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*Piotr Kozarzewski*

# Privatization and Corporate Governance in Poland: Problems and Trends

W a r s a w , M a y 2 0 0 6

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## Abstract

The paper is devoted to the problems of the impact of privatization on corporate governance formation in Poland. It discusses the dilemmas of choosing a model for privatization and corporate governance, legal background, mechanisms of corporate governance formation depending on a privatization method applied, and the evolution of these structures in the course of systemic transformation in Poland.

The Author comes to the conclusion that the processes of privatization and corporate governance formation in Poland are marked by both successes and failures. The most spectacular success is privatization in the "broad sense" which boosted the growth of new private businesses and the share of the private sector in the national economy. Privatization in the "narrow sense" (ownership transformation of state-owned enterprises) was only a partial success, both in terms of quantity and quality. Some methods of privatization proved to be more "permeable," easier to implement for a number of social, political and technical reasons than the others; thus, the progress of privatization was very uneven across sectors, and some of them (infrastructure, extractive industries and some others) remain predominantly state-owned. There were two reasons for this situation: the highly gradualist, consensual character of Polish privatization procedures and the emergence of interest groups not interested in privatization of remaining state-controlled companies.

Recently, new trends are seen that can be interpreted as a certain convergence of corporate governance models and a convergence between the effects of different privatization methods in corporate governance and performance of enterprises. Taking this into account, the Author elaborates on whether the "how to privatize" question still actual and on the "feasibility vs. efficiency" privatization policy dilemma.

## Foreword

The paper is devoted to the problems of the impact of privatization on corporate governance formation in Poland. It discusses the dilemmas of choosing a model for privatization and corporate governance, legal background, mechanisms of corporate governance formation depending on a privatization method applied, and the evolution of these structures in the course of systemic transformation in Poland. In this paper, term "privatization" is used in a narrow sense. It means transfer of state-owned stock into private (non-state) hands (unlike privatization in the broad sense; i.e., development of the private sector of economy — both through privatization of state-owned enterprises and spontaneous formation of *de novo* private companies). The OECD definition of corporate governance is used: the system by which business corporations are directed and controlled (OECD, 1999). The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs.

# 1. Privatization

### 1.1. Intellectual and ideological context. Choosing the model

Through almost the whole period of Communist rule in Poland, serious discussions were held on improving the efficiency of Polish enterprise sector. Unlike most other countries of the Soviet bloc, those discussions went far beyond ideas of how to improve the central planning system. One of the most popular approaches was that of participation of employees in the management of state-owned firms. Apart from purely ideological justifications of such an approach (workers as co-owners of the state property), it was believed that employee participation would boost enterprise performance by overcoming labor alienation and by harmonizing interests of employees with those of the firm and the whole national economy. Even if some of the discussion participants had doubts as to whether state-owned enterprises with employee participation were the most effective form of enterprise (especially compared to privately owned companies), they believed that in the given circumstances, this was the most radical and effective solution.

In Communist times, there were two serious efforts to introduce employee participation in Poland. In 1956, workers' councils were set up in state-owned enterprises, but their powers were severely limited by the unreformed centrally planned system of distribution of pro-

duction tasks among enterprises. In 1981, a deeper reform of enterprise sector started, with employee self-management being part of a new set of decentralized principles of state-owned enterprise operation, known as "The Three S's" (self-management, self-financing and self-dependence). Thus, when the Communist regime collapsed in Poland, a strong self-management intellectual tradition existed, and groups supporting this approach had arisen within enterprises and academia and on the political arena.

At the beginning of transformation, the attention of the first non-Communist government was concentrated on the more obvious, and highly urgent, tasks of macroeconomic stabilization and liberalization, subjects which were perhaps somewhat less controversial than ownership transformation. Here, shock therapy measures had been applied, while privatization and institutional changes were carried out rather cautiously and gradually (in contrast to the mass privatization procedures used later in, for example, the Russian Federation and the Czech Republic). Maintaining a balanced budget, combating inflation and ensuring macroeconomic equilibrium as well as introducing a greater degree of economic freedom has always been included in a standard set of activities undertaken by many countries in the world and were applied in Poland with a considerable degree of success. Yet, with respect to radical institutional changes and large-scale privatization, recourse to existing Western practices was impossible, since there was no previous experience on this scale (the privatization of entire economies).

At the same time, there was no consensus concerning the direction of privatization processes among economic and political elites, in the government and between the government and its foreign and domestic advisers. While agreeing with the main rationale for large-scale ownership transformation (found in property rights theory, which explained the inefficiency of the socialist enterprise sector on the basis of incomplete property rights), the participants of the discussion had different views on at least three important questions:

– What type of owner (and more generally — what type of corporate control) is the most efficient?

– What other goals can be met by privatization?

– What should be done to make the privatization process itself as efficient as possible?

A general debate on the privatization concept took place in late 1989 and 1990. Three main concepts of privatization came up against each other, each providing a separate answer to the aforementioned questions:

– a commercial concept of the sale of state-owned assets using classical methods, including trade sales but most importantly public offerings (based on the British experience);

– nonequivalent privatization based on employee ownership and the US Employee Stock Ownership Program concept and backed by the Polish labor self-management tradition;

– nonequivalent privatization through free distribution of assets among all citizens, based on newly drafted privatization concepts (Błaszczyk, 1993; Gilejko, 1995).

In its first economic program of October 1989 (the so-called Balcerowicz Plan), the government gave preference to the first, "classical" concept of privatization, combined with rapid development of *de novo* private sector which would absorb workforce from the shrinking state and ex-state sector. In turn, the privatization law, passed July 13, 1990, tried to make use of all the three privatization concepts in order to ensure the widest possible impact of privatization on transformation economic, social and political transformation in Poland. Ideologically, it reflected coexistence of different views on the scope and methods of ownership transformation, and more generally — on the principles of the post-Communist transformation as a whole. The privatization law represents a certain combination of two main options: liberal conceptions patterned after solutions adopted in developed market economy countries, and a participatory approach originating from the Polish labor self-management movement and tending towards a kind of "Third Way" of development.

### 1.2. Goals and methods of privatization

During the whole post-Communist period, no detailed description of the main goals of privatization was prepared. Only a few of the goals were ever officially mentioned, and most of them had to be deduced from decisions made by the Parliament and governmental agencies (Kochanowicz et al., 2005).

The economic program of the first post-Communist government addressed privatization issues in the context of the creation of market institutions which had stood the test of time in Western economies. Following that simple course of thought, the main privatization goal was of a systemic character: to contribute to **the change of the economic system through creation of private entities**. Within the framework of this goal, a number of sub-goals existed, of which the most important was the creation of well-functioning markets, including a securities market.

Apart from this purely systemic role, privatization was **to solve the problem of microeconomic inefficiency** of state-owned enterprises; this would, in turn, contribute to the rise in productivity of the whole enterprise sector.

Although never officially formulated, the third goal was of crucial importance: **to make the whole reform process smooth, stable and irreversible**. Privatization was expected to create not only incentives for economic development, but also to create powerful pro-reform lobby of actors, involved in privatization process and using its results. Such a lobby would exert strong pressure on decision-makers to continue pro-market reforms. The assumption was that a critical mass must be achieved, when liberal and market institutions and actors become stronger than the forces and institutions of the Communist past.

