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Ownership and Control of Polish Listed Corporations

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Abstract

With the company-level data on listed and unlisted companies we analyse ownership and control of the Polish corporations. We find that voting control in listed corporations is remarkably concentrated with the median size of the largest block amounting to 39,5%. A sustainable concentration trend has been observed over the whole last decade. Other companies and individuals/families (mostly founders) dominate among the largest blockholders of Polish corporations. Banks' involvement in control is below common expectations. It is also observed that – especially in smaller firms – managerial ownership is quite large. Frequently, managers are also the company founders and first or second largest blockholder. The extent of ownership and control separation is very modest, however the statutory arrangements for all companies have not been analysed. The most popular device to leverage control over ownership is preferred (dual-class) share issues. Control through subsidiaries is applied to a lesser extent. The presence of the large blockholders in listed corporations puts the issue of minority rights and potential conflict of interests on the agenda. Our analysis shows that the Polish capital market is in a desperate need of improvement in this respect, as well as for a new strategy to increase its liquidity.

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I. Introduction

For the past 20 years Polish enterprises have been a playground for deep and wide institutional changes including, first of all, ownership and control. The background of these changes as well as their outcomes has varied significantly over time. Both politically forced re-arrangement of control without ownership changes and market driven reforms affecting ownership (privatisation) and (for some enterprises to a lesser extent) control rescheduling can be observed within this period of time.

The first shift in enterprise control structures can be traced back to the beginning of the 1980s. The political pressure exerted on government by the free trade union movement resulted in a significant separation of control over the state-owned enterprises from ownership. Formally, the control was split among the State Treasury, a quasi-supervisory board dominated by employees (a so-called employees` council) and a general assembly of employees. This control rescheduling experiment lasted for about 10 years and brought mixed results. In general, control over managers was tightened and in numerous cases improvements in performance were evident, however within the world of soft budget constraints the managers' secrecy was still enormous. This, for instance, resulted in a huge appropriation of enterprise assets within so called "shadow privatisation" taking place since 1988. The experiment also created a strong employee self-governance movement.

With the introduction of the stabilisation plan in 1990 (so-called Balcerowicz's plan) the set of incentives for enterprises was dramatically changed. Withdrawal of subsidies and opening up of the economy forced the enterprises to adjust to market signals. The control over enterprises was additionally (formally) extended to banks and suppliers who could force them into bankruptcy. These changes in control arrangements were further supplemented by privatisation schemes.

The economic transition in Central and Eastern Europe has brought the attention of many international and domestic researchers, resulting in a large strand of literature on privatisation, corporate restructuring and institution building. However, the way that Polish corporations are owned and controlled has not been deeply analysed so far.

The first evidence on ownership structure is reported in Belka et al. (1995). He found that in 23 out of 200 analysed enterprises ownership was concentrated. The largest shareholder usually held about 50% of shares with a tendency towards 70%-85%. The ownership was additionally limited to a very narrow circle. In a few cases, ownership was shared by two partners (50/50 or 49/51). Eight out of 23 corporations were in the hands of senior managers and/or employees, 10 were controlled by private individuals and 10 by foreign or joint venture entities. The position of managers and employees in privatised corporations was further investigated. In 22 out of 40 cases managers and other employees together held a dominant position among shareholders. Managers owned on average 21.6% of shares compared to 48.8% in employees' hands. Domestic private banks (average shareholding of 3%), investment funds, individuals and firms were reported among minority shareholders. Belka et al. (1995) concludes that the position of managers in governance of privatised enterprises was very strong.

The relationship between various issues of corporate restructuring and ownership is documented in a number of extensive international, comparative studies (Frydman et al. 1999, 2000). Privatisation is most effective when control is sold to an outside investor rather than managers or employees (Frydman et al. 1999). In general, firms controlled by an outsider restructure and grow faster than those owned by insiders. This is mostly attributed to the incentive effect rather than the human capital effect (Frydman et al. 2000).

Research conducted by domestic researchers focused mostly on employees and management-led privatisation (so called "direct privatisation"). Gardawski (2000) finds that the majority of companies analysed have an outside owner. In 18% of the cases, they owned on average 65% of shares. Domestic corporations, banks, foreign investors and managers, if they appear among shareholders hold on average 33%, 15%, 26%, 26% of shares respectively. Kozarzewski (1999) focused specifically on companies that were privatised through employee leasing contracts[3]. In an extensive study he documented that employee shareholdings declined over time while managers and outsiders leveraged their positions. The biggest increase in corporate shareholding was observed in the case of outsiders (4.5 times in 1995 compared to the early 1990s). In 1995, in 38% of the analysed companies, an outside investor held at least 20% of shares, in 50% of companies outsiders were among the top ten shareholders. The pace of ownership concentration depended mostly upon industry, company size and profitability. Kozarzewski (1999) reports that there was no free market for employees` shareholdings. Those who were real initiators of a privatisation plan (usually managers) were strongly opposed to uncontrolled transfer of control to outsiders (and even insiders). Trading in employee shares was therefore heavily regulated by managers and/or supervisory boards. In 87% of company statutes any sale usually required written approval from the management board or supervisors or existing shareholders had the right to buy the shares first. In spite of all these measures and management opposition, ownership concentration finally took place, however, managers – to some extent – achieved their goals: "protection devices" when applied significantly lowered the size of outsider shareholding.

[3] This was the most popular way to privatise small and even medium sized state owned enterprises. It consisted of legal (but not physical) dissolution of an enterprise and leasing its assets to a company formed by employees.

The basic goal of this paper is to shed light on ownership and control of Polish public corporations. We begin with a basic view of the corporate sector and then provide data on voting control concentration and its evolution over the last decade. In section IV, most common control structures that are used by blockholders are discussed. Sections V and VI comment on transparency of ownership, control structures and the position of minorities in Polish corporations.

The paper is generally descriptive but we believe it is a good starting point for further research. Among the most urgent issues – we think – there is to be see if different control structures result in different corporate performance results and whether large blockholders take advantage of weak law enforcement. It would also be interesting to analyse the policy mix that led to the observed ownership and control patterns.

II. Polish corporate landscape

Decades of a planned economy left Poland with a real shortage of legal structures for business conduct. The decade of the 1990s began with the most "popular" structure of state-owned enterprise (SOE) and cooperatives. Since that time, the re-birth of stock corporations and limited partnerships has taken place. Now these two structures account for the majority of legal entities operating in industry and services. In the year 2000, stock corporations accounted for about 78% of the top 500 turnover and 60% of employment. As for limited liability companies, it was 12.4% and 7% respectively. In 1990, there were about 36,000 stock and limited liability companies[4], and 8400 state-owned enterprises. Ten years later, the number of SOEs dropped to 2,600 while stock corporations and limited liability companies rocketed up to 7,500 and 138,000 respectively.

Stock corporation (spółka akcyjna or in abbreviated form S.A.) and limited liability companies (spółka z ograniczoną odpowiedzialnością or Sp. z o.o.) are 70 year old structures introduced, in a modern form, into Poland at the beginning of the 1930s. Both structures and the entire body of corporate law is heavily based on German legal tradition, however some solutions from other systems are also present.

A stock corporation – the only structure provided for public companies – is set up by a shareholder agreement deposited at the court register. It is run by a management board (of at least 1 member) elected by the supervisory board or shareholder assembly (as provided in the statute) for no more than 5 years.

The managers are monitored by a supervisory board (of at least 3 members) elected by shareholder assembly. A shareholder or a group of shareholders holding at least 20% of all

[4] The earliest separate figures for both structures refer to the year 1992. At that time there were 2600 stock corporations and 66,400 limited liability companies.

shares have the power to demand a board election in cumulative voting. Since the supervisory board is elected in that way, each group automatically has the right to delegate one of its members to supervise managers individually (that includes the right to attend management board meetings but without decision making power).

