industrialised economies. Also, different forms of cross holdings can be a way to strengthen the cooperation and support relation specific investment in a value chain network.

5. SOME EXAMPLES FROM THE WEST

To illustrate the connection between the markets and surrounding institutions and the resulting governance system I will shortly present some Western examples. In the Western discussion of corporate governance we usually talk about the Anglo–American and the German–Japanese model (Shleifer and Vishny, 1997).

The *US system* is based on a very liberal model without much interference from the state. Markets for products, capital, labour and management are highly developed, and the regulatory framework protects competition. There is a well-functioning legal system with clear rules for enforcement of contracts and clear rules supporting the ownership rights of shareholders and supporting a high standard of information about financial performance of companies. At the same time there has been a quite restrictive legislation limiting the possibilities for banks to be owners of enterprises. In consequence, we observe diversified shareholders and pension funds as the main groups of owners. They are mostly quite passive and permit a strong management position. Ownership and control are separated, and monitoring occurs primarily via capital markets, hostile takeovers, and markets for managers.

In contrast to the Anglo–American system, *Germany* has a long tradition for universal banking, where a bank owns a large amount of shares in parallel to being the main creditor of the company. German banks often control large parts of the shares on proxy for individual shareholders. The banks are the core owners of most of the large enterprises in Germany. The stock market is not very developed and the number of publicly quoted enterprises is relatively low compared to the situation in the UK and the US. Enterprises obtain most of their capital from inter-

nal accumulation, but also bank loans play a considerable role. Another feature of the German governance system is a highly regulated labour market with strong unions and a system of codetermination introduced through state regulation (Fitzroy et al., 1997). This system gives the employees in large companies 50% of the seats in the supervisory board, which is the highest strategic decision-making authority and which selects the executive managers. In the rare case of 50–50 votes the supervisory board chairman representing the shareholders has the decisive vote.

The *Italian model* is less discussed in the literature, yet it exhibits features that are widespread in the world. The regulation of shareholders' rights and the quality of information have not been strong enough to develop a strong stock market. The banks are not important owners either. The typical Italian governance structure is single proprietorship with individuals or families as the core owners.

All the three types of corporate governance have worked reasonably well for long periods of time. However, there are important differences concerning the distribution of control and financial returns. There is not a single ideal model of governance. The evolution of either model is path-dependent, and the result of political choices concerning key economic institutions. Decisions over privatisation, bank legislation, labour market rules and regulation of competition thus shape the paths of development of the governance system.

6. SPECIFIC CONDITIONS OF TRANSITION SHAPING THE GOVERNANCE SYSTEM

In Central and Eastern Europe, transition-specific influences shape the governance systems. However, the conditions for developing the governance structures change over the different stages of transition. I shall first present these stages as they can be observed on different markets and in relation to the development of different institutions and state regulation. Then I shall outline how different privatisation methods and the development of markets and institutions influence the development of governance structure seen in a stakeholder perspective. The idea is not to present a comprehensive empirical analysis. Then a detailed description of the background in each country and the specific strategy for transition including first of all the privatisation method would be necessary. It would also be necessary to go deeper into an analysis of the situation for specific firms and stakeholders. Such an analysis is currently being done for the Baltic countries (see Mygind, 2000) and a few preliminary results will be presented to illustrate some trends, which show the relevance of the presented conceptual framework.

It is important to see the transition and the development of the governance system as a dynamic process. *Figure 3* indicates the different stages of transition.

