to specific country contexts; they are dealt with in depth in the country studies. This chapter attempts to generalize on them and to identify pertinent issues, which apply region-wide, and to draw policy conclusions relevant for a larger group of countries after mass privatization. The authors are Marko Simoneti who served as the coordinator and Andreja Böhm who was his assistant in this research project.

1. The Governance of Privatization Funds in the Czech Republic

Jozef Kotrba, Evžen Kočenda and Jan Hanousek

MASS PRIVATIZATION PROGRAM

Introduction

At the start of privatization, the economy of the Czech Republic (and of course Slovakia) was far more state owned than in any other Central and Eastern European (CEE) country. According to estimates of the former Federal Statistical Office and the Czech National Bank, in 1990 – i.e., in the first year after the end of the communist government – as little as 4% to 5% of the nation's GDP was generated in the private sector. Even the share of the non-state sector, which included cooperatives run in a fashion similar to state-owned enterprises (SOEs), was quite low (see Table 1.1).

Table 1.1 Private sector share in the Czech Republic

	1990	1991	1992	1993	1994	1995	1996
GDP generated in the private sector (%)	12	17	28	45	56	64	74

Source Czech Statistical Office

Quite naturally, with the economy being so heavily state controlled, a great deal of attention was paid to privatization. First (ordered chronologically) came the restitution laws, prescribing the return of certain property to its previous owners. Second came 'small-scale privatization' used mostly for the privatization of smaller units through public auctions. Last, but most important due to its scale, was 'mass privatization' involving a whole range of privatization methods – from auctions and direct sales to the voucher method, based on a partly-free distribution of shares to the general public. Apart from that, some property was transferred to municipalities (municipalities were also beneficiaries of free transfers within mass privatization).

particularly in agriculture, but also in retail trading and other branches.

From the quantitative point of view, the most important method was mass privatization: up until June 30, 1993, property worth CSK 597 billion[1] was approved for privatization, out of which property worth CSK 278 billion was distributed via vouchers. Second in importance were transfers to municipalities: around 6,000 municipalities received property worth CSK 350 billion in 1991, and they received some more property from mass privatization in the two subsequent years. Property involved in restitution amounted to between CSK 75 and 125 billion. Small privatization attracted sales amounting to CSK 31 billion. Foreign direct investment had contributed only CSK 58.2 billion between January 1, 1990 and September 30, 1993: its role is, in proportion to the amount of property privatized, relatively small. Because this study deals with those investment privatization funds emerging from 'large-scale privatization', we will omit further detailed discussion on restitution and/or 'small privatization'.

Key Institutions in the Privatization Process

Many institutions played an important role in the privatization process. At the time of the Czechoslovak federation, some of them already existed but only at the republic level. The Ministries of Privatization (one in each republic; on the federal level, their responsibilities with respect to federal property were held by the Ministry of Finance), the Fund of National Property (FNP; Czech, Slovak and, until December 31, 1993, also Federal FNP), and City and District Privatization Committees were all created solely for the sake of privatization. Many other institutions, such as Ministries of Finance (also one in each republic and a federal one), and the so-called 'founding ministries', took on privatization as an additional task.

The Ministry of Privatization (the official name is 'Ministry for the Administration of National Property and its Privatization') was founded in both the Czech and Slovak republics after the first free elections in 1990. Its agenda was broad: it was responsible for some restitution cases (receiving claims for financial compensation), and formally approved all businesses to be auctioned within small and mass privatization. Whereas its role in the former was restricted to a simple yes or no decision, its role in mass privatization developed into quite an active one: it often entered into negotiations with submitters of privatization proposals and made suggestions which sometimes resulted in significant changes to projects.

The Funds of National Property (of the Czech Republic, Slovak Republic and Federal) were established in 1991. All of them were designed with rather limited agendas: the Funds of the republics were recipients of sales proceeds from small and mass privatization, and they financed certain compensation claims as part of restitution. They were the vehicle for the formal exchange of property after a privatization project had been approved by all parties, but they were not supposed to alter or renegotiate the terms of the deal. The Funds are not under the authority of the government but are responsible to their respective parliaments.

played the role of founding ministries. In the planned economy period, each state-owned enterprise was subjected to one of the 'branch ministries', each being designed to control a particular branch of the economy: manufacturing, heavy engineering, construction, domestic trade and a few others. Since 1989, the number of such ministries has been progressively reduced. In the Czech Republic, two of them cover industry and trade, one covers agriculture, and the ministries of health and cultural affairs are responsible for selected enterprises. The founding ministries ensured that management of enterprises in their sphere, which were to be privatized, submitted a basic privatization proposal. They also submitted evaluations of all projects concerning 'their' enterprises.