The fourth goal was **of a fiscal nature**. On the one hand, the value of the state-owned stock designated for privatization was large, therefore the potential privatization revenues of the budget were also significant and able to contribute to reduction of the budget deficit. On the other hand, privatization could lift the financial burden of maintaining loss-making enterprises and sectors and thus contribute to reduction of fiscal deficit.

The fifth group of goals was related to the use of privatization for **solving a wide set of social problems**. On the one hand, attempts were made to attain a kind of social justice (via distribution of part of the privatized stock among the whole population and, additionally, by creating preferences for certain groups who were felt to deserve such entitlements). Additionally, attempts were made to use privatization to resolve the social problems in concrete enterprises by imposing on the buyers certain obligations concerning employment, wages, environmental protection, etc.

**A set of hidden goals** existed as well, when the government drew public attention to one goal while the real, most important goals were not advertised because they were less attractive to the broad public. In some cases we can describe this as an "honest" hidden agenda (for example, stressing the social profits from privatization in order to gain public support and unblock or speed up the privatization process — e.g., this included preferential treatment of insiders). Trying to build a strong coalition of pro-reform forces, the government had to bear in mind that different coalition members might have different motivations, so it seemed to be politically rational not to spell out the goals. Moreover, given the multiplicity of objectives and the constraints, a detailed description of the privatization goals would have been almost impossible.

In other cases, however, hidden goals were less "honest." For example, they appeared in the course of formation of entrenched interest groups which were interested in privatization (or more often lack of privatization, e.g. in the sectors where privatization would mean discontinuance of public financial support), or some specific method of privatization of enterprises or whole branches, primarily in view of the gains they expected to reap as a result. Members of these groups rather seldom occupied the highest positions in the government or administration; they were influential mostly as lobbyists or voters.

The problem is that at least some of the goals may be — and in fact were — contradictory. For example, pursuing the fiscal goals sometimes jeopardized the goal of increasing of microeconomic efficiency (the more an investor must pay to the budget, the less he may invest in a company). In addition, maximizing global revenues from privatization requires a gradual approach (because glutting the market with privatization offers would reduce the market prices of enterprises), while the tactical goal of reduction of the budget deficit in a given year could lead to just such an attempt to maximize privatization revenues in a given year, thus lowering the total revenues to be achieved from privatization. Excessive attention

to the social obligations of an investor may lead to inadequate investments in the company (an excessively high wage bill reduces funds available for investment). The goals related to "social justice" (e.g., "enterprises should belong to their employees" or "enterprises should belong to the whole society") contradict the need to find efficient owners for privatized enterprises.

It is quite obvious that contradictions between official and hidden goals can be highly destructive for the privatization process, especially in the case of "dishonest" goals. Their pursuit not only leads to slowdown and distortions in the privatization process, but has severe political consequences related to the corruption of the state apparatus, deceleration of the construction of institutions of the market economy, and growing disappointment of population.

A set of goals on the enterprise level also existed. These were the group and individual goals of the managers and employees of state-owned enterprises. Quite often such goals were not in line with the privatization policy conducted by the government. This problem is of a special importance in Poland, where insiders have very substantial impact on privatization of "their" enterprises. At this level, too, we observe openly proclaimed and hidden goals, the latter often connected with enfranchisement of certain enterprise actors (primarily managers).

Another important feature of Polish privatization (and the whole enterprise sector reform) is its gradualist, highly consensual character. Its authors were aware of a trade-off between the speed and quality of transformation processes. They believed that lower speed resulting from careful preparation of privatization deals (both in the technical and social dimensions) is much more important than massive and rapid formal change of owners, because the reformed market environment would exert strong pressure on state-owned enterprises and force them to adapt and restructure, thus making their privatization less urgent, although still necessary. The gradual character of Polish privatization also reflected a choice made in the discussion of what should come first: privatization (which would create demand for further reforms)[1] or regulation and institutional constraints (in order to create a framework for actors' behavior and prevent tunneling).[2] The gradualism reflected a choice in favor of the latter solution. And, last but not least, consensual character of privatization procedures had to help in overcoming the assumed resistance of insiders and other stakeholders.

### 1.3. Legal framework

The main features of Polish privatization (multiplicity of goals and its low-pace consensual character) were reflected in the privatization law, which envisaged a wide range of possible methods and paths of ownership transformation.

[1] See Frydman and Rapaczynski (1995); Boycko, Schleifer and Vishny (1995).
[2] For example, see Murrell and Wang (1993).

The main privatization act is the Act of August 30, 1996 on Commercialization and Privatization of State-owned Enterprises which came into effect only in April, 1997. Before that, the Act of July 13, 1990 on Privatization of State-owned Enterprises had been in force. The law distinguish two basic privatization methods: indirect and direct.

The indirect (formerly called capital) method consists of two stages. At the first stage, a state-owned enterprise (SOE) is commercialized, i.e., it changes its legal form and is transformed into a company, where 100 per cent of shares belong to the Treasury (so-called sole-shareholder company of the Treasury, Polish acronym: JSSP), and begins to operate under provisions of the Company Code, common to all entities (except state-owned enterprises and a limited number of companies which are governed by special legal acts). At the second stage, the sale of the shares takes place in a number of ways: public offering, sale to strategic investor (or combination of these two) and inclusion to National Investment Fund program.

On April 30, 1993, the Act on National Investment Funds (NIF) was adopted introducing a kind of mass privatization program which, contrary to such programs in other post-Communist countries, had been designed not only to transfer a significant part of the state's sectors assets to Polish citizens, but also to create a mechanism for actively restructuring the companies participating in mass privatization. NIFs received blocks of shares of 512 companies which undergo mass privatization, and Polish citizens received a kind of vouchers which they could invest in the NIFs. It is worth noting, that mass character of NIF program was only a demand side (all Polish citizens), and not on supply side, as in other countries where mass privatization took place. The NIF program was supposed to accelerate the pace of privatization, at the same time providing for restructuring of companies, facilitated by the experience of the professional management companies employed by the NIFs. These goals were never fully achieved (Błaszczyk et. al., 2001).

The direct (formerly somewhat misleadingly called liquidation) method consists of liquidation of a SOE in a legal sense; then, the assets of the enterprise (in totality or divided into separated organized parts) are privatized in one of the three possible ways (in Poland often called "paths"):

– sale;

– entering as a contribution in kind into a company established by the Treasury and a private investor;

– leasing (management-employee buy-out — MEBO).

The last path needs more attention because it was very popular and is Polish contribution into methodology of post-Communist privatization. A SOE can enter this path only on the request and with consent of insiders. A company (as a rule, LLC) with participation of employees is being set up which leases the equity of formally liquidated SOE. The company signs a leasing contract with the Treasury. The contract provisions stipulate that upon re-

payment of all the capital installments and leasing fees the assets of the liquidated SOE will become the property of the company.

Another method of privatization was provided by Art. 19 of the Act of September 25, 1981 on State-owned Enterprises. It applies to SOEs in financial distress — the enterprise is liquidated and its assets are sold out. Some enterprises in agricultural sector are privatized according to the principles provided by the Act of October 19, 1991 on Management of Agriculture Property of the Treasury. There are also separate acts devoted to ownership transformation of certain enterprises and sectors of the economy. Recently, a number of acts have been adopted which link privatization with sectoral restructuring.