The third and the most important body in a stock corporation is the shareholder assembly taking place once a year or more frequently (an extraordinary assembly). The assembly has exclusive power to make decisions upon such issues as: shares and convertible bond issues, statute changes, buy backs, or sell offs (partial or whole, in which case a 3/4 majority of votes is needed).

Share capital is collected by private or public issue of various types of shares (bearer, registered, common, preferred, non-voting). They can be purchased by anybody including managers and the company in question (the issuer - only in specified situations, i.e. for the purpose of buy backs or takeover defence). Share capital in a stock corporation should amount to not less than c.a. 125, 000 Euro.

Access to basic information on stock corporations is quite good. Apart from data available from commercial databases (Hoppensted Bonier, Dun & Bradstreet) comprehensive information can be found in the court register. All the important documents such as the shareholder agreement, statute, annual reports and shareholder assembly resolutions should be deposited there. Although access to the court register has so far been satisfactory (the documents mentioned being stored in paper form) we are convinced that this situation will improve thanks to court register reform begun in 2000. Its goal is to transform the old style register into an integrated, up-to-date, electronically accessible database.

III. Concentration of corporate control

1. Non-financial public companies

The public capital market – although much smaller than in developed countries – offers a good starting point for analysing ownership and corporate control in Poland. With its more than two hundred corporations it is responsible for about 20% of industrial and financial enterprise turnover, 3.4% of total employment. Its capitalisation amounts up to 18% of GDP. It offers a large variety of enterprises in terms of branches, size and origin.

For the purpose of this research, a database was compiled covering almost the whole decade of 1991-2000. It includes ownership and control data for 190 non-financial corporations listed on the WSE and 20 from the OTC market. The data from previous years was used to analyse how the patterns of ownership and control have evolved over time. It should be remembered, however, that the number of public corporations evolved significantly over time in Poland. In 1995 there were only 21 corporations and just 9 in 1991.

The data we use come from mandatory disclosures. Due to the fact that a voting block was not well defined in Polish law[5] the notification practice lagged behind the disclosure philosophy stipulated in the Transparency Directive. Even after recent amendments, voting (shareholder) agreements do not require notification unless one party increases his/her stake and anyway such combined notification is quite difficult to enforce. Blocks owned by founders and family members are usually notified separately, however they may be treated as a single voting block. Because of that we had to improve the "quality" of data by making some "manual" corrections. This could, of course, result in over- or under- consolidations of shares.

Firstly, shares owned by private firms, which were in turn controlled by individuals were directly attributed to these individuals. Secondly, we consolidated shares owned by members of one family into one block. Generally, shares owned by founders were not consolidated.

The following charts show the process and how the notification looks in practice. For Ryszard Krause controlling Kompap (Plc.) we used the stake 41%, however he officially notified only 31%, as his stake in another public company Prokom Software, being also shareholder in Kompap, was below 50%. For Sobiesław Zasada (Plc.) we attributed a family stake of 81% of cash flow rights and 90% of voting rights, however the biggest notified stake was 42%/57% of Sobiesław Zasada Ltd (figure 1 & 2).

[Figure 1& 2 about here]

The results reported in table 1 suggest that voting control is concentrated in line with patterns observed in continental Europe (Becht, Mayer 2000). In the case of 161 out of 210 corporations, we found out that one shareholder owned at least 25% of the votes, in 75 corporations one shareholder owned at least 50% of the votes. The median size of the largest blocks amounts to 39.5% of votes (and 37.2% of cash flow rights). After consolidation of shares possessed by individuals, assumed by us to be founders of a company, the median size goes up from 39.5% to 45.8%[6]. The median size of the second, third and fourth blocks is 10.4%, 5% and 0% of voting rights respectively. Without blocks owned by the state or national

[5] The previous amendment to the law on public trading in securities, which came into force at the beginning of 2001 improved the situation in this respect.

[6] For this checking in 5 cases we also consolidated into one block shares owned by several different parties acting in our view in concert in order to omit the need to announce a public tender after purchasing more than 10% of voting rights within less than 3 months.

investment funds these figures drop to 9.6% and 0%. This shows that the control of the largest blockholder is hardly contestable.

[Table 1 about here]

Cumulative distribution of the largest voting blocks[7] (figure 3) allows us to observe a very modest concentration of voting blocks around four levels. The first one is 29%-33.5% of voting rights (26 corporations). This may reflect the unwillingness of shareholders to break through the 33% level which requires consent from the Polish Securities and Exchange Commission (PSEC) and the fact that in companies taking part in the mass privatisation program, the leading fund obtained a 33% stake. The importance of the 33% limit may also be observed in previous years, since up to the beginning of 1998 crossing that threshold required a tender (bid) for acquiring all the shares of the company (now the mandatory tender offer applies when crossing the 50% level). Other concentration levels are: 40.9-43.5% (11 companies), 49.5-50% (6 companies), 74.1-75.7% (11 companies). The concentration level of around 75% is most likely caused by PSEC policy to limit or slow down the process of de-listing. The PSEC unwritten policy was to subordinate the consent to cross the 50% threshold upon a promise that the investor would not increase their stake to over 75%. According to company law, 25% of votes at shareholder meeting is a blocking stake – changes to the statute and new share issues require a ¾ majority.

[Figure 3 about here]

Polish public corporations are most frequently in the hands of other corporations (also other public companies) and individuals (families). These groups were responsible for about 39.4% and 30.8% respectively of the biggest blocks. Additionally, individuals owned 1/3 of all disclosed blocks (corporations – 27.6%). Financial institutions – comprised of mostly national investment funds and equity funds managed by Enterprise Investors – owned 14% of all the biggest blocks. At the end of the ownership list there were the State Treasury and other state entities with 9.1%, and surprisingly, banks with only 6.3% of all the biggest blocks.

The average size of block owned by a physical person is about 40.6%. This figure, we suppose, should be slightly higher because, it has to be remembered that for the purpose of this analysis the blocks owned by founders were not consolidated. The average size of blocks owned by domestic (Polish) non-listed firms is very similar to that above – 43.5%, while in

[7] The figures report the fraction of companies with the largest blocks minus the values reported on the vertical axis. The 45% line reflects a uniform density of firms by voting blocks.

the case of public corporations it is much higher – 54.2%. We observed a significant difference in the size of blocks in the hands of foreign investors – 67%. This difference is also evident in the case of the second largest blocks – 24% for foreign investors compared to 15.1% and 15.8% for individuals and private corporations respectively. Much smaller differences in block size are observed in the case of domestic and foreign financial institutions – for the largest blocks, the average for domestic investors was 31.2% compared to 35.5% for foreign. For the second and the third largest blocks, the differences were insignificant.

Ownership structure analysis also revealed – not surprisingly – that in many medium sized corporations and even larger ones there exists a close combination (overlapping) of three roles: a founder – blockholder - manager. In about 35 cases, it was noted that managers held blocks of shares ranging from 5% up to 93% with an average block of 28.5%. Moreover, in 20 corporations the blocks owned by managers were simultaneously the largest ones and in 10 cases the second largest. In the majority of these cases managers belonged to a narrow group of founders. The group of founder-manager corporations was comprised of mostly companies developed from private start-ups. Only four companies originated from privatisation.