The Federal Ministry of Finance had two roles: it had responsibilities to the privatization ministry with respect to those enterprises directly controlled by the federal government. It was also in charge of organizing the demand side of voucher privatization (i.e., for distributing vouchers to citizens and documenting their distribution) as well as of running the matching mechanism to equalize demand with the (fixed) supply. For this purpose, a special branch of the ministry, the 'Center for Voucher Privatization' was founded. The first wave of voucher privatization was organized only at the federal level (no Centers for Voucher Privatization were formed in the republics). The second wave was under the control of the Ministry of Finance and the Center for Voucher Privatization of the Czech Republic.

Mass Privatization

The first proposal for a mass privatization program occurred within the Czechoslovak context as early as December 1989 (Svejnar, 1989). It was basically a proposal to transform state-owned companies into joint-stock companies and, in the second step, to distribute their shares for free amongst the citizens. The following strategies for distributing company shares were discussed in Czechoslovakia:

- give the shares (a) to the citizens through shares in several mutual funds holding shares of firms. The shares of the mutual funds would be distributed freely to inhabitants, (b) to pension and health insurance companies, (c) to local governments or to other entities (Svejnar, 1989). Very similar proposals were (and still are) discussed in Poland (Lipton and Sachs, 1990 or Frydman and Rapaczynski, 1991);
- distribute shares through holding companies, so that each firm would be controlled by one company (Blanchard *et al.*, 1991); and
- issue free or almost free vouchers, entitling holders to demand shares of any privatized firm. This method leaves all decisions up to citizens (those who choose to participate).

Republics was quite flexible in terms of privatization methods: it allowed for direct sales, auctions, transformation into a joint-stock company and the sale or voucher distribution of shares, or a combination of different methods. Within the voucher scheme, there was also some freedom of choice: citizens could either bid with their vouchers for stocks of some particular companies, or allocate them to mutual funds. Unlike in plans discussed in Poland, those funds were established based solely on the decision of private or semiprivate entities to run such a fund; most of the funds were controlled by financial institutions. On the other hand, flexibility in the use of vouchers did not go as far as vouchers used in Russia. Vouchers could not be used for any other purchases (i.e., in small-scale privatization). Further discussion on voucher privatization can be found in Coffee (1996).

Legal framework of mass privatization

The legal basis for mass privatization consisted of several laws and administrative regulations. The Law on the Conditions of Transferring State Property to Other Persons (#92/1991), passed on February 26, 1991 (effective since April 1991) gave basic guidelines for the privatization of state-owned enterprises, banks, insurance companies and other institutions, including shares and other property assets owned by the state or the above institutions of other enterprises (e.g., a Czechoslovak property share on joint ventures, owned either directly by the state or by a state-owned enterprise). The law also established a Federal Fund of National Property. Unlike in restitution laws, the new owners could be either domestic or foreign entities. The property to be privatized included all assets, liabilities and claims of an enterprise; all contracts, wages and other agreements of the enterprise remained valid after being privatized. The only exceptions were property falling within natural restitution or privatized in small privatization and areas where the law requires state ownership.

Mass privatization was carried out through the five privatization methods possible:

- transformation into a joint-stock company and further transfers of the shares (i.e., by voucher privatization);
- direct sale to a predetermined buyer;
- public auction or public tender;
- transfer to municipal property; and
- transfer to social security, health insurance and other publicly beneficial institutions.

The privatization of each enterprise was based on an officially accepted privatization project. According to the law, each enterprise chosen by the government for privatization in one of two privatization waves (all state-owned enterprises were listed either in one of the waves or as enterprises temporarily exempt from privatization[2]) was obliged to submit its basic privatization project.

projects were primarily designed by the management of an enterprise. Moreover, anybody could present a competing project which, if it satisfied certain requirements, would be considered on an equal basis by all authorities involved in the privatization. After the projects were submitted, the founding ministry evaluated them (in some cases there were more than a dozen projects for a single firm) and passed its evaluation to the decisive body – the Federal Ministry of Finance (for former federal property) or to the republican Ministry for Privatization. In some cases, the right to decide was taken from those ministries by the government. This was mostly the case when a project was based on a direct sale without auction or public competition and/or when a foreign entity was the buyer.