All methods and paths of privatization are equivalent (buyers pay market price or the price based on valuation), except the NIF program, where certificates of ownership have been distributed among the population for a small fee.

The privatization law regulates not only the privatization process itself, but also in some cases the initial corporate governance structure, including initial ownership distribution and composition of corporate governance bodies. The scope and character of the impact of the regulations depends on the privatization method applied (see also the next section). However, the common feature is preferences for insiders, both in starting privatization, and in distribution of shares. Before the privatization act of 1996 was adopted, all privatization deals had been initiated or had needed to be approved by the governing bodies of SOEs. In 1997, such a requirement was lifted.

According to the 1990 Act, in indirect (capital) privatization employees had a right to acquire 10 per cent of shares at reduced price; these preferences were increased by the 1996 Act by granting a right to insiders to acquire 15 per cent of shares for free. Another 15 per cent can be received for free by farmers and fishermen if they were suppliers of the former SOE (with restrictions regarding the volume of supplies). Besides, the new Act lifted the requirement that JSSPs, as a transitional entity, should be privatized within 2 years after commercialization. It introduced a legal background for impeding ownership transformation in this group of companies.

Until 1997, the leasing path of direct privatization preferred extremely insiderized patterns of ownership structure: the new company should have been founded by the majority of employees, no institutional outsiders were permitted (unless accepted by the Ministry of Ownership Transformation). The Act of 1996 imposes certain limits on the use of direct privatization paths and the role of insiders in ownership transformation. Limits have been set on the size of enterprises (in terms of employment level, assets and turnover); outsiders gained a right to take initiative in privatization without prior consent of insiders; in leasing path, at least 20 per cent of shares in the new company must be in the hands of outsiders; possibilities of participation of legal persons have been increased.

To govern the privatization processes, a brand new special structure within public administration had do be set up. The Ministry of Ownership Transformation (reconstituted in 1996 as the Ministry of the Treasury) had to perform functions which had not existed before, which for the reformers meant that it had to be organized in a way differing significantly from the established culture of public administration in Poland. Moreover, its functions, as originally conceived, were limited in time (meaning that it was to be liquidated after privatization ended). Thus the ministry had to create its patterns of behavior, internal structure etc. in a new and uncertain environment, and be very task-oriented (not to form another interest group interested in perpetuation of the transition period or, if the end of transition becomes inevitable, adopt “end-game” behavior trying to convert its authority into another, more liquid form). This was, moreover, the problem of all new agencies created to serve the process of post-Communist transformation.

### 1.4. Quantitative effects of privatization

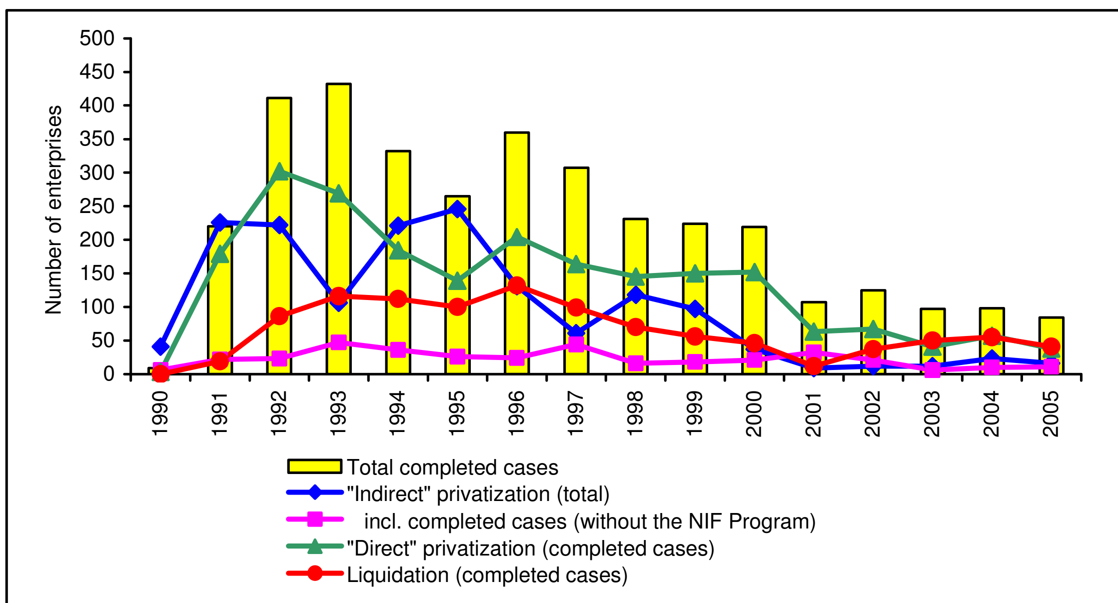
The most striking, and arguably most important quantitative result of the process of privatization of the Polish economy has been the creation of over 220,000 new private companies (and nearly 2.8 million private one-person and family businesses), which make up more than 97% of all registered firms, employ 70% of the work force and are responsible for 75% of GDP (Central Statistical Office, 2005; EBRD, 2005).

In Poland, the so-called small privatization, affecting the retail, catering and service sectors, was conducted very rapidly: by the end of 1992, 97% of all units in these sectors had been privatized. This was a decentralized, “grassroots” process led by thousands of local authorities, virtually without any intervention from the central government.

Decentralization of initiation of privatization deals in enterprise sector and the high role of insiders in this process, together with possibility of establishing management-employee ownership, acted as a catalyst of privatization of SOEs. During the first years, MEBOs and other forms of decentralized, “participatory” privatization greatly outnumbered centralized, government-led sales of enterprises. At the same time, the overall pace of privatization of the enterprise sector was much slower than had been anticipated. Besides, since the mid-1990s we have witnessed a substantial slowdown of the privatization process, which occurred due to two main reasons: the stock of “easy to privatize” (in technical, social and political terms) enterprises was rapidly depleted, and political pressure for privatization slowdown increased (Figure 1). There was a certain revival of both indirect and direct privatization in 2004-first half of 2005 owing to activity of the new Minister of the Treasury which was a strong supporter of pro-market reforms and private sector development. However, the prospects for acceleration of privatization in Poland still remain rather dim, because the new ruling coalition

which came to power in autumn 2005 opposes continuation of coherent market reforms including ownership transformation.

*Figure 1*
**Dynamics of privatization (number of enterprises by years, 1990–2005)**




Source: Ministry of the Treasury data (http://www.msp.gov.pl).

The speed of ownership transformation depended mainly on the industry, size, organizational structure and profitability of an enterprise. The privatization of small and medium-sized enterprises (SMEs) in manufacturing, trade and construction was usually accomplished relatively quickly (as technically and politically less complicated — more than half of them were bought by managers and employees). The other pole was represented by the largest enterprises, especially from infrastructural sectors, mining and metallurgy. Obstacles of a political nature started to appear as well (i.e., powerful interest groups which defended the *status quo* and created pressure on the government to slow down privatization). Apart form "re-consolidating" sectoral programs which have been adopted, the 1993 Law on the Ownership Transformation of Certain SOEs of Special Importance for the National Economy was passed, which in fact excluded a large number of enterprises from the privatization process. Additionally, as it was said above, the 1996 Privatization Law in practice lifted the obligation to privatize commercialized state-owned enterprises. As a result, privatization was completed only in the case of 67% of state-owned enterprises (Błaszczyk, 2005), and in 2005, state-controlled firms still produced about 25% of the GDP (EBRD, 2005).