In value terms the ownership of Polish public companies looks different. Foreign investors are major players with a 14.6% share in market capitalisation (in the case of strategic investors), and 5.3% in the case of financial investors. The second position belongs to the State Treasury and other state entities (state-owned enterprises, state-owned banks, municipalities, foundations) which altogether have a 12.5% share. Individuals (families) and corporations – the most common block holders – represent 10.2% and 6.3% of market capitalisation. Finally, banks – very passive in block holding – are again passive players in value terms (1.2% share in capitalisation). The same refers to other domestic financial institutions (0.6%), although we think this situation will change dramatically as the pension funds sector is quickly growing in size[8].

2. Evolution of the control concentration

The above data on block-holding refer to the situation observed at the end of the year 2000. It is also worth looking at the concentration trend over the whole decade (tables 2 and 3, figure 4). In 1991, with few public companies on the market, concentration of voting control was very moderate. The median size of the largest block (shareholder) amounted to 18% and Q4 to 47%. In the case of the second largest blockholder it was 10% and 17.8% respectively. Since that time a systematic increase in the size of blocks has been observed although the pattern of concentration has varied. Between 1991 and 1996 an upward trend was very slow

[8] There are about 20 pension funds investing in Poland since pension reform inception in 1999. At the end of year 2000 they managed $ 2.5 bln.

with two years (1993 and 1996) of de-concentration. Since 1996 the concentration process has accelerated. The cumulative distribution of firms by voting blocks was getting closer to the 45% threshold. Referring to distribution and concentration levels, it is worth noticing that in 1996 at almost 76% of public companies the largest shareholder had less than 33% of voting rights compared to 56% in 1998 and only 44% in 2000.

[Table 2 & 3 about here]

The consolidation trend needs further investigation as the changes in ownership and control patterns may reflect new companies coming to the market or it may be also the case that some companies were subject to concentration while others were able to disperse ownership and control. Both the decreasing number of newcomers and value of the IPO market in 1998-2000 strongly support the consolidation hypothesis. The period of 1997-1999 was also a time of many tender offers on the market. The amendment to the law on public trading in securities shifted the threshold for mandatory bids from 33% to 50% thus reflecting both pressure of the consolidation trend and the authorities' hope that this move would slow the process of company withdrawal from the market.

The de-concentration periods in 1993 and 1996 may be reflections of the strong market performance (bullish markets) which attracted new share issues and decreased the stakes of founders. However, 1997 with its record number of new public companies and IPO market value draws a question with this argument.

[Figure 4 about here]

What were the reasons for the overall consolidation trend? Corporate governance literature suggests the following answers. La Porta et al (1996) suggests that ownership concentration is the investors "reply" to poor protection of shareholder rights. In fact in recent years several cases of expropriation of minorities took place – ranging from opportunistic manager behaviour, tunnelling and self-dealing by strategic investors, failures to provide the public with important information about company, insider trading and paying the minorities significantly lower prices than the ones paid for controlling stakes. The investors' perception of protection and especially enforcement of minorities' rights is rather poor.

Poor enforcement of minorities' rights made the consolidation of ownership and control inevitable, as it addresses the problem of unaccountable managers – evident when owners are dispersed (Shleifer and Vishny 1986). However, part of the process was caused by changes in privatisation strategies – combining flotation with a sale to the so-called strategic investor. Poor enforcement allowed strategic investors and other blockholders to extract private benefits at the expense of minority shareholders. Additionally, very often the prices offered to minorities by strategic investors were very unfair. The liquidity of these companies was also affected. On the other hand, new family companies entering the market were not able to attract new institutional investors – partly because of their size (low liquidity) and partly because of their unwillingness to transfer control to the market, and poor management.

The weak shareholder protection argument may be somewhat justified by the difference in the size of blocks owned by domestic and foreign investors. The average size for the largest blocks owned by foreign strategic investors is much higher (67%) than those owned by domestic companies or individuals (43.5% and 40.6% respectively[9]). This difference is also evident in the case of the second largest block. Foreigners with weak knowledge and access to courts and judges prefer bigger blocks to execute their rights than domestic investors usually more familiar with a local legal system. The same situation is reported in Russia where legal protection of shareholders is very poor (Shleifer & Vishny 1996).

The opportunism of Polish managers was responsible for at least a part of the concentration trend. In the short history of the Polish stock market there were many examples of empire building and high managerial remuneration contracts - especially among former state owned companies privatised through IPO. Many of them within a couple of years were turned into over-diversified conglomerates. All of these corporations entered into heavy restructuring (including firing "old" managers[10]) in the wake of pressure from foreign strategic or institutional investors. .

Two factors – we tend to believe - allowed for managerial opportunism to develop in the early 1990s. Firstly - privatisation strategies employed by the state combined with the underdeveloped capital market (a lack of domestic institutional investors). Many state-owned enterprises were privatised through IPO (sometimes with significant stakes left in state hands) while managers and employees gained a privileged position in privatisation due to political reasons. Many enterprises, which later were publicly listed, were privatised by management and employee buy-outs. Therefore the position of managers became very strong. The second factor was weak competition - at the beginning of the 1990's many product markets, although formally liberalised, were still protected by monopolies and (declining) tariffs. Domestic rivalry was non-existent and inflow of FDI quite thin due to an unstable and discouraging economic environment. The competition was thus unable to force corporations to market adjustments in a short time, especially if they inherited a monopolistic position. This situation created room for managers of public, formerly state-owned corporations (which constituted the largest fraction of public corporations) to engage in ineffective expansion projects.

[9] The second figure would be slightly higher if we combined stakes owned by founders into one block.
[10] Many of them were directors of these companies before privatisation.

Besides political motivation and eagerness to create more efficient corporate structures, the change in privatisation strategies - in favour of strategic investors - may be attributed to the Zingales (1994) proposition on a control premium attached to large blocks of shares. We suppose – although it needs further testing – that the State Treasury's willingness to cash and capture premiums for control engendered the preference to sell large stakes to strategic investors, rather than to disperse the ownership on the market (through IPO). Figure 5 presents the structure of some privatisation IPOs over the last decade. The lower side of the plot represents the fraction of shares reserved for sale to a dispersed public (physical persons or legal entities), and the upper, darker part the shares reserved *expresis verbis* for one (strategic) investor or left in state hands for further disposal (usually for sale to one investor)[11]. It can be noticed that relations of both fractions of shares changed over time. In the first half of the 1990`s privatisation IPOs were structured with the preference for ownership dispersion. For example, in the case of Kable, Próchnik, Polifarb Cieszyn about 80% of the shares in each company were sold to the market by the Ministry of Privatisation. In the mid-1990s the economic climate in Poland improved enough (GDP growth in 1995 amounted to 7%) to allow the Ministry of Privatisation thus to gain better prices as well as to privatize much bigger companies than before. Simultaneously the policy makers realised that privatisation could be a very efficient source of budgetary revenues – the only source of money to cover the high costs of structural reforms (pension, health service reform, etc.). In that situation the Ministry of Privatisation was unable (due to technical reasons) to increase the pace of privatisation and therefore decided (maybe unintentionally) to increase revenues through cashing out and capturing premium for control. This could be achieved only by selling large blocks of shares to a single investor, so they applied different strategies of combined selling of a company to the market and to a strategic investor. In a few cases they sold the stakes still possessed in privatised companies already introduced to the public market (TPSA, BPH, Pekao and other banks) or they have an option to do so (KGHM, PKN). In the case of PZU (the biggest Polish insurer) the sale to the strategic investor (Eureko) took place before the announced IPO.

[Figure 5 about here]

IV. Separation of ownership and control, most common control structures

The available data allowed to analyse how and to what extent control is separated from ownership. The overall picture is far from the separation patterns observed in Western Europe

[11] The fraction of shares left in state hands usually included shares reserved for restitution purposes and for financing pension reform. Altogether it was about 10% of shares of each IPO.