Each project had to include a proposal to organize the privatized enterprise (for privatization, SOEs could be divided into new firms which could be sold or transferred separately), and one of the five approved privatization methods. Projects also had to contain information on the recent history of the privatized enterprise: for the period of 1989 to 1991 (for projects submitted in the first wave) it had to reveal data on employment, wages, capital, total sales and costs, profit and foreign trade.[3] To enable submitters of competing projects to provide this information (most of it was non-public in character), the management of privatized SOEs were obliged to provide information needed for the privatization project upon request.

The pricing of privatized enterprises differed according to the method of privatization and according to the status of the prospective buyer. In all cases, the book value had to be stated in a project: for this purpose, a copy of the enterprise's balance sheet had to be attached to determine net worth. Land and immovables had to be priced according to the existing pricing regulation[4] (which in most cases differed significantly from the book value) and an estimate of off-balance sheet assets had to be provided. For public auctions, tenders or direct sales to domestic buyers, this book value was taken as the basis for the starting or sale price; for transformations into joint-stock companies, it would determine its equity value. Foreign buyers had to propose a price based on an audit by an independent accountant, which was then subjected to further negotiations. The lawmakers intended this provision to present an advantage to local buyers; in fact, book values were often based on assets of dubious worth, so that direct sales to both domestic and foreign buyers used values estimated by auditing firms.

After a project was approved by the proper decision-maker, the property of an SOE was transferred to the Federal (or each republic's) Fund of National Property. This organizational peculiarity dissolved the firm without the founder liquidating it (founding ministry), and established a 'new' company by the Fund. The Fund's assets and their yields were separated from both federal and republic budgets. The Funds then sold or transferred the property according to the method(s) proposed in the approved project, possibly involving a provision that the Fund retain part of the property in its hands (in reality this only applied to some joint-stock companies). One of the methods of distributing shares was mass privatization with the use of the voucher scheme, which is later described in detail.

	Who was responsible	*Date due*
Approving and publishing lists of enterprises to be privatized in 1st and 2nd rounds and of those not to be privatized	Founding ministries, governments	June 1991
Submitting projects to founding ministries	Enterprises	31 Oct. 1991
Submitting projects to the Ministry of Privatization	Enterprise founders	30 Nov. 1991
Planned submitting of firm lists for voucher privatization with specified number of voucher shares	Ministries of Privat'n	15 Dec. 1991
Prolonged deadline for competing projects	Project submitters	20 Jan. 1992
Approving projects and subsequent privatizing of SOEs	Ministries of Privt'n, Governments	from 20 Jan. 1992[5]
Submitting of projects for second wave: exception for enterprises founded by Ministry of Health and for selected enterprises	Project submitters, founding ministries	16 Jul. 1992 31 Oct 1992 1 Jan. 1993
Submitting and publishing of preliminary list of enterprises to be privatized in second wave of voucher privatization	Ministry of Privat'n	1 Oct. 1993
Approving projects and subsequent privatizing of SOEs (2nd wave)	Ministry of Privat'n, Government	29 Oct. 1993

Mass privatization: scope and some results

Mass privatization involved most state-owned assets in industry, agriculture and trade. By way of illustration: the officially reported book value of capital in the Czech Republic in 1990 was CSK 2,604 billion, including houses, castles, railways and other non-privatized property. The book value of enterprises approved for privatization in the first wave was CSK 539 billion on June 30, 1993. The total value of the 2,800 enterprises planned to be privatized in the first wave amounted to approximately CSK 680 billion; some enterprises scheduled for the first wave were, however, moved to the second wave. The second wave had to cover around 2,000 enterprises worth approximately CSK 550 billion.

The first steps towards mass privatization had already been taken in 1991 (the relevant law being valid since April 1, 1991). It turned out that the process of compiling a project, the founding ministries processing it, the privatization authorities approving it and finally transferring the property to the new owner was rather lengthy. In fact, privatization started only in 1992 (see Table 1.2).