Thus, the characteristic feature of Polish privatization is quite a large number of cases of "unfinished privatization" in the form of about than 500 predominantly large companies that were only commercialized, but never privatized (the so-called sole-shareholder company of the Treasury, Polish acronym: JSSP), and about 100 companies where the Treasury has

stakes of more than 50% (Nawrot, 2003). Moreover, in the National Registry of Business Entities (REGON) there are still more than 1300 state-owned enterprises[3] (out of the total number of 8453 SOEs at the beginning of transition) (Central Statistical Office 1991, 2005).

*Table 1*

**Selected data on privatization of state-owned enterprises**

| Methods of privatization | Number of companies (June 2005) | Total employment, thousands (end 2004) | Performance (2004) | | |
|---|---|---|---|---|---|
| | | | Cost level indicator | Turnover profitability rate | |
| | | | | gross | net |
| “Indirect” privatization: | 1573 | | | | |
| JSSP | 541 | 234.9 | 95.5 | 7.4 | 5.4 |
| completed cases[a] | 355 | 219.5 | 91.6 | 8.5 | 7.0 |
| - with participation of foreign investors | 139 | 75.2 | 92.9 | 7.1 | 6.0 |
| companies included in NIF Program | 512 | 111.0 | 95.3 | 4.7 | 3.7 |
| Debt conversion | 17 | 1.9[b] | 118.9[b] | -18.9 | -18.9 |
| “Direct” privatization: | 2135 | | | | |
| MEBO | 1364 | 137.5 | 95.3 | 4.7 | 3.5 |
| in-kind contribution | 227 | 44.0 | 87.5 | 12.5 | 10.9 |
| other forms of “direct” privatization | 544 | 2.5[b] | 103.3[b] | -3.3[b] | -3.5[b] |
| Liquidation (completed cases) | 1008 | | | | |
| TOTAL | 5673 | 805.3 | 93.3 | 7.6 | 6.0 |

[a] The share of the Treasury is less than 50%. Without the NIF program.
[b] In 2003.
Source: Central Statistical Office (2003, 2005), Ministry of the Treasury (2003, 2005).

# 2. Corporate governance

## 2.1. Intellectual background and political context

At the microeconomic level, one of the main tasks of privatization was the building of efficient corporate governance mechanisms that would help to overcome the governance problems which in Communist times were one of the main obstacles to raising the efficiency and productivity of the enterprise sector.

The choice of the right corporate governance model was not an easy task, however.

**First**, there was a question what corporate governance model would be the best for the Polish enterprise sector. In developed market economies, two main models existed (Anglo-Saxon and Continental) that reflected different philosophies of corporate governance, especially in the field of corporate control mechanisms and company mission.

[3] However, the real number of still existing SOEs may be lower, because of problems with updating the registry.

Pragmatically speaking, the Continental model was more suitable for Poland (as well as other post-Communist countries) for a number of reasons:

– the influence of external control (in the form of commodity, financial, take-over and other markets) did not exist or was not sufficiently effective. In such conditions, the efficient functioning of internal supervision was of fundamental importance;

– the investment potential of the Polish population was weak, therefore the main sources of capital had to be looked for elsewhere. The Continental model assumed the significant role of a strategic investor, in Polish circumstances — most likely foreign (and, later, also domestic industrial and institutional);

– both the managerial skills and technical assets of Polish enterprises were archaic and not adapted to the new challenges of the emerging market environment. Strategic investors, especially foreign ones, were able to bring to a company not only capital, but also a new culture of management, of company behavior towards its environment, new technology etc.

**Second**, the corporate governance model was expected not only to meet enterprises' needs (i.e., their efficient operation), but also serve the transition in Poland in general, being a part of the new political, social and economic model. Therefore, the choice of a model depended on social and political considerations as well. Here, the choice between Anglo-Saxon and Continental model was not so obvious, because the Anglo-Saxon idea of shareholder value suited the ideas of mass enfranchisement of population. On the other hand, the Continental model was of a more participatory character, which suited the advocates of employee self-management and participation.

**Third**, unlike green-field companies, privatized enterprises did not emerge out of the blue. They represent a continuation (in economic, organizational, social and other ways) of the former SOE. The "legacy" of SOEs has several aspects, including the following:

– the state-owned enterprise had its own organizational structure, with each body having its own competencies to which all actors had become accustomed;

– in most state-owned enterprises, stable structures of power and influence had been established, and many insider actors were afraid of losing them after privatization;

– the mentality and behavior of the main insider actors were to a great extent determined by their previous experience in the state-owned enterprise.

Here, a real threat was that entrenched insiders would resist any attempt to change the internal *status quo*. Therefore, there was a popular view that strong owner control must be imposed, while taking insiders' concerns into account. Under such circumstances, the Continental model seemed to be a good solution (Jarosz, Kozarzewski, 2002; Kozarzewski, 2006).

### 2.2. The legal background

So, in general, the Continental model of corporate governance was chosen, with slight inconsistencies and alterations caused by ideological and political considerations, as well as pressure exerted by the main actors on the Polish corporate governance scene. It is worth noting, however, that Polish policy-makers, as well as their colleagues in other transition countries, were under strong intellectual pressure of Anglo-Saxon economic theories and literature, which led to attempts to introduce from the very beginning some elements of capital market-based relations and institutions as well. Therefore, Polish legislation included possibilities for development of Anglo-Saxon corporate governance solutions, e.g., by introducing sound and transparent regulations of the organized capital market and creating conditions for its development (e.g., with the help of initial public offerings of privatized enterprises, and, later, by introducing new players on the stock exchange).

The main act which regulates corporate governance relations at a company level is the Company Code of September 15, 2000 (enacted on January 1, 2001). It replaces the Commercial Code of June 27, 1934.

On a company level, it introduces two-tier system with separate executive and supervisory boards. Supervisory boards are compulsory in all JSCs and large LLCs. As a rule, supervisory board members are elected at the shareholders' meeting (group voting is possible). In most cases, supervisory board appoints the members of the executive board (in general, the supervisory board's position *vis-à-vis* executive board has been strengthened in the new Code). Formally, supervisory board has a wide range of powers, especially controlling ones, as a safeguard against opportunism of managers. It supervises all spheres of the company's functioning and has a right to study all documentation and to receive all necessary information not only from executive board members, but also from every employee in the company. Supervisory board's powers can be fine-tuned in order to reflect the needs of corporate governance in a specific company.

Notwithstanding its basically Continental character, in most cases Polish legislation does not take the concerns of stakeholders into account in corporate governance structures. For example, there is no requirement to include representatives of stakeholders (e.g., employees) into the supervisory board. However, the surveys show that in many privatized companies stakeholders (first of all managers and employees) are represented in this body as a part of personnel policy of core shareholders.

Another peculiarity of the Polish legal system is that the main vehicle for representation of stakeholder interests is privatization legislation, rather than regulations affecting the enter-

prise sector in general. Thus, there are fundamental differences in the corporate governance regime depending on whether an enterprise originated in the state sector or the *de novo* private sector — a situation which is, to our knowledge, not found in any other European country. Apart from above-mentioned insider-dependent originating of privatization cases and establishing preferences for insiders and some suppliers in acquiring shares, privatization legislation introduces legal support for stakeholder interests in corporate governance bodies. In both cases theses are insiders' interests in privatized enterprises:

– in the course of indirect privatization, when employees of the former SOE and some categories of suppliers are granted an option for free shares, and employees have a right to appoint 40 per cent of members of the supervisory board as long as the Treasury remains the sole shareholder;

– in the companies that have been privatized through commercialization and are employing more than 500 persons, employees elect one member of the Executive Board. This provision is very unclear. For example, it is not known for what period after privatization employees have such a right.