- the extent of separation as well as the range of separation devices is - in general - very modest. Polish corporate law provides the following legal devices to leverage control over cash flow stakes:

a) dual class shares (preferred shares)
b) voting cap
c) golden share - statutory provisions providing specified preferences (i.e. the right to appoint a few members of the supervisory board etc.) to a particular shareholder
d) non-voting shares (introduced since 2001).

Control can also be leveraged through hierarchical structures (pyramids), cross shareholdings, acquisitions through subsidiaries and dependent entities. To shield specifically against hostile take-overs, except for the above, the following devices may be used:

a) authorised capital (introduced since the beginning of 2001),
b) own share purchase (only up to 10% of shares).

Our analysis shows that preferred shares with multiple voting rights are the most common device to leverage control over cash flow rights. 79 corporations out of 210 (i.e. 37.6%) have issued preferred shares, mainly smaller companies founded by individuals or companies privatised through management and employee buy-outs. In the majority of cases (81%) the maximum preference allowed by law was used - five votes attached to one share. Surprisingly not always the largest shareholder had more votes than cash flow rights - this happened in 11.5% of the cases. "Positive" separation existed (more votes than cash flow rights) in 25.5% of the largest blocks. In 63% the number of votes equalled cash flow rights. The extent of separation measured by the number of votes per share amounted to an average of 1.5. In about 40 corporations the control exerted with preferred shares could not be contestable as they represented more than 50% of all voting rights. For instance the founders of Bakoma (a renowned yogurt producer closely co-operating with Danone) – Mrs and Mr Komorowski – control together through dual class shares 61% of votes with a two times lower share in cash flow.)

In several cases the real separation could be much deeper than revealed in the notifications. The case of Agros (figure 6) is a good example in this respect. This large food processing company was controlled by TIGA – a privatisation vehicle set up by employees and managers of former state-owned enterprise. Thanks to preferred shares (one share – five votes) TIGA controlled 81.4% of Agros Holding votes, while its stake in cash flow was only 47.5%. In fact full control of Agros should be assigned to Zofia Gaber (the company's director before privatisation and then the president of the management board), who was the largest owner of

TIGA with a 18,5% stake and the chairwoman of TIGA supervisory board. This type of privatisation scheme frequently allowed managers of the former SOEs to gain privileged positions. Because of the legal loopholes it was also possible to take control of Agros by buying (non-listed) TIGA and avoiding a mandatory bid.

[Figure 6 about here]

Golden share is a statutory provision which awards a particular shareholder (usually the founder) extra corporate privileges – for instance the right to nominate a member(s) of the supervisory or management boards. This device is most frequently identified with large privatisation deals and the State Treasury will retain control over strategic decisions and the composition of governing bodies in a company. To our surprise we found such a device in a number of statutes of corporations not originating from privatisation. In the above mentioned Bakoma the statute gives Mr and Mrs Komorowski the right, irrespectively of the amount of shares held, to nominate 3 out of 5 members of the supervisory board including chairman (and also to set the chairman's remuneration). Moreover, the chairman of the management board is elected not by the whole supervisory board, as usual, but by its chairman alone. In Prokom Software – the largest software producer and system integrator in Poland– its founder Mr. Krauze has the right to nominate 3 out of 5 members of the supervisory board including the board chairman. In another firm – Computerland – the right to nominate 2 out of 7 members of the supervisory board is awarded to a shareholder who has held the largest stake of shares (at least 5%) for the longest period of time (no shorter than 6 months).

Leveraging control through hierarchical structures (pyramids) seems to be much less popular than preferred shares. We noted the appearance of this device only in 6 cases. A good example of such hierarchical structure is the economic "empire" of Jan Kulczyk, the richest man in Poland and one of the richest in Central and Eastern Europe. Jan Kulczyk and his wife possess, through two private (non-listed) entities (Kulczyk Holding and Kulczyk Privatestiftung registered in Austria), significant stakes in: Warta S.A. (Plc.) – the second largest insurer in Poland – Polish Telecom TP S.A. (both are among the biggest corporations listed on the Warsaw Stock Exchange), and many others. Another example could be Mr Ryszard Krauze who controls - through Prokom Investment (private) and the above-mentioned Prokom Software (public) – a large variety of other corporations, including: Wirtualna Polska (Wirtual Poland – the largest portal) and Softbank (a public corporation providing sophisticated software for banks).

In about 20 cases it was observed that control was leveraged through own-share purchase executed by subsidiaries. In 8 corporations the block owned by a subsidiary was the largest one with an average size of 22%; in 5 cases it was the second largest (average size 13%). Wawel – a candy and chocolate maker – has two subsidiaries, WIK and DOT, which hold together 20% votes of Wawel. Wawel itself is controlled by Mr Malek (21% of votes), who is also chairman of the supervisory board. Altogether, directly and indirectly, Mr Malek controls 41% of votes. Compared to previous years the subsidiaries are now employed more frequently, while cross shareholdings are less common (only 2 cases).

The leverage action undertaken through subsidiaries could be additionally supported through purchase of own shares by the corporation in question. Since January 2001 any corporation is allowed to buy up to 10% of its own shares to "...defend against direct, significant damage to a company"[12]. So far we have not registered any case where such a device was employed.

In some corporate statutes voting cap was found to be used as a control device and a handy solution to defend against a take-over threat. In the media group Agora no shareholder can execute more than 20% of votes (except holders of preferred shares), unless they have at least 75% as a result of a mandatory bid for all outstanding shares. A similar solution was introduced by Computerland. According to our review of statutes, the utilisation of voting cap is not predominant.

Since the beginning of 2001, authorised capital has been introduced by a new company law. It provides for management (upon decision of GSM) to issue – within 3 years - new shares of total value not exceeding ¾ of existing share capital. This measure was introduced to improve company ability to tap the market at the right time. However, it can also be used as an anti-take-over device, especially if the management authorisation allows the issue of shares without pre-emptive rights. It is too early to judge the popularity of this device among public corporations. So far only in a couple of corporations have shareholders agreed on authorised capital.

Transparency of control devices raises rather mixed feelings. Information on such devices as preferred shares and golden share should be included in the statute deposited in the court registry as well as in the prospectus. Both documents are available only in paper form. Transparency requirements for public companies require neither that they reveal an up-to date statute on the web site nor its provision to any investor upon request.

The Warsaw Stock Exchange has not been the scene of large take-over battles so far. Some examples of proxy fighting were observed when the Small Investors Association took

[12] Before January 2001 a corporation was not allowed to buy own shares.

steps against some blockholders[13]. According to our estimations, due to ownership and control concentration only up to 20% of public companies could be threatened by hostile take-overs (however we didn't take into account voting caps or other statutory provisions). Public companies may also be shielded from the threat of a hostile take-over by:

- ✓ strict notification requirements (each increase of 2% over the threshold of 10% of voting rights – both when buying directly or through dependent entities[14]),
- ✓ an obligation to acquire no more than 10% of votes in each three-month period unless calling a public tender, and
- ✓ the disposition of the regulator (PSEC), which wants to limit the process company withdrawal from public trading (an investor has to gain consent from PSEC to increase his stake over 25. 33% and 50% voting right thresholds).