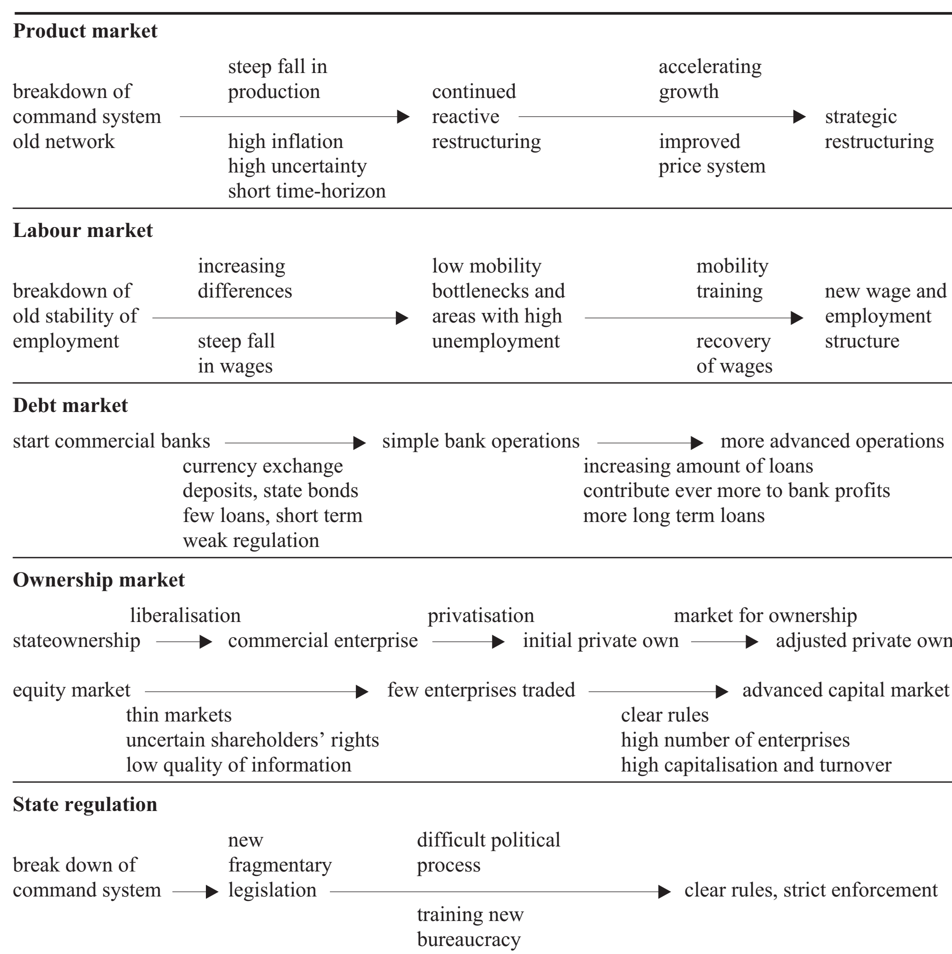

Figure 3. Stages of transition of governance structures

In the transition process the *product markets* have changed radically. All countries in transition experienced a steep drop in output when the command economy was abolished and new rules were imposed on the companies. The enterprises should no longer produce for the planners, but for the customers in the market. Most enterprises had problems selling their products, they could not pay for the necessary inputs, etc. Production was cut, many product lines completely closed

down, and old links between enterprises and national economies were broken down. The new developing product markets were changing very fast and also the opening for foreign competition from Western industrialised countries had a hard impact on domestic companies. The result was fast and deep changes, initially in the form of a steep fall in production and then gradual recovery combined with the development of new products, production methods, markets and networks. Many companies faced a serious crisis and during this period of fast change and high uncertainty, short-term relations dominated. After many years, production has started to increase, inflation has been stabilised and there is less uncertainty around the relative prices. The enterprises have started to go from reactive to strategic restructuring.

The output drop was reflected in a depressed situation on the *labour market*. In some countries, especially in Central Europe, the result was a steep rise in unemployment. In other countries, especially in the former Soviet Union, except for the Baltics, the increase in unemployment was delayed. Instead real wages were drastically cut while the employees formally stayed at their enterprise (World Bank, 1996). In both situations there are only few alternative employment possibilities, lack of mobility, low unemployment benefits – high costs of losing the job for the employees. The problem is often concentrated in places with one large company employing most of the local labour force. During the transition-increased mobility, through training and development of the market for housing, and growth on the product market can improve the situation.

The *debt market* has been undergoing deep changes in the early transition. New commercial banks have developed from scratch and from the old banking system. Before, the role of the banks was more or less to register flows of money and debt according to the plan. In the new market system the banks shall evaluate the debtors – the prospect of the business and the security of different forms of collateral. This change involves many complicated processes including legislation on registration of assets, bankruptcy, etc., and it involves developing new skills for bank employees. There will be a long period with only a fragmentarily functioning debt market. The banks concentrate on simple bank operations and loans that are given only on short term with a high real interest rate. Regulation of banks are fragmentary in the early years and in most countries in transition there have been widespread bank failures with negative effects for the general trust in banking and sometimes with serious consequences for the whole society (e.g. Baltija Bank in Latvia). Lack of trust in the banking system also means that people are reluctant to deposit their savings in the banks. When regulation becomes more efficient and the banking sector develops, more funds can be channeled through the banking system and lent to private investors. However, the governance structure of the

banks themselves is often very problematic (Brada, 1996). Often state-owned banks continued the system of soft credits to enterprises throwing good money after bad (Phelps et al., 1993) by lending more money to the enterprise to avoid their complete bankruptcy.