Apparently, after the rush in the second quarter of 1992 (within which one finds the beginning of the first wave of voucher privatization), the privatization process went much more slowly in the subsequent quarter and, in the fourth quarter of privatization, compared to the 32 billion in the third, or even the 366 billion in the 'voucher quarter'. This was due to several factors: after June 1992, a new administration came to power (unlike in Slovakia, there was only a minor shift in the political makeup of the government in the Czech Republic; however, in both republics there was a change in the head of the privatization ministry). Probably more significant was the fact that the least problematic projects were approved easily, and the 'troublemakers' kept the administration busy. Table 1.4 shows that there were a number of non-eligible projects from the first wave (submitted at the latest in the beginning of 1992) which were not decided before the end of 1993.

Table 1.3 Mass privatization: approved projects[(1)]

Privatization method	*Number of privatization units* *Volume of property approved by Dec. 31* *1992*	*1993*	*1994*	*1995*
Public auction	336 3,881	639 6,439	2,000 9,126	2,128 9,314
Public tender	300 10,436	599 20,283	1,117 29,556	1,394 33,001
Direct sale	986 26,613	2,522 56,906	10,024 94,879	11,343[(2)] 91,653[(2)]
Privatization of joint-stock co.	1,218 420,171	1,716 696,998	1,870 744,525	1,883 768,101
Unpaid transfer	1,052 9,633	2,488 28,641	4,380 59,042	4,857[(2)] 55,749[(2)]
Total	3,900 470,734	7,964 809,267	19,391 937,128	21,605 957,818

Notes
(1) Former federal property is not included.
(2) In some cases, the approved privatization method failed (the buyer did not pay, the municipality refused to take over the hospital). In such cases, the privatization project was returned and reconsidered. Since direct sales, in particular, were 're-approved' as public tenders, the volume of property approved as of December 31, 1995 was lower than the previous year.

Source Ministry for Privatization of the Czech Republic

In the beginning of 1993, mass privatization sped up again: projects for the second wave came in, and the bulk of large enterprises undergoing voucher privatization had to be finalized by October 1993. However, the speed achieved in the early period of privatization was not matched. After 1993, privatization projects of the major industrial firms had already been decided. Most privatization units approved were smaller agricultural and healthcare establishments so that, in spite of the seemingly sharp increase in the number of units, the value of property for privatization was stagnating. Tables 1.4 and 1.5 present a comprehensive breakdown of projects finalized by the Fund of National Property and final numbers of privatized enterprises according to such projects.

Privatization method	Number of privatization units Volume of property privatized by Dec. 31			
	1992	*1993*	*1994*	*1995*
Public auction	174 n.a.	278 2,885	558 4,210	777 6,787
Public tender	128 n.a.	285 10,081	400 17.813	570 18,432
Direct sale	587 n.a.	1,143 35,351	2,240 45,111	4,611 55,171
Restitution & direct sale	n.a. n.a.	73 5,259	262 5,889	244(1) 3,675
Privatization of joint-stock co.	1,210 n.a.	1,423 530,322	1,841 559,697	1737 754,652
Free transfer	559 n.a.	1,157 10,050	2,360 16,685	3,281 29,787
Total units privatized(2)	2,565 n.a.	4,359 593.847	7,664 646,505	11,220 868.504

Notes
(1) Property returned and privatization cancelled in some cases. In total, 991 projects were returned from the Fund to the Ministry in 1995 alone. Some of the returned projects had already been implemented.
(2) Excluding restitution administered by the FNP; these units are included in standard reports by the Fund, but not in 'approved units' by the Ministry.

Source Fund of National Property of the Czech Republic

Table 1.5 Privatization projects and privatized enterprises in the Czech Republic

Status as of	Dec. 31, 1993		Dec. 31, 1994		Dec. 31, 1995	
Number of projects	*Projects*	*Firms(1)*	*Projects*	*Firms*	*Projects*	*Firms*
Submitted	23,607	4,335	26,614	4,638	27,901	5,087
Decided	14,374	2,694	21,144	3,842	24,259	4,424
Approved	4,646	2,470	6,737	3,278	7,367	3,552
Rejected	9,728	224	14,407	564	16,892	872
Undecided	9,223	1,641	5,470	796	3,642	663

Note
(1) Number of firms for which projects were decided, undecided or all projects rejected.