The most publicised case of an unsuccessful hostile take-over was Deutsche Bank's fight for bank BIG BG. The ownership of BIG BG was quite dispersed however the control was locked in subsidiaries. Additionally a voting cap of 15% was introduced (except for one shareholder whose limit was 20%). Deutsche Bank – for more than a year - cumulated shares independently and through friendly entities (to avoid the mandatory bid requirement before acquiring more than 50% and to avoid application to the PSEC to increase its stake over 25%). To defeat the takeover threat the management obtained the bank's foreign partners (BCP and Eureko) as white knights. At the final stage Deutsche Bank managed to get the advantage because of an agreement with one of the largest shareholders (insurance company - PZU and its subsidiary PZU Life). However, opponents managed to raise legal arguments against the way the Deutsche Bank group cumulated shares (buying shares with the breach of regulation on acquiring substantial blocks which is penalised with the inability to execute the votes) and managed to break and postpone the general shareholder meeting. The latter allowed for changes in PZU management as the State Treasury rejected the agreement with Deutsche Bank (it is worth noticing that after the first privatisation phase BIG BG together with Eureko possessed a 30% stake in PZU). As Deutsche Bank group elected the new supervisory board (which then changed the management board) the GSM had not been finished, the former boards did not want to step down. The argument was taken to court but eventually (probably because of strong political pressure) Deutsche Bank gave up and sold its stakes.

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[13] The first case of raising proxies publicly was however Bank Handlowy with its management wanting to get approval of a merger with another bank (BRE Bank), which was opposed by the State Treasury and state- owned insurer (PZU).

[14] Before the previous amendments these obligations referred also to entities acting in concert. Also after crossing the 10% threshold an investor is obliged to publicly declare his plans regarding future acquisitions in the next 12 months.

The modest level of ownership and control separation – in such a young market as the Polish one is not a surprise. The range of separation devices could not be broader compared to that reported for Western Europe by Becht (1997). This situation is likely to change quickly in the future. Firstly, the shift from preferred shares to pyramids could be expected due to changes in the regulations. Corporate law permitted not more than 5 votes per one preferred share till the end of 2000. This allowed for significant separation of ownership and control in several public companies (see Agros, Agora etc.) in a rather cheap and transparent manner (mandatory notification refers both to cash flow rights and voting rights). The new Commercial Companies code (in force since January 2001), inspired by the philosophy of corporate democracy, lowered the number of votes per share from 5 to 2[15] additionally forbidding issues of preferred shares by public companies. This modification may force shareholders to search for new control devices and shift to pyramids. Secondly, new devices will be employed or "discovered". For instance authors of new corporate law together with "democratisation" of preferred shares introduced a less "democratic" device in the form of non-voting shares (giving some privileges in dividend pay-outs). This could directly lead to the creation of cascades, however at the moment registered shares are not allowed to be listed. Thirdly, we expect that domestic shareholders (mainly founders) will absorb more knowledge and become more skilled in managing the control - ownership relationship (or retaining control). Voting caps and golden shares will probably become more popular. Altogether these should lead to better separation and greater variety of the control devices in use.

V. Ownership transparency - transposition of the Transparency Directive

Although transparency of the stock market in Poland was at the heart of its foundation, it took a couple of years to work out a model of transparency which in general conforms to the Transparency Directive (TD)[16]. It can`t be said, however, that the law on public trading in securities fully absorbs all major provisions of TD. The Law on Public Trading in Securities was passed in March 1991. Since that time there have been 3 important amendments with the last one in force since January 2001[17]. The first regulation (in force from 1991 to 1994) defined 6 thresholds for disclosing ownership stakes: 10%, 20%, 33%, 50%, 66%, 75% of voting rights. This was almost exactly in line with article 4 of TD, but the group definition left much to be determined. It referred only to the situation of the controlling entity (second indent in art. 7 of TD and the definition from art. 8). Disclosing thresholds were significantly

[15] In the most common limited liability company (spółka z o.o.) preferences were reduced from 5 to 3 votes per share (stake).
[16] Transparency Directive of 12 December 1988 (88/627/EEC).
[17] In fact in 1997 the new act was introduced as the previous one (covering also open-ended funds) and was divided into: the law on public trading in securities and the law on investment funds.

tightened in 1994. The first threshold was lowered to 5%, the next one remained at 10%. All investors had to report each +/-2% (or more) transaction(s) above that level. Group definition remained unchanged. In 2000 legislators left the disclosure thresholds practically unchanged[18] but improved group definition by expanding notification requirements for acquisitions realised through other parties acting in concert. Since then the group definition reflects most of the indents of art. 7 of TD, however indirectly.

The general picture of the notification process looks as follows. Any shareholder acquiring, exceeding or falling below the stipulated thresholds is obliged - to inform the company (issuer), the Securities and Exchange Commission and the Antimonopoly Office - within 7 days of the transaction[19]. The information should include the amount of shares owned and percentage share in cash flow and total votes. Then the issuer should immediately pass this information to the Stock Exchange and the Polish Press Agency (a nationwide information agency). A wide public distribution of information is the last stage. This is done by means of newspapers and direct access to an electronic reporting system, which is run by the Securities and Exchange Commission.

The obligation to notify when thresholds have been exceeded appears also in the case of buying or selling convertible bonds of a listed company, depository receipts and other securities, from which the right or obligation to buy shares of a listed company is derived.

The acquisition, disposal or holding, by a direct or indirect subsidiary, of shares in a public company or depository receipts issued in connection with such shares, will be construed (deemed) as the acquisition, disposal or holding of such shares or depository receipts by the parent company. The performance of a legal act by a subsidiary or the occurrence of any other legal event in relation to such an entity will lead to obligations also on the part of its parent company.

A parent company (dominant entity) is the one that:

1. holds the majority of voting rights in the governing bodies of another entity (subsidiary) directly or indirectly through other entities (subsidiaries) or by virtue of agreements with other persons, or
2. is authorised to nominate and dismiss the majority of members of governing bodies of another entity (subsidiary), or
3. more than one-half of the members of the other entity's (subsidiary's) management board are simultaneously members of the management board, proxy or are executive managers in the first entity or in some other entity which is a subsidiary of the first entity.

The notification obligations are:

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18 Slightly higher interval for notification (plus 5% instead of 2%) was introduced for the OTC market.
19 Formally 4 days after transaction registration, which should take place within 3 days of the transaction.

1. also binding jointly upon all entities bound by a written or oral understanding regarding:
   i) joint acquisition of shares of the public company or the depository receipts issued in connection with such shares, or
   ii) concerted voting of the company's shareholders in the GSM on matters of significance for the company, or
   iii) pursuit of a long-term joint policy regarding the company's management

 - even if only one such entity has performed or has intended to perform activities resulting in the creation of such obligations;

2. binding upon an investment fund also in cases where reaching or exceeding of a vote percentage threshold specified in such regulations will be the result of a joint acquisition, disposal or holding of shares or depository receipts by:
   i) other investment funds managed by the same investment funds society,
   ii) other investment funds established outside of the Republic of Poland and managed by the same entity,
3. binding also upon entities whose reaching or exceeding of the number of votes specified in such regulations is the result of an acquisition, disposal or holding of shares or depository receipts:
   i) by a third party in its own name but for and to the order of the said entity (with the exception provided by the law),
   ii) in the process of performing asset management with respect to shares comprised in managed securities portfolios on which the said entity, as portfolio manager, may, on behalf of its clients, exercise voting rights in the general meeting of shareholders.

Public access to block-holding information is satisfactory as transactions are publicly reported and the current shareholder structure for each company is available both on paper (a list updated every two or three weeks accessible at the PSEC Information Outlet) and in electronic format (several specialised websites). Access to historical, cumulative information is rather problematic. Except for a commercial, electronic data base available from Notoria Publisher no cumulative information is publicly available, however the PSEC is probably in possession of such a breakdown.

Any blockholder failing to disclose the passing of a threshold may be subject to two sanctions. Firstly he is unable to execute voting rights acquired in that way, and secondly is subject to a penalty fee of up to 1 million zloty (about $ 250,000,0 in mid- 2001).