Notwithstanding these shortcomings, the polish legal background for corporate governance can be assessed as good, with strong disclosure and transparency requirements and protection from abuse.

The Commercial Code contains a system of safeguards against minority shareholders abuse. Shareholder has a right to appeal against a decision of the shareholder's meeting if such a decision violates the company charter, good practices or the company's concern. By the way, such a right belongs to executive and supervisory boards' members as well. Minority shareholders have extended rights for group voting. There are three types of preferential shares:

– privileged shares, giving their holders greater than one and no more than 2 voices per share (till the end of 2004, the Treasury can have up to 5 voices per share);

– golden share;

– non-voting share (since 2001).

A voting cap can be introduced for shareholders that possess more than 20 per cent of voices. On the other hand, most important decisions should be approved by qualified majority of voices on the shareholders' meeting (2/3 to 3/4). There are provisions against collusion of shareholders. Every member of the supervisory board and a shareholder who possess at least 10 per cent of shares has a right to call an extraordinary shareholders' meeting.

The Act of January 21, 1997 on Public Securities Trading and the new Act of July 29, 2005 on Financial Instruments Trading that the replaced the previous law, grants a shareholder or a group of shareholders that possess at least 5 per cent of votes a right to appoint a special controller whose task is to investigate a concrete problem of the company's function-

ing. The same act imposes on a strategic investor an obligation of mandatory bid if he possesses more than 50 per cent of votes. Such a bid must be also announced when someone is going to buy more than 10 per cent of shares. There is a system of safeguards which is intended to ensure proper prices for sellers of shares. In publicly listed companies, an investor must obtain a permission of The Securities and Exchange Commission to pass a threshold of 25 per cent, 33 per cent, and 50 per cent of voices. All blocks of shares which give their owners at least 5 per cent of voices must be registered.

One of the most important means of preserving shareholders rights *vis-à-vis* managers and large shareholders are information and disclosure requirements. The rights of the supervisory board were mentioned above. The Company Code grants a right for any shareholder to ask the executive board for information that is necessary for evaluation of topics discussed at the shareholders' meeting. According to the Act of September 29, 1994 on Accounting, financial statements of companies must include information on remuneration of top managers and supervisory board members, as well as on any loan they may receive from the company. Information must be provided about capital groups (other companies in which the company possess at least 20 per cent of shares). The Act on Public Securities Trading provides publicly listed companies with additional requirements regarding informational transparency. These companies have to publish all information which may influence the price of shares. There are special disclosure provisions devoted to selling and buying shares by major shareholders. It should be noted, that most of the regulations mentioned in the last two paragraphs apply only to publicly listed companies.

On the other hand, there are provisions of the Polish law which are intended to withstand the misuse of the above-mentioned safeguards. When a shareholder starts a legal action against a decision of the shareholders' meeting, this does not stops its execution; in case if the court decides that the protest is groundless, the suer has to pay a penalty up to ten times of the cost of the court examination. A company has a right to deny a shareholder an access to some data if it would cause damage to the company.

Not all problems related to managing conflict of interests of members of the executive board, supervisory board, and shareholders are handled in a proper way. The law covers problems of personal capital links with other firms and responsibility towards the company. At the same time, there is no legal requirement to include independent members in supervisory boards, although such a provision can be found in charter of a few Polish companies. The Warsaw Stock Exchange has recently introduced a "soft" requirement for listed companies to include before the end of 2004 at least 50 per cent of independent members to their Supervisory Boards (see below).

There is another sphere where conflict of interests is not properly managed. Although auditor has to be independent from the audited company (do not possess shares, not to be

the company's attorney, etc.), there is no legal prohibition for an auditor to be simultaneously a consultant for the same firm. Moreover, if such an auditor provides bookkeeping for a firm, he still can perform audit (except for those part of financial documents which has been prepared by himself). Lack of proper regulations in this sphere is potentially very dangerous, which is confirmed by the bookkeeping scandals in the USA.

In practice, in Poland there are a lot of cases both of abuse majority and minority rights, as well as of managers' opportunism. There are three main causes which make those violations possible (Tamowicz, Dzierżanowski, 2002; Kozarzewski, 2003):

– the problems of corporate governance formation in Poland. As a result of consensual privatization, dispersed and highly insiderized patterns of ownership structure often emerged with strong positions of managers and to some extent non-managerial employees. A widespread weak role of supervisory boards in the corporate governance system is reported in the surveys, executive boards often being the most influential body (this situation is jokingly called "Vistula model" of corporate governance,[4] as opposed to Continental and Anglo-Saxon models). That hampers the effective control of shareholders over managers and outsiders over insiders (given generally still weak outsider investorship in Poland). As a result there are problems with overcoming the "legacy of Socialism" in former state-owned enterprises with very strong position of managers most of them being directors before privatization. On the other hand, if a company is sold to outsiders, highly concentrated pattern of ownership structure emerges which makes possible minority abuses. High role of the Treasury in many firms which are undergoing indirect privatization is also important;

– the inadequate law. First, the law that describes corporate governance structures in companies is not instructive enough, too often giving general idea and principles rather than concrete solutions. Second, the system of rights and safeguards that regulates corporate governance relations within companies is not extremely efficient. For example, minority interests can be (and sometimes are) abused with the help of anti-collusion provisions. Disclosure requirements do not cover all cases of gaining control over a firm with the help of affiliated and subordinated companies. There are situations when mandatory bids can be avoided without breaking the law. Prevention of hostile takeovers by outsiders is also possible. Manipulations of the dates of shareholders' meetings are widespread. Managers have legal possibilities of profits stripping and tunneling. Disclosure provisions are often regarded as very complicated and there is a widespread opinion among managers, that some of them are impracticable. Third, legal acts sometimes contradict each other and overlap;

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[4] The term was coined by Krzysztof Lis, Chairman of the Polish Privatisation Agency at the beginning of transformation

– poor enforcement of the law. Nor the courts, neither the prosecutors have sufficient capacities or skills to cope with cases of illegal actions in companies. Within the Warsaw Territorial Public Prosecutor's Office a department of capital market offences has been established, but positive results are still hard to be seen. Fiscal administration is incapable to cope with transfer pricing.

In recent years, attempts have been made to strengthen corporate governance by elaborating and introducing best practices of corporate governance. The main idea behind this approach is that because legal regulations themselves are incapable of dealing with all the problems of corporate governance, a set of principles should be prepared which would both serve as instruction on how to behave correctly and as a form of moral pressure on companies to introduce these principles. In Poland, two teams prepared their own best practices codes: the Polish Corporate Governance Forum affiliated with the Gdansk Institute for Market Economics, and Corporate Governance Forum affiliated with the Institute for Business Development. The idea of the first project was rather to explain the idea and main principles of proper corporate governance practice, whereas the second one was aimed more at giving concrete suggestions how corporate governance bodies within a company should behave, what decisions they are to make, etc.