The *ownership market* also developed through different stages. In the early stage the state-owned enterprises were commercialised. Liberalisation of prices and trade meant increased autonomy for these enterprises. Privatisation was the next step creating the initial private ownership structure, which will develop further in the post-privatisation period. *Stock markets* were established from scratch in all transition economies. This requires not only legislation on the registration, auditing, rules for disclosure of information, etc., but also that the participants on the stock market develop the necessary skills and experience. Some methods of privatisation can give a push to the development of the stock market. This is the case with voucher privatisation when many enterprises are listed on the stock exchange. This means high capitalisation, but trading of these shares may be rather thin, because of uncertainty about the trading system, the information from the enterprises, shareholders rights, etc. One of the main functions of the stock exchange, the valuation of enterprises, does not work. The stock exchange can, therefore, not be used to evaluate the performance of the managers. Allocating capital by issuing new shares for new or expanding companies cannot function either. A few blue chip companies revealing good quality information, etc., may be more heavily traded and they can be the basis for a more developed stock exchange. The list of blue chips can gradually be increased and the stock exchange may thus play a more important role in later stages of transition.

The quality of *state regulation* also goes through different stages. Except for East Germany taking over West German legislation, it has not been possible to implement a comprehensive big-bang reform of state regulation with the introduction of all the necessary new legislation in a very short period of time. In the early stage legislation is fragmentary and often internally contradicting. There is not a uniform package of legislation to be chosen to create a functioning market economy. A lot of difficult political choices have to be made, and during the transition process the political power changes frequently and so does legislation. However, introducing new legislation is only the first step. New state organisations must be built and the administrators be trained for the new tasks. The bureaucrats are lacking basic management skills for proper regulation of the market. Furthermore, the state is under a severe financial strain limiting the possibility for paying a competitive remuneration to state employees. Most likely old routines and corruption will prevail for a long period. It takes many years to develop a well-functioning state bureaucracy imposing clear rules and strict enforcement on the private sector. For

a long period uncertainty and low quality information about the economic performance of enterprises will be an important barrier for development of a well-functioning governance system.

The *enterprise level conditions* are closely related to the situation on the product market and the labour market. In the early stages the market value of most old enterprises are low. That is one reason why privatisation by direct sale may result in very low prices. The enterprise can engage in reactive restructuring: cutting down production and employment, but lack of capital is an important barrier for strategic restructuring building up new production processes, developing new products, new distribution channels, networks, etc. If some of the enterprises have profitable activities, they may be able to finance strategic restructuring from internal sources. This is especially true for small new enterprises, where starting up and development is important for the strategic restructuring of production.

During the period of the command economy Eastern Europe was dominated by very large enterprises, often the sole employers in local areas. Employees had quite specialised skills, high technical training, but low knowledge about management in a market economy. The enterprises were organised strictly hierarchically and the management style was paternalistic with a low degree of participation from the employees. During transition many of the large enterprises have been closed down or divided in smaller entities. The employees needed more market-oriented and flexible skills. New management methods imply more decentralisation and empowerment of the employees.

The *stakeholder-related conditions* are to a high degree dependent on the conditions of the different markets and the important differences between different stakeholders. For employees short-run survival is the main goal in the early stages. They have limited access to capital and if they obtain shares through privatisation, many of them will sell them to cover daily living expenses. The capital constraint may be somewhat released during transition, and their understanding of the market economy and their ability to control the manager will probably gradually increase.

The privatisation process determines the initial ownership and control structures and the conditions for the further development of the governance structure in the post-privatisation period. *Figure 4* summarises in the first column how different privatisation methods favour the ownership of different stakeholders and indicates in which countries the specific method had an important role. Firm-specific conditions and external conditions related to different markets and state regulation are shown in column 3 and 4. The last column summarises some expected trends in later stages.