Source Report of Ministry of Privatization of the Czech Republic

authorities originally thought that in most cases only one project would be submitted for each firm, and the approval process would really be an approval process and not a decision-making one, this did not happen at all. Only about one quarter of the projects submitted were basic projects designed by the management of firms: for 4,493 firms 23,319 projects were submitted. Even though one firm could be privatized by more than one project (if it was being privatized in parts, there was no reason to sell all parts according to a single project) and, therefore, not all submitted projects really competed with each other, for most firms, privatization authorities had to select the winning project out of many. Table 1.6 summarizes those who submitted projects for enterprises included in the first wave of privatization.

Table 1.6 Submitters of projects in the Czech Republic

Project submitted by	1991 – Dec. 31, 1993			
	Total	*%*	*Approved*	*%*
Management of company	4,992	21.15	2,492	53.63
Management of establishment	711	3.01	203	4.37
Bidder for purchase of company	11,478	48.62	1,255	27.01
District Privatization Commission	1,123	4.76	176	3.79
Restitution claimants	630	2.67	134	2.88
Local government	715	3.03	55	1.18
Consulting firms	527	2.32	72	1.55
Employees	1,141	4.83	30	.65
Total	23.607	100	4,647	100

Source Report of the Ministry of Privatization of the Czech Republic

THE ROLE OF INVESTMENT PRIVATIZATION FUNDS (IPFS) IN THE PRIVATIZATION AND POST-PRIVATIZATION PERIODS

Investment Privatization Funds

A brief paragraph of the Law on the Conditions of Transferring State Property to Other Persons (#92/1991) enabled investment privatization funds (IPFs) to participate in voucher privatization. Even though the By-law on the Issue and Use of Privatization Vouchers (#383/91) and particularly its amendment in law on their regulation (248/1991 on Investment Corporations and Investment Funds) was passed only in April 28, 1992 – two months after the deadline for registration of IPFs. Until then, the establishing of IPFs was guided by the Law on Joint-Stock Companies (#104/1990) for companies established before December 31, 1991, and thereafter by the newly-introduced Commercial Code (Law # 513/1991).

The delay in passing the law on investment corporations had two major negative impacts on the first wave: one of them was a lack of regulation. Whereas that impact might have been welcomed by the founders of IPFs, the other one was not: the only possible form IPFs could take was as independent joint-stock companies, with all the complexities of corporate governance they can bring about. The Law on Investment Corporations and Funds allowed this legal form too but, in addition, it allowed open or closed mutual funds with far easier and cheaper management. Both closed and open mutual funds were widely used in the second wave.

To establish an IPF, its founder had to be a 'legal entity' (i.e., had to be incorporated) with equity of at least CSK 1,000,000 (i.e., US$ 33,000) per fund established. To apply to a ministry of privatization for approval, a founder had to submit a proposal for the establisher's plan and for the contract between himself and the IPF (which was a separate corporation) concerning the conditions of controlling the fund and a draft of the status of the IPF. The establisher's plan had to contain the following:

- conditions of managing the fund by the founder;
- number and qualifications of the proposed staff of the fund's administration;
- composition of the board of directors and supervising board of the fund, including some further information about its members;
- principles of the fund's policy towards branch specialization, attitudes towards risk sharing and so on;
- approval to furnish the fund with equity capital of CSK 100,000 before voucher privatization starts.

The contract between the founder and the fund had to include conditions for rewarding the founder for managing the fund. This reward could not exceed 2% of the nominal value of the shares gained in voucher privatization within the course of privatization or 3% of the property of the fund a year after privatization.

The founding institutions of the privatization funds, the founders, came from a broad spectrum of different legal bodies. A significant number of them were financial institutions of various types. Figures 1.1 and 1.2 provide basic information on this subject with respect to the number of points each fund attracted.