In 2002, the Warsaw Stock Exchange has introduced "comply or explain" provision by adopting the Best Practices Code for listed companies (updated in 2005), based on the second project, but also using some ideas from the first one. As a result, the Code became less concrete and instructive, but at the same time tried to show some general ideas of good corporate behavior. The Code includes a few concrete provisions absent in Polish company law:

– at least 50 per cent of supervisory board members should be independent (they are granted extended rights);

– management remuneration must be disclosed in detail;

– decisions of the general assembly of shareholders must be formulated in a way which makes it possible to sue them;

– auditors must be changed at least every five years;

– the special controller must be fully independent;

– when a company buys back its own shares, all shareholders must have equal rights to sell their shares.

Other provisions seem to be too general and declarative and therefore not enforceable in practice. Beginning July 1, 2003, all listed companies had to report whether they complied with the provisions of the Code, and if not, what specific provisions were not introduced and why. But in fact even the above mentioned concrete provisions will hardly be enforced in a majority number of companies, because there is no effective punishment for not introducing those measures into companies' charters and everyday behavior. At most, the WSE can pub-

lish a list of companies which do not comply with the best practices regulations. Therefore, this document is rather a kind of moral obligation imposed on companies, than a strict regulation. However, more and more listed companies at least verbally declare their willingness to play “the best practices game.” Compliance (at least formal) to the provisions of the Code is also improving. By the end of 2005, only 8 companies out of 254 declared that they were not going to comply the Code. The number of companies that declared compliance to all the principles increased from 3 in 2003 to 36 in 2005. The most common problem was the principle of at least 50% independent members on the supervisory board. Only 54 companies declared compliance with this principle in 2005 (which is still a great progress comparing to 3 companies in 2003).[5] As we can see, there is still a long way to go.

Attempts are being made to introduce best corporate governance practices also in the state-controlled sector of enterprises. In 2004, the Ministry of the Treasury approved Principles of Ownership Supervision over Companies with State Treasury Shareholdings and Other State Legal Persons. While applying being obligatory in SOEs supervised by the Ministry of the Treasury, they can only serve as suggestions in the companies owned by subnational governments and in the firms with mixed state-private ownership. The principles are primarily directed at state-designated supervisory board members, and serve as compendia on the fundamentals of the company law provisions. In 2005, the revised principles were approved. On the one hand, they include some improvements, e.g., increased autonomy of the state-designated supervisory boards and establishing a duty for supervisory board members to monitor the use the state aid by the SOE, as well as data on the economic performance of the company and the compliance of the company with the set economic performance targets. On the other hand, several steps back were taken, e.g., in the field of monitoring the supervisory boards and setting a standard of transparency for SOEs comparable to the level of disclosure of listed companies (World Bank, 2005).

# 3. Privatization and corporate governance

## 3.1. Initial conditions

The heterogeneous character of Polish privatization led to heterogeneity of emerging types of ownership structure. Indirect (capital) privatization included mostly large SOEs, in relatively good economic and financial condition, and in sectors whose privatization was politically uncontroversial. In the “mainstream” indirect privatization, strategic investors were preferred; minority blocks of shares were distributed among employees and other small

[5] The Warsaw Stock Exchange data, http://www.gpw.pl.

shareholders. However, one should remember, that a significant number of enterprises (541 in June 2005) failed to privatize after commercialization and the Treasury remains their sole shareholder (comparing with 355 companies where indirect privatization has been completed).

In the NIF program, most companies are medium-sized (100-500 employees); the main blocks of shares were distributed among 15 investment funds (one, the so-called leading fund, received 33 per cent of shares, others received 1,93 per cent each); the Treasury was the second largest shareholder, keeping 25 per cent of shares, and employees received the remaining 15 per cent.

Direct privatization as a whole included mostly small and medium-sized enterprises, even before maximum size of SOEs was imposed in 1997. There is also a significant differentiation within the direct method of privatization:

– direct sale mostly covered rather small firms which could be easily sold to a new owner. At the same time, a modification of this "path," called "the fast track," covered enterprises in economic distress, and the buyer had to pay off the firm's debts. In both cases, as a rule, an enterprise was sold to one person, so concentrated patterns of ownership were preferred;

– on the contribution in kind "path," the were no clear preferences for a specific type of enterprise; however, the importance of this path is very small (only 9.7 per cent of all direct privatization cases);

– for leasing (MEBOs) a specific category of SOEs suited more: rather small or medium-sized (in order to be affordable for employees), and in rather good economic and financial condition (in order to produce enough profit to pay leasing fees and do not need immediate investments). Legal requirements predestined highly insiderized and to a large extent dispersed ownership structure.

The second factor that strongly influenced the post-privatization processes was to a greater or lesser extent "artificial" character of initial ownership structure in a majority of companies, set by the privatization method or "path" applied and/or other administrative decisions. As a consequence, after privatization, widespread adaptive processes were set in motion. In terms of ownership structure, two main processes were seen: towards concentration and towards outsiderization, i.e., transfer of shares from insiders to outsiders. Later on, these processes of property transfer from one category of owners to another slowed down; at the same time, transfers within the same shareholder category intensified (e.g., among industrial investors). The processes of concentration and outsiderization did not led to a high degree of unification of ownership structure; we witness rather more or less strong path dependence, the impact of "privatization history" of a company on the way its ownership, corporate governance and behavior patterns were forming (Kozarzewski 2003).

### 3.2. Corporate governance patterns

Among emerging corporate governance patterns, at least three deserve special attention, all of them formally staying within the Continental model.

**The first pattern** is represented by the largest companies which went through "indirect" privatization and have concentrated ownership structures, often dominated by foreign investors. In the sector of former SOEs, they are unquestionable leaders in post-privatization restructuring and creation of highly efficient corporate governance structures and behavior.

The ownership structure of this group of companies is highly concentrated (and the concentration level is still growing), and insiders' participation is very limited, unlike in privatized SMEs and in spite of the pro-insider provisions of Polish privatization law (half-price and free shares for employees in the case of indirect privatization).

In most such companies, deep changes in corporate governance structures have been introduced, and the "legacy" of the state-owned past has already been overcome (Kozarzewski, 2002). Thus, the processes of post-communist corporate governance transformation are complete. However, changes in corporate control mechanisms appear to be conditional on the characteristics of the controlling shareholder(s). The companies with the highest levels of ownership concentration, especially those dominated by foreign investors, have more coherent corporate governance structures. In the companies with the lowest levels of ownership concentration, the shareholders' majority is often rather formal and does not ensure full real control over the company.

Within the pattern in question, companies with foreign investor domination deserve special attention. Corporate governance structures in most of these companies are very transparent with clear division of powers among the executive board, supervisory board, and general assembly of shareholders. At the same time, the foreign investor keeps tight and efficient control over the firm. An important feature of corporate governance policy in such companies is the introduction of incentives for insiders (primarily managers), in the form of small blocks of shares and/or seats on the supervisory board. In this group of companies, we observe the deepest strategic restructuring, involving large investments and innovative technological changes, which leads to the high economic performance.

During the last few years, however, the gap between domestic- and foreign-controlled companies is shrinking. Now, domestic industrial investors in terms of competitiveness and innovation do not substantially differ from foreign investors (Woodward et al., 2005). It seems that foreign investors should not be blamed for that. This is a result of strengthening of the domestic industrial investors who learned how to manage their property in efficient way.