Apart from disclosure duties upon passing thresholds, the additional information on shareholder structure can be derived from notifications on shareholders (name, votes, amount of shares) entitled to take part and those (5%+) who actually took part in a shareholder meeting.

VI. Minority protection in Poland

It is now beyond discussion that having large investors onboard creates some costs. Full or at least significant control over a corporation may create a strong temptation to diverge from value maximisation objectives. In pursuing private benefits, blockholders may expropriate other investors, managers, employees and other stakeholders (Shleifer, Vishny 1996). The expropriation may take a variety of forms including among others transfer pricing, expropriation of business opportunities, preferential assets sale, or targeted share issue. There is now an increasing number of empirical studies documenting the forms and degree of minority expropriation. The most interesting are reviewed in Claessens et al (1999).

La Porta et al (1996) develops an interesting thesis that minority treatment and in general shareholder rights are historically determined by the type of legal system. It is evidenced that shareholder rights in common law countries (US, UK) are much better defined and protected than in civil law countries (with German and Scandinavian law standing in between). If control of Polish corporations is rather concentrated than dispersed - as we have documented above - and corporate law is heavily based on the German model an interesting question is whether minorities are expropriated. Case study analysis suggests that they are, however there is no empirical evidence on the extent of expropriation.

Pistor (2000) and Pistor et al (2000) documented significant improvements in shareholder and creditor rights in transition countries including Poland. She observed that some improvements were strongly determined by the type of privatisation policy. For instance minority protection was better developed in countries that carried out mass privatisation schemes (as Poland did). The EBRD legal indicator survey (1999) awarded Poland the *'moderate'* mark for the way minorities were protected (there was a four-mark scale with: *'ineffective'* as the worst and *'reasonably comprehensive'* as the best). A *'Moderate'* mark in this case meant the existence of basic protection with rather problematic execution. Some cases of ineffective execution of law reported in the survey were responsible for Poland’s score being lower than a year before. This is conforms with Pistor’s (2000) warnings that good law on the books is only a part of the whole story.

Postrach (1999) reports many cases of minority expropriation in Polish listed companies. In some national investment funds (NIF) – emerged from the mass privatisation program – there were numerous cases of self-dealing transactions. The bank shareholder of a management company running a NIF was selected by that NIF (its supervisory board) to organise a quite large issue of its short-term bills. In another case an NIF`s controlling shareholder pushed through a decision to sign a management contract for running that fund with the firm controlled by himself. Some NIFs planned targeted issues of shares or convertible bonds. In a couple of other cases below-market price share issues were directed to managers (and key employees) who were simultaneously a dominant shareholder(s). Although such issues were motivated by efficiency- oriented goals, the difference between market and issue price was usually very controversial. In one case the issue price was 22 times below its market valuation whereas the chief manager was simultaneously a main shareholder (Postrach 1999).

A good example of expropriation of business opportunities is the agreement concerning distribution of vodka-based beverages signed by Pernod Ricard (the strategic investor) with the controlled Agros Plc. The agreement awarded Pernod the exclusive right for 25 years to vodka brand names registered for Agros in the US without any fee for Agros. The controversy emerged when experts estimated these brand names to be the most valuable asset of Agros.

Too loosely-defined mandatory bid requirements allowed shareholders to be paid significantly different prices in recent years. In the case of Polifarb Debica the price paid to minority shareholders was 20% lower than the one for large blocks. Additionally, the gradual consolidation process created another opportunity for minority expropriation. In a number of cases share prices of quite large corporations controlled by large, strategic investors were under-performing the market for several years. For instance shares of Stomil Debica – controlled 60% by Goodyear – dropped by 70% within 3 years and Goodyear was suspected of being interested in pushing down the price in order to de-list the company cheaply. Another company – Stomil Olsztyn controlled by Michelin – became the most carefully analysed and watched battlefield between minorities and a large blockholder in Poland. Michelin was suspected to have transfer profits through excessive licence fees, disadvantageous export agreements and research & development support. All these transactions are estimated – by some analysts – to have caused about $50 mln of additional costs for Stomil. It is very likely that Michelin will try to de-list Stomil Olsztyn to close further disputes.

The above mentioned examples are not exhaustive. The list of abuses to minority rights is much longer and the whole subject needs further investigation. It is interesting how these problems are being addressed. Although Polish corporate law accommodates many internationally renowned standards for minority protection (for instance the aforementioned Transparency Directive) the most improvement and better protection should be expected from growing shareholder activism. Pension funds operating since 1999 are becoming more and more active. They account at the moment for about 4.2% of market capitalisation. Although law prohibits them from executing more than 10% of votes, in a number of cases their strong position has resulted in the rejection of some disadvantageous decisions and resolutions. Pension funds are usually accompanied by international institutional investors, who have been active on the Polish market since the mid-1990s. Also, small investors are now in a better position due to the establishment of the Individual Investors Association (IIA) in 1999. This independent association attempts to support minorities by collecting proxies and by newspaper campaigns. IIA has successfully intervened in 7 cases so far.

The evaluation of legal protection against shareholder rights violation is a mixed picture. It has to be appreciated that the law contains many classical provisions, however there are some loopholes and inconsistencies. Also enforcement is quite weak. For example, the new corporate law reduces the minimum size of a supervisory board from 5 to 3 members in line with the argument of cutting supervisory board costs. Unfortunately "savings" in this respect may be at the expense of minorities, as the election of supervisory board members representing minority shareholders (so-called group voting or cumulative voting) is quite difficult or even impossible. In order to elect at least one representative a group of outside shareholders must represent at least 33% of votes at the shareholder meeting, that is a quite high level (compared to 20% of votes in the case of 5 board members). The new provision for "an auditor for special purposes" introduced in the Law on Public Trading in Securities from the beginning of 2001 is also confusing. It provides that any shareholder (or group) having at least 5% of votes can propose at a general assembly a resolution to elect an auditor to review specific areas of corporate business. But again, this provision was structured in such an unfortunate manner that it may be violated in practice. In the case of Stomil Olsztyn, Michelin rejected the auditor proposed by minorities (who required a review of the licence fees paid to Michelin) and elected another firm which had audited Stomil previously. The conflict of interest was evident but not for the main blockholder. It is now beyond discussion that this provision is unclear and the way the auditor for special purposes is elected must be precisely defined (or one has to wait until the Supreme Court will provide interpretation which may take a lot of time).

There are also many other confusing or contradictory provisions in corporate law. A new law decreased the extent of preferences in voting per registered share (from 5 to 2) to make a corporation more "democratic" and simultaneously introduced shares with no voting rights. Moreover, corporations are now allowed to buy own shares to "...defend against direct, significant damage to a company", which may be used as anti-take-over device. These provisions seem to protect managers rather than minorities.

There is no single, easy way to improve protection of shareholder rights in Poland. We suppose that a three-way change is necessary. Firstly, shareholder activism should be strongly promoted in the form of minority associations (as IIA) and pension fund involvement in corporate supervision. The former requires careful evaluation of pension fund regulations. Secondly, enforcement of the law has to be improved and several amendments in the overall legal framework are necessary. Thirdly, and even most importantly, is the bottom-up implementation of corporate governance and ethical standards (a corporate governance code). The pressure from domestic and international investors in this respect would be more valuable than direct state intervention. Last but not least, the promotion of liquidity would be helpful in order to increase the potential for outside control.