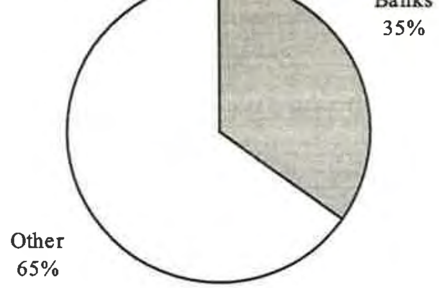

Figure 1.1 Fund founders: wave 1

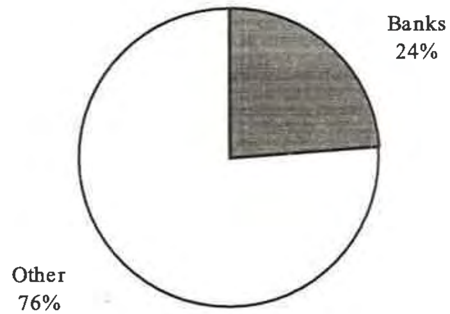

Figure 1.2 Fund founders: wave 2

In the first wave, privatization funds founded by banks captured 35% of the market with the points that were allocated to IPFs. In the second wave, this amount was somewhat lower, but the funds created by banks were still able to take 24% of the market. Under the term 'bank' are included not only typical banking houses and their sister companies but also insurance companies and their sisters as well. The rest of the market with voucher points to be allocated to IPFs was within the domain of funds that were created by other institutions. The majority of these institutions were manufacturing works. Their activities were supposed to be related to the business of a particular founder.

Each fund which intended to take part in voucher privatization had to be approved by the Ministry of Privatization; this was rather peculiar in the first wave since both voucher privatization and activities of IPFs were spread over all the Federation. The approved fund had to be established as a company (IPFs only), and after receiving an organization identification number, the fund could be registered, published in the official list of funds participating in the particular wave and become one of the options for the participants of voucher privatization in the 'zero round'. The first and second waves were quite different. We shall therefore discuss them separately.

The regulation of funds evolved slowly. The first step was an incompatibility clause, excluding top government officials from the boards of IPFs (via an amendment to the By-law on the Issue of Vouchers). The same norm restricted bidding by IPFs in the following way: an IPF could not invest more than 10% of its points in a single company, and could not obtain more than a 20% share of a company. IPFs established by a single founder were allowed to get 40%, but by a later law this was reduced to 20%, so that no single founder could receive more than one fifth of an enterprise privatized through vouchers. References to how other countries privatizing state-owned enterprises in terms of percentage stake acquisitions are discussed by Luftmann (1992) amongst others. However, since IPFs could merge (and they really did), the effect of this provision – if its purpose was to prevent a fund from controlling a firm – is questionable. Another provision of Law #248/1992 prevented the purchase of shares of financial institutions by IPFs founded by financial institutions (among other companies, shares of largest banks, insurance companies and savings and loans were offered in the first wave). Due to a lack of enforcement, this provision was also widely violated without noticeable consequences.

Voucher Privatization and the Role of Individual Investors and IPFs

The Law on Mass Privatization also allowed the distribution of shares of joint-stock companies via vouchers. Law #92/1991 stated who could take part in this process, but failed to give any detailed description of how the process should be organized. This was done by the by-law of the federal government #383/1991 on September 5, 1991 (effective September 30), which defined the technical procedure of voucher privatization and precisely described how an eligible person can obtain vouchers and set rudimentary guidelines for the functioning of Investment Privatization Funds (special mutual funds to which voucher holders could transfer their entitlement for free shares).

Unlike other privatization methods, voucher privatization depended heavily on the division of the process into privatization waves. In each wave, certain previously announced groups of enterprises (several hundreds to thousands) were offered for privatization. The voucher scheme was based on the matching of bids by voucher holders with a fixed number of supplied shares of enterprises, the goal being to sell off as much as possible.

The supply of enterprises to be privatized through vouchers was the outcome of the process of submitting and approving privatization projects as described in the previous section. The privatization authorities set a rough goal in terms of how much property should go into voucher privatization. In the process of submitting and reviewing the projects, privatization ministries had to submit

information to the Federal Ministry of Finance. Since the process was federally organized, and citizens in both republics were allowed to bid for enterprises in their own republic as well as in the other, after registration it was necessary to adjust the amount of property supplied in each republic to the number of participating citizens.

The demand side of voucher privatization was formed by vouchers distributed to citizens. Starting in late 1991, post offices had to supply voucher books for the first round; the same procedure was used in late 1993 for the second round. Every Czechoslovak (Czech only for the second wave) citizen over 18 permanently residing in Czechoslovakia could register one such book for a fee of CSK 1,000 (approx. US$ 35). After doing so, the citizen was entitled to bid for shares of privatized enterprises within the given privatization wave: each voucher, formally worth 1,000 'investment points' was divided into ten 100 point parts. Before real bidding for shares began, participants could transfer the whole voucher, or a part of their point endowment, to the Investment Privatization Funds. Throughout the rest of the