Stakeholder	Privatisation*	Firm-specific conditions	Influence by markets and regulation	Change in later stages
Employee ownership	favourable price, loans leasing, or vouchers Albania, Croatia, Lithuania, Poland, Romania, Russia, Slovenia, Ukraine SMEs: Poland, Estonia, Latvia	favoured privatisat. ⇒ also large firms high capital intensity not favoured in privatisation ⇒ defensive, small low capital intensity	uncertainty, low information low development of stock market and market for management	employee-owned taken over by management improved opportunities for other investors ⇒ less important
Management ownership	wild privatisations small privatisation all countries	low capital SME	favours insider ownership relatively to outside ownership	growth means more external capital
Portfolio	voucher based mass privatisation ⇒ investment funds Czech, Slovak, Poland	large firms high capital intensity	weak regulation ⇒ governance problems tunneling weak finance market ⇒ weak monitoring	strengthened regulation developed financial market ⇒ more portfolio
FIGs venture capital	shares for loans Russia	often monopoly energy, transport finance	advantage if weak state	if state capture ⇒ barrier for transition
Banks	privatisation of large banks often late in transition		future role depend on regulation	
Strategic foreign investor	direct sale Estonia, Hungary, Latvia, Poland, Slovakia	often large firms high capital intensity	highest in most developed transitions + investment climate	continue to grow

* Based on EBRD 1999, with a few corrections for the Baltic countries, see Mygind (2000).

Figure 4. Factors influencing stakeholder ownership in early and late transition

Employees and managers can acquire ownership in the privatisation process by receiving equity ownership for free, or being offered to buy ownership at a relatively low price. Their cash constraint may be released by voucher privatisation, favourable installment systems, subsidised credits, leasing with the option to buy, etc. Broad *employee ownership* had some connections to the development in the second half of the 1980s in USSR and Poland. In former Yugoslavia self-management played an important role already from the 1960s. In many of the successor states privatisation favoured broad employee ownership, most notably in Russia, Lithuania and Slovenia (Uvalic and Vaughan-Whitehead, 1997).

Insiders, especially managers, could use their informational advantage and their position to obtain advantages in taking over the enterprise. So called wild privatisations were widespread in the early stages of transition when the

price-mechanism was hampered by hyperinflation, general uncertainty on the market, and fragmentary and contradicting state regulation.

Small privatisation resulted predominantly in *management ownership* in nearly all transition countries in Eastern Europe. Management ownership was not supported by the special methods of privatisation favouring employees and/or managers. Also the unstable product markets with short-term relationships and high transaction cost favoured persons with the closest access to information about the enterprises. The labour market conditions favoured *employee* ownership, especially in cases where one company was the dominant local employer. In a situation with high unemployment, low employment benefits, low mobility, and highly specific human capital there was a pressure for defensive takeovers of white elephants (Earle and Estrin, 1995).

The relative weakness of the stock market and the relatively weak state regulation of ownership rights further strengthened insider ownership. Even if the privatisation model was not directly favouring insiders, these conditions combined with the fact that the market value of many of these "white elephants" were quite low facilitated insider takeovers in spite of insiders' limited access to capital. Therefore, insiders got a high proportion of ownership in the early stage of transition. This was especially the case in economies with privatisation methods favouring insiders, but also when privatisation methods were neutral and insiders got a relatively high share of ownership.

Later in the transition process when banking was more developed, *managers* had better chances than other employees to obtain loans, because the banks believe in higher alignment of interests with managers than with employees in general. In many cases it was possible for managers to use some formal ownership by employees as an instrument for de facto transfer of ownership to themselves (Mygind and Pedersen, 1996). The paternalistic tradition of management pushed further this development. Managers dominated most of the insider takeovers and in later stages of transition management increased its share of ownership (Mygind, 2000, Jones and Mygind, 1999). The share of insider ownership declined during the transition process with the development of more efficient state regulation and more sophisticated capital markets, while other stakeholders improved their possibility for being owners compared with insiders.

Privatisation is not the only determinant of the governance system. Many enterprises are started from scratch, although often with some assets more or less legally taken over/privatised from state-owned enterprises. Such enterprises will probably follow a normal life cycle starting with entrepreneurial/management ownership and in later stages include external owners. For many privatised enterprises the initial ownership structure may have been reached only because of special advantages for some stakeholders. If there is not a strong path dependency,

e.g. by employees learning to be active owners through a developed system of participation, it can be expected that many of these employee-owned enterprises will change to management or outside ownership.

Portfolio capital is widespread in countries using vouchers for privatisation of enterprises. However, without a well-functioning stock market their role in the governance of enterprises is limited. *Investment funds* can be built into the system like in the Polish model or they may develop more spontaneously like it was the case in the Czech Republic. The Czech experience indicates that lack of regulation of investment funds and postponed privatisation of the main banks have resulted in an inefficient governance structure where managers of many of the investment funds have been able to appropriate rights and perform tunneling in a large scale.