We are convinced that a strategy for improving liquidity should be at the heart of decision makers if they want the Polish stock market to survive and grow. Such a strategy should include at least three elements. Rescheduling the state privatisation strategy is necessary – companies should be floated on the stock exchange in a more dispersed manner. Moreover, regulations should not be so indifferent to the control concentration process. We think that the mandatory bid rule should apply at the level of 33% of votes (and not 50%). A dominant shareholder above 33% should be eventually forced to decrease its voting power or allowed to de-list a company after buying all outstanding shares (at a fair price). A smaller in its size (or number of listed companies) but deeper (more liquid) market will more effectively protect all shareholders. Thirdly, effective measures to balance advantages of blockholders or strong and independent managers with accountability (outside control) has to be found. The observed patterns of control concentration (through large blocks) results in low liquidity. In order to have both accountable managers and liquidity should not we recourse to such control devices as multiple voting shares (giving 5 or more votes per one share).

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Tables and figures

Table 1. Blockholding in Poland in % (as at end of 2000)

item	1st Largest	2nd Largest	3rd Largest	4th largest
Average	44,6	15,6	9,4	7,7
Q1	25,4	5	0,0	0,0
Q2 (median)	39,5	10,4	5,0	0,0
Q3	60,3	18,5	8,6	5,2
Q 4	99,7	40,6	20,1	18,3

Source: own computations

Table 2. Evolution of Control Concentration (largest blockholder in %)

Item/year	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Q1	25,4	24,2	20,4	17,7	14,9	17,2	12,8	12,	17,5	7,5
Q2 (Median)	39,5	37,4	32,3	29,4	23,6	26,4	25	20,1	25,4	17,9
Q3	60,3	58	54,6	47,6	33,2	47,5	49,3	30,5	40,0	36,2
Q4 (max)	99,7	99,7	95,3	91,3	91,3	97	93,8	65,	47,2	47,2
Average	44,6	42,9	38,8	34,3	31,1	34,1	33,1	25,2	29,4	27,9
Number of observations	210	185	164	111	65	48	34	19	13	8
Number of blocks	208	183	159	107	64	47	34	18	12	6

Source: own computations

Table 3 Evolution of Control Concentration (second largest blockholder in %)

Item/year	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Q1	5,0	5,1	5,2	5,2	5,2	5,1	1,1	0,0	0,0	0,0
Q2 (Median)	10,4	10,1	9,9	10,0	8,8	7,5	5,5	10,0	5,5	10,0
Q3	18,5	17,2	16,5	15,4	13,1	14,1	10,2	10,1	10,4	10,1
Q4 (max)	40,6	40,6	40,0	39,6	34,9	34,9	25	25,0	20,0	17,8
Average	15,6	14,8	14,2	13,5	11,6	11,3	9,7	12,7	10,7	11,6
Number of observations	210	185	164	111	65	48	34	19	13	8
Number of blocks	161	143	130	88	52	40	25	13	5	5

Source: own computations

Figure 1. Notification and control over Kompap SA
(question mark means that stake is not disclosed)

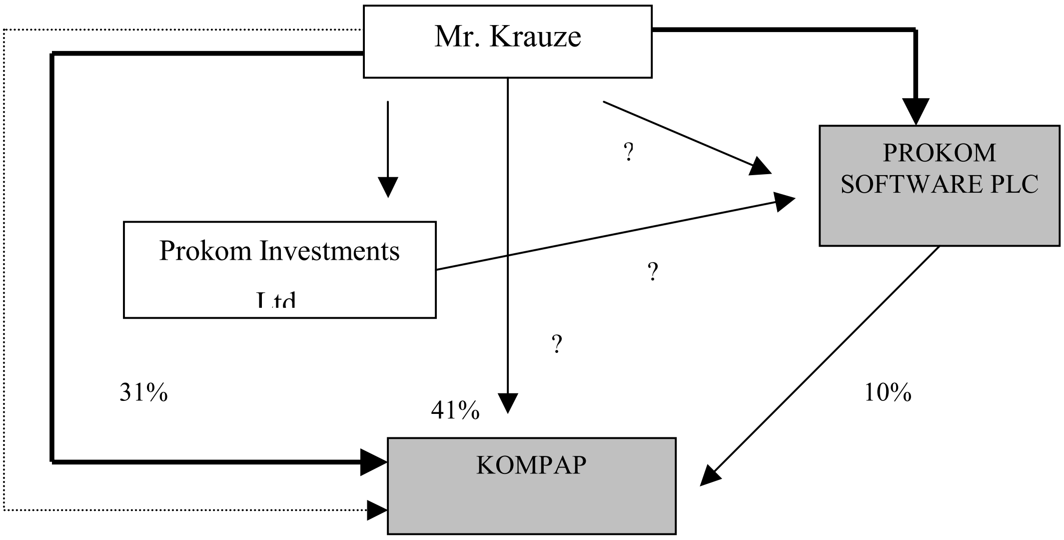

Figure 2. Notification and control over Zasada SA (question mark means stake not disclosed)

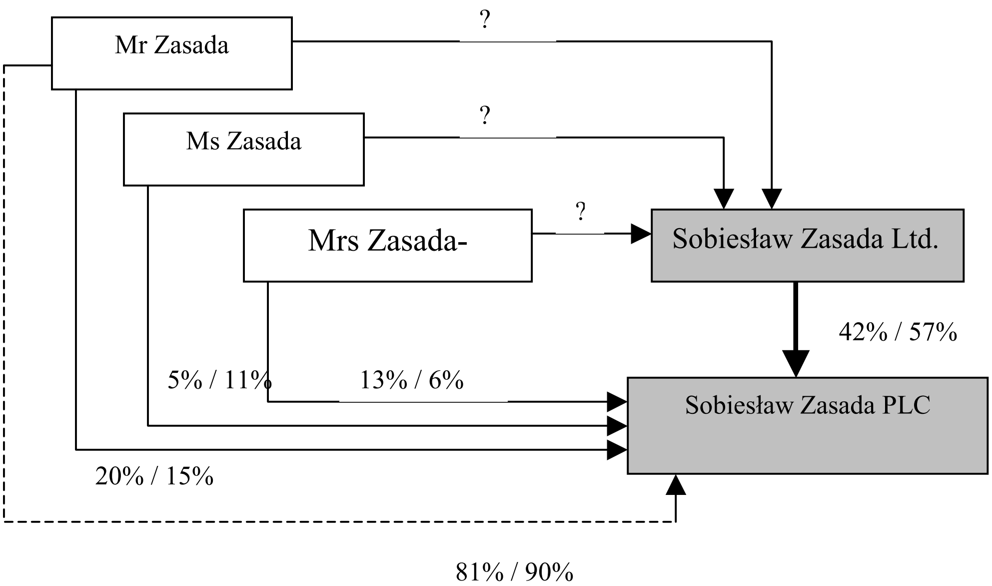

Figure 3. Distribution of the largest blockholder.