**The second pattern** is found in MEBO companies. Most of them used the leasing path of direct privatization, although a significant number of such companies emerged as a result of direct sale and even "indirect" privatization. There were two main trends of ownership

transformation there: towards concentration of shares and toward their "outsiderization." These processes had varying intensity in different groups of companies, and three patterns of ownership structure have emerged:

– management-employee pattern (large blocks of shares in the hands of managers, the rest dispersed among non-managerial employees);

– dispersed insider ownership;

– ownership concentrated in the hands of an outside investor.

The most important factor that influenced the direction and dynamics of ownership changes was the economic performance of the company, which favors concentration and "outsiderization" of ownership when very poor or very good. In the former case, this can be seen as a trade-off between the power of insiders and the firm's chances for continued existence. In the latter case, it reflects the opportunity of insiders to reap significant gains by selling their shares to outside investors. By the end of the 1990s, the post-privatization processes of property redistribution have been completed in most MEBO companies, and now only minor changes can be seen (Kozarzewski, Woodward, 2003).

Compared with enterprises that have been privatized through indirect methods, corporate governance structures in MEBO companies seem to be to a great extent dysfunctional. A problematic division of powers and functions can be seen in many companies, which is caused by unclear principal-agent relations.

Besides, MEBO companies are characterized by a very high inertia of the authority and influence structures which emerged already during the Communist period. Reproduction of the managerial elites in these companies (especially with respect to SOE directors and the executive boards of the privatized companies) as a rule takes the form of internal "direct reproduction" (Wasilewski, Wnuk-Lipinski, 1995); i.e., one that does not entail shifts of individuals within the hierarchy of authority.

In fact, initially most of these companies had not enough incentives nor capabilities to introduce deep changes in their structures and behavior. Most of them were viable profitable small and medium-size enterprises at the beginning of privatization, many of them already having their niches on the emerging market. This situation made immediate restructuring measures less urgent, so many companies limited their efforts to shallow and simple restructuring measures, taking additionally into account, that they didn't have enough capital. A real motivation for deep restructuring appeared only when there was a real threat to the company's further existence. During the better part of the 1990s, this led to a gradually falling (albeit still favorable) trend in MEBO companies' economic indices, in contrast to the rising trend in companies privatized through sales to strategic (especially foreign) investors. By the end of the decade however, a large number of MEBO companies seemed to realize that lack of restructuring measures might jeopardize their future, and tried to change their behavior,

i.e., to start investment programs and deep strategic restructuring. Since then we witness steady improvement in their performance.

As to the ideological underpinnings of this path of privatization, it turned out that claims regarding workers' aspirations for employee participation had been exaggerated. As a rule, they did not express a desire to participate in management of their firms, and shares with no dividends were as a rule of no use for them (Kozarzewski, 1999). The main motivation for workers to retain shares was the fear of unwelcome changes that an external investor might cause (lay-offs, worsening labor conditions, etc). The popular idea of capitalism based on employee ownership collapsed, but this collapse gave room for the development of corporate governance mechanisms based on clearly defined property rights and a strict separation of between ownership, supervisory and managerial functions.

**The third pattern** is represented by JSSPs, companies wholly owned by the state. Initially, JSSPs were intended to be a transition entity between the SOE and a private company (with this stage lasting no longer than two years). However, in practice, for every third enterprise which entered "indirect" privatization, ownership transformation stopped at this stage indefinitely. At the beginning, the main cause for this delay were problems with entering the next stage of privatization: technical difficulties related to restructuring and preparing a privatization deal, lack of appropriate buyers, etc. Later on, however, strong lobbies emerged which were interested in keeping enterprises in this intermediate stage. These included managers who were interested in keeping public support of their companies, and trade unions and other organized groups of employees who were not interested in privatization because it would lead to deep restructuring followed by shutdowns of loss-making enterprises, lay-offs, and liquidation of branch privileges. A separate category of insiders not interested in future privatization consisted of the Treasury representatives on the supervisory boards. For them, privatization meant the loss of their positions. Simultaneously, after a significant slowdown of the entire reform process in Poland beginning in 1992, and increase in clientelist behavior of the political elite, JSSPs began to be regarded as a significant asset in the hands of politicians and governmental bureaucracy. The Ministry of Ownership Transformation (and, later, the Ministry of the Treasury) proved to be to a large extent incapable of staying within the boundaries of a task-oriented organization set up for organizing the process of transition. It suffered a growing conflict between its owner's and seller's functions: the fewer assets under control of the ministry, the less its political weight. This attitude was strengthened by winning political parties, which started to treat state assets as spoils that belong to the victors. One of the most attractive parts of this "loot" were the seats on the supervisory boards of the JSSPs, and for a long period of time the Ministry used them as an instrument of preserving its political importance and stability regardless of the changes of governments (Błaszczyk 2005;

Jarosz, 2001). Thus, the Ministry became one of the interest groups working to slow down the reforms.

Although JSSPs are regarded as a highly valuable asset in political struggles, at the enterprise level the role of the Ministry of the Treasury as an owner is in most cases extremely weak: the real priority is to keep this property and extract material gains from this possession, and not to manage it in a microeconomically efficient way. It is therefore not surprising that in terms of corporate governance and enterprise performance JSSPs have become the most dysfunctional group of companies included in the privatization process (Kozarzewski, 2005). Most JSSPs were for a long period of time left in an intermediate state, being neither a "regular" SOE nor a private company, without any concrete prospects or priorities for further ownership transformation, restructuring, etc. Therefore, in practice, existing corporate governance structures are characterized by a high degree of influence of managers and trade unions and the very weak role of the representatives of the Treasury. Additionally, in many JSSPs the spheres of influence of the main actors have not stabilized, which gives ground for perpetual conflicts (Kozarzewski, 2003a).

Notwithstanding generally negative assessment of corporate governance and performance in the state-controlled sector, in 2004-2005 some positive trends were seen. First of all, there was a significant increase in sales and cost reduction, mainly in coal mining and metallurgy. Some of these positive trends can be attributed to changes in the Ministry of the Treasury policy aimed, among others, at strengthening its owner's role and restructuring efforts in the state-controlled sector. This policy included closing down loss-making SOEs and initiating bankruptcy procedures it the case of a number insolvent companies controlled by the Treasury. It improved performance of the state enterprise sector as a whole, although hasn't raised performance of individual enterprises. Another important factor was increased state support for some sectors that were regarded as "sensitive" socially and politically, e.g., coal mining. Last but not least, favorable changes in the world markets took place: there was growing demand for products produced mainly by the state-controlled sector in Poland: energy resources (fuels and coal), ferrous and non-ferrous metals (Błaszczyk, 2005). Therefore, only a minor part of the observed performance improvement can be attributed to the better governance; besides, its sustainability is very weak because of high dependence on the situation on the world markets.

### 3.3. Capital market

Institutionalized market is strictly regulated by the Act on Public Securities Trading and represented by the Warsaw Stock Exchange (WSE). There is popular opinion, that in terms of organization and enforcement, the WSE is probably the best stock exchange in post-Communist countries.

However, the list of flaws in Polish organized securities market is still rather long.

This market is highly concentrated. Large enterprises dominate, there are very few middle-sized and small companies. Main players are also big, first of all institutional investors; small individual investors are numerous, but very weak; their share on the stock market is steadily declining (from 50 per cent of total turnover of shares in 2000 to 28 per cent in 2003).[6] Therefore the concern of small individual investors maybe is not abused, but simply ignored.