Risk capital of the *venture type* had limited possibilities in the early stages because of the lack of a well-developed stock market. However, if they could exploit knowledge on market deficiencies they had an advantage. In later stages there is more room for this type of ownership.

The *banks'* role as owners depend on the specific legislation concerning universal banking versus arms-length banking. In most transitional countries universal banking is possible. However, it is too early to see whether new types of financial industrial groups will develop turning the governance structure in the direction of the German model. The new commercial banks can take advantage of different types of privatisation methods. They can establish investment funds in connection to a voucher system. If they are allowed and if they have enough capital they can go into investment banking and be the centre in *financial industrial groups* (FIGs). FIGs have developed in countries with "crony capitalism". In Russia we have the example of "loans for shares" where the government got loans in exchange for cheap shares to the dominating FIGs. They are especially strong in sectors with limited competition such as energy, transport and integrated with some of the largest banks. They benefited from a high degree of capture of the state. If they continue to play a dominating role using the state as an instrument for limiting competition and appropriating rights, institution building and restructuring will be hampered.

In some of the most advanced countries like Estonia and Hungary *foreign strategic investors* have played an important role in privatisation, which was already in the early stage based on direct sale. Multinational companies acquired affiliates to be integrated in their value chain. Liberalisation and institution building were quite fast in these countries and the investment climate also promoted FDI. Later also other countries had a considerable inflow of FDI indicating that strategic investors play an important role for the governance structure in later stages of transition as well.

Finally, the *public authorities* continue to play a role as owners in cases of no privatisation. This applies to enterprises producing public goods, activities with important externalities, and enterprises, which is politically defined as "strategic". A strategy of hard budget constraints in relation to tax arrears may lead to a temporary renationalisation of some enterprises. A high proportion of state ownership could also indicate a delay of privatisation as in Belarus.

7. CONCLUSION

The definition of enterprise governance based on the distribution of fixed, residual and appropriated rights on different groups of stakeholders has been justified by pointing to important trends in the development of enterprise governance in the countries in transition. It has been shown how the development of different markets and institutions play an important role for the distribution of rights on different groups of stakeholders. The privatisation methods and the development of the product and labour market as well as capital market institutions and the character and quality of state regulation can explain the development of the enterprise governance system.

The stakeholder analysis gives a theoretical foundation to assess the importance and dynamics of specific owner groups. The theoretical framework thus explains the high incidence of insider ownership and the hesitant development of especially diversified outside ownership in the early stages of transition. In combination with a dynamic analysis of the transition process it has been shown why in later stages the ownership will shift from broad groups of employees to managers and from insiders to outsiders. The strong role of insider ownership seen in the early stages of transition will probably not be sustainable in the longer run. When the institutional system is more developed and markets are more stable in general and especially the financial markets more developed, different types of external owners will play a stronger role.

It is outside the scope of this article to make empirical tests of the hypotheses developed. However in the last section I have referred to some tendencies found especially in our research on the development of the governance structure in the Baltic countries and the empirical evidence seems to fit well with the theoretical predictions. I also showed how the theory might explain the differences in the Western governance models. However, it has not been the purpose of the article to predict which models transitional economies are adapting. A detailed analysis will show important differences, but still, it is evident that the rather rudimentary development of capital market institutions and state regulation point mainly in the direction of the Italian model. However, for some countries the role of banks and

investment funds have elements of the German governance model. This is a paradox seen in relation to the emphasis on the Anglo–American model in the debate about corporate governance for transitional economies. In some countries like Hungary and Estonia foreign strategic investors played a considerable role in relation to the privatisation of large enterprises. In other countries strategic investors as well as portfolio investors were not important before the later stages of transition which included some large privatisations in energy, transport and telecommunications. However, a more detailed discussion will need a deeper analysis of the development of different institutions and markets in different transitional countries.

It is outside the scope of this article, but I believe that the theoretical framework developed here can be a fruitful tool for such an analysis.

The theory points to specific enterprise- and stakeholder- specific conditions that influence the governance structure. In this context I point to the recent trend in the West with increasing employee ownership in relation to the new economy in IT-related businesses. The production process is more and more based on human capital, and enterprises with high identification between employees and corporate goals have the highest ability to compete on the market. The question is whether Eastern Europe can jump into the new economy not only making good technological use of its high quality of education, but also as a result of the good governance structures of its human-capital-based companies?

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