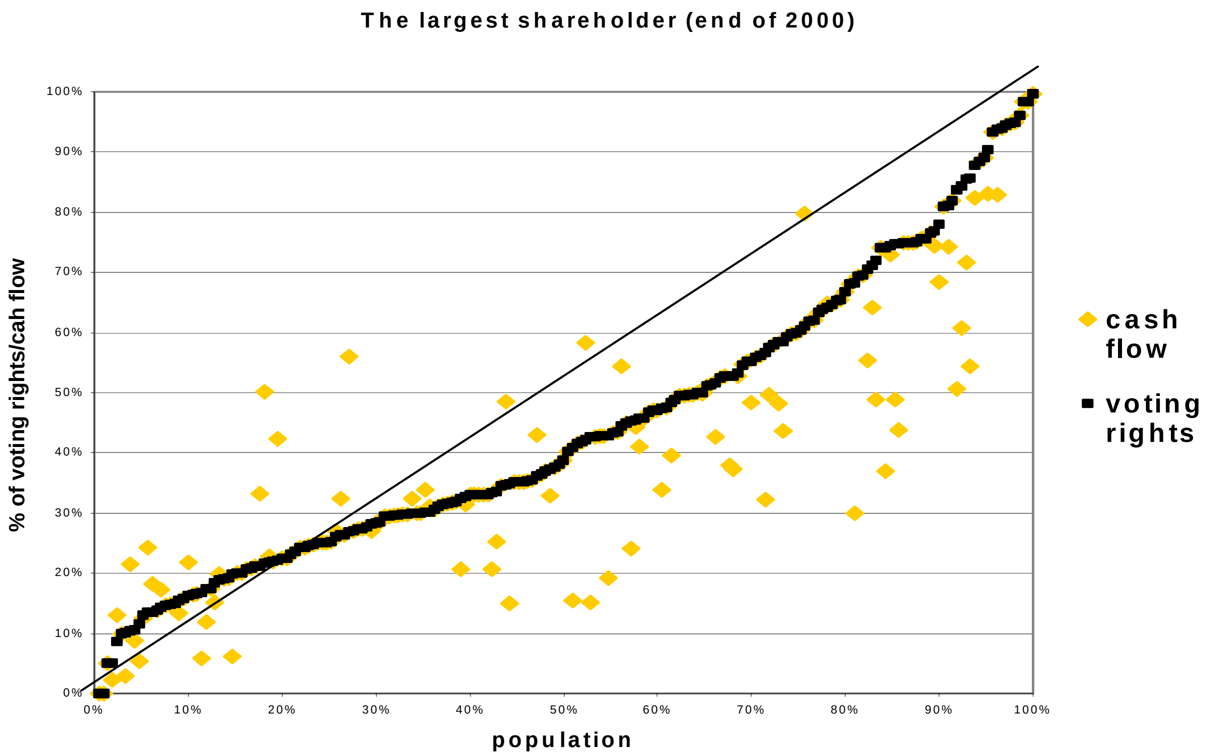

Figure 4. Evolution of control concentration (1991-2000)

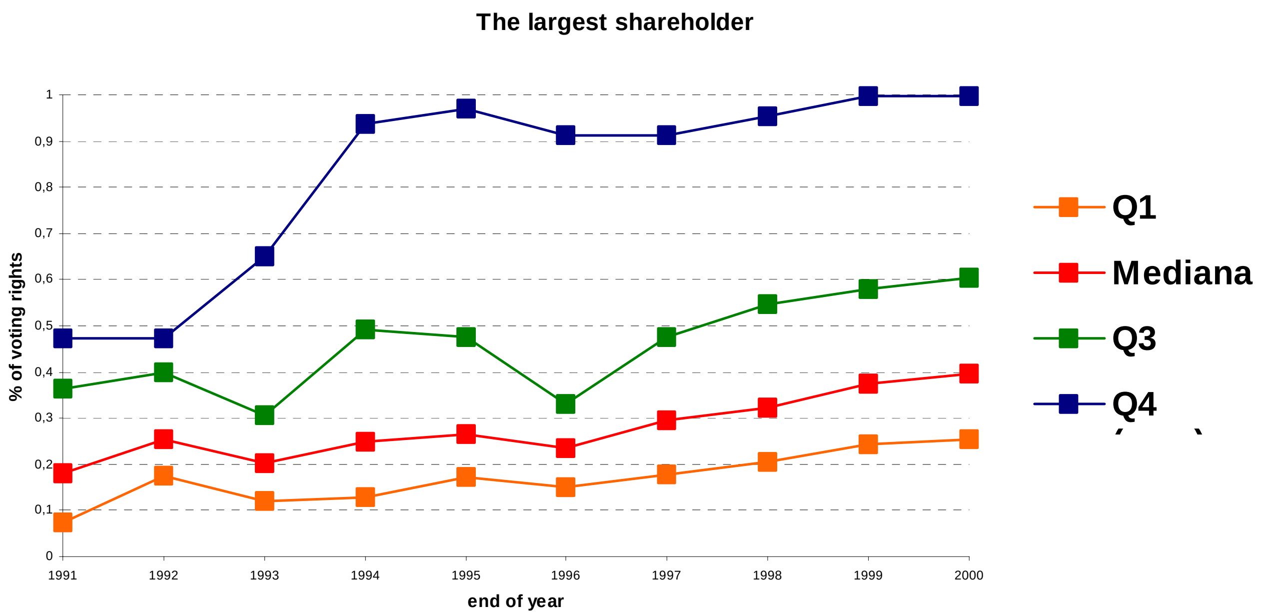

Figure 5. Structure of some privatization IPOs (1991-1999).

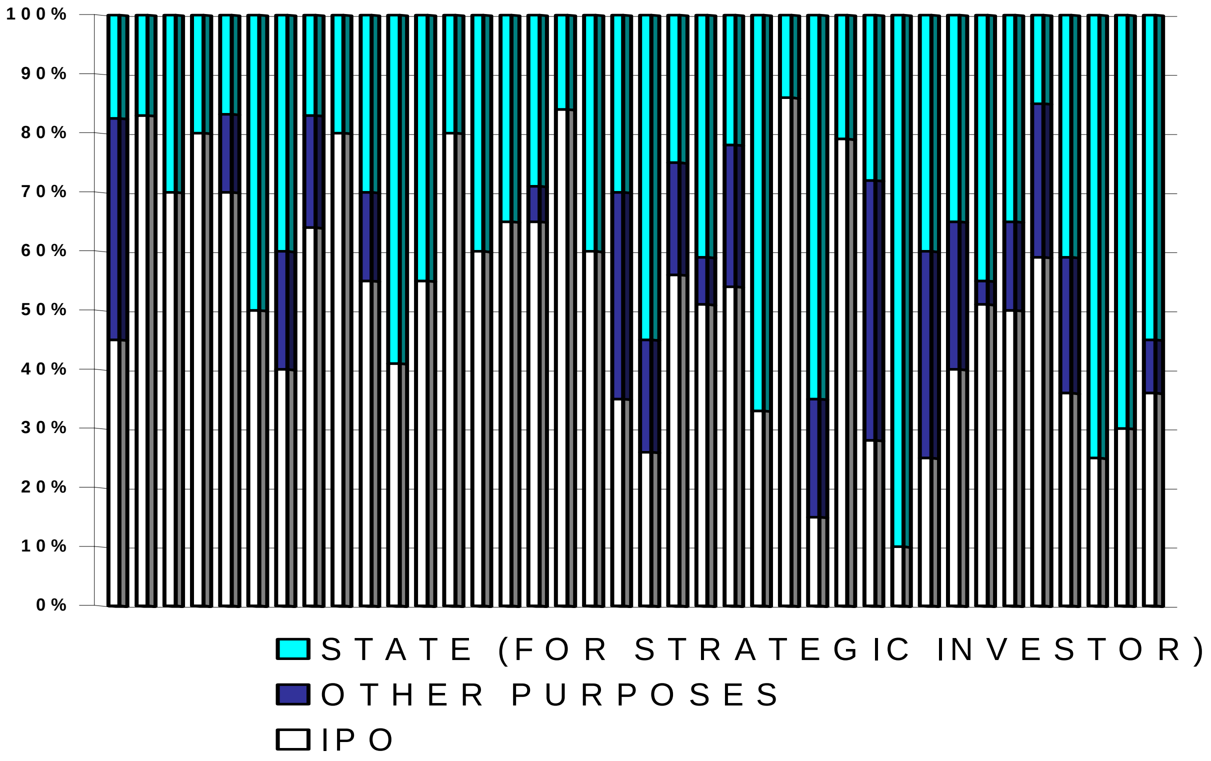

Figure 6. Control over Agros (leveraged through preferred shares)