The WSE was established mainly to serve initial public offerings in the course of indirect privatization. It is still dominated by privatized sector: more than a half companies listed are former state-owned enterprises. The largest ones are those which have been privatized by indirect method through initial public offering. Domination of privatized enterprises become a barrier for further development of the WSE, because the main task of indirect privatization was to find strategic investors for SOEe, and such investors were not interested in keeping the companies public, at least at that stage of development of markets. In many cases, they were forced to do it by the provisions of privatization contracts; very often only small part of shares was on the market. Slowing pace of privatization contributed to further fall on the supply side.

During the first decade of its existence, the WSE was not able to gain equilibrium of demand and supply. At the beginning, there was huge supply of shares of larges privatized companies. Later, the situation has changed: new players were entering the market which produced additional demand (e.g., pension funds), and there was not enough supply of stock for them. As a result, the WSE represented very small market which has a tendency to shrink. Overall capitalization of the WSE was rather low (15 per cent GDP) and showed falling trend. At the beginning of the new century, the turnover of the WSE on the cash market was shrinking at a pace of over 20 per cent a year. There were virtually no new entries, and some companies were exiting the market. The total number of companies listed was falling (from 230 by the end of 2001 to 216 by the end of 2002 and 203 by the end of 2003). Thus, the WSE did not properly perform two basic functions of a stock exchange: valuation and a source of capital for private sector. The irony is that the Treasury was the largest beneficiary of capital inflow through the WSE.

Fortunately, negative trends reversed in 2004. The WSE started to grow both in terms of turnover and number of companies listed. This happened due to both increased privatization activity of the new Minister of the Treasury, who previously was a Chairman of the Securities and Exchange Commission and favored initial public offerings, and to increased demand of private companies for resources obtainable on the stock market. What is important,

[6] The Warsaw Stock Exchange data, http://www.gpw.pl.

this time the WSE expansion was based not only on privatization deals, but also on *de novo* private companies. By the end of 2004, there were already 230 listed companies, and 254 by the end of 2005. Besides, it is worth noting that the growth was achieved without any relaxing of regulations, but to a large extent due to development of market economy which finally created both demand and supply of securities at a relatively high level.

# 4. Conclusions

The processes of privatization and corporate governance formation are marked by both successes and failures. The most spectacular success is privatization in the "broad sense" which boosted the growth of new private businesses and the share of the private sector in the national economy. Privatization in the "narrow sense" (ownership transformation of state-owned enterprises) was only a partial success, both in terms of quantity and quality. Some methods of privatization proved to be more "permeable," easier to implement for a number of social, political and technical reasons than the others; thus, the progress of privatization was very uneven across sectors, and some of them (infrastructure, extractive industries and some others) remain predominantly state-owned. There were two reasons for this situation: the highly gradualist, consensual character of Polish privatization procedures and the emergence of interest groups not interested in privatization of remaining state-controlled companies.

Polish privatization and corporate governance legislation is very extensive and covers all important spheres of ownership transformation, as well as companies' and capital market's functioning. It created rather strong legal grounds for corporate governance and creation of sound capital market. However, in practice, the real corporate governance mechanisms often proved to be inefficient. Minority shareholders abuse is quite common, but at the same time legal provisions aimed at minority protection are sometimes used for "majority abuse" by minorities that represent powerful industrial interests. There are also numerous cases of managers' opportunism, asset stripping and tunneling. External corporate governance mechanisms are often weak and do not always ensure effective regulation of companies' behavior. First of all, the growing but still weak and shallow capital market must be mentioned.

It seems that there are the following causes of dysfunction in privatization and corporate governance spheres:

– lack of coherent concept of ownership transformation and development of private property relations. Some very important issues of interrelations between privatization and desired corporate governance models and mechanisms are still unresolved;

– contradictions in the policy of the state (especially concerning securities market, external institutional investors, and the role of insiders), clientelism;

– not fully adequate legislation: at the same time, overregulated, underregulated and misregulated; lack of integrity which hampers meeting the goals of transformation. Some provisions of the law have political character and are intended to gain support of various actors. Sometimes, provisions of law are too general and are not instructive enough;

– poor enforcement of the law and other regulations.

Privatization in Poland is characterized by high diversification of methods and has mainly consensual character. SOEs with different characteristics were designated to various methods and "paths," which introduced a strong selection bias, exerted a heavy impact on initial ownership structure of privatized enterprises, and on post-privatization processes as well, including formation of corporate governance. Formally staying within the boundaries of the Continental model, it was highly diversified.

Recently, new trends are seen that can be interpreted as a certain convergence with the Anglo-Saxon corporate governance model. The development of markets, especially financial and managers' ones, created ground for a new type of core investors, whose strategy is based mainly on the market value of a company rather than some other forms of return on investment or based on pursuing some other goals. In 1990s, the popular strategy was concentration of capital in one hands and, if a company was listed, initiation of delisting procedure. Now, more and more investors treat stock market seriously and take it into account in their strategies. Increased supply of securities without compromising its quality for sure help these investors to realize their plans and contributes to the creation of the "virtuous circle" of capital market development.

A certain type of convergence can be seen between the effects of different privatization methods in corporate governance and performance as well. A lot of enterprises that has been privatized with the help of methods which are widely regarded as less efficient, in the course of the recent years are showing significant improvement in performance that occurs manly due to internal factors, i.e., better governance. At the same time, the gap between the privatized and the state-controlled enterprise sectors is still growing, although the latter shows some signs of performance improvement. However, this improvement is not based on a steady grounds and is not expected to be sustainable.

Is therefore the "how to privatize" question still actual? Does it make sense to promote privatization methods that ensure rapid formation of efficient corporate governance structures taking into account the fact that in a long run, market forces would force deep improvements in companies where privatization methods were not able to create an efficient owner and efficient strategies immediately, but were much more feasible politically, socially, technically, etc.?

There is no simple answer to this question and the problem needs further investigation. At this moment it can be said that any privatization in most cases proves to be better than none. Therefore, less microeconomically efficient method of privatization may be applied when otherwise a company would stay in the state hands. However, when we have a possibility to choose between privatization methods, it seems that the choice of the one that promises better corporate governance solutions and higher microeconomic efficiency is advisable. Choosing more "feasible" but lest "efficient" method would cost us loosing opportunities for fast and deep restructuring of a company, rapid improvement in its performance. It simply means lost time that is used by other companies for improvement of their competitiveness. Besides, it hampers the development of markets by postponing the introduction of efficient market attitudes. It should be stressed that during the transition an enterprise plays a dual role being not only an object of some reforming efforts of the government, but also playing a role of an active co-creator of market attitudes and relationships. In other words, enterprises to a large extent create environment in which they operate and there would be no market without actors who play according to the market rules. And, last but not least, it hampers the growth of the national economy.

Another problem lays in the false character of many "feasibility vs. efficiency" dilemmas, because following the "feasibility" path (that e.g. favored some social groups in order to gain their support for the reforms and/or overcome their resistance to changes) often proved to be counterproductive. In a longer perspective, instead of unblocking and/or accelerating the pro-market reforms, it created special interest groups that caused reform slowdown and numerous dysfunctions and pathologies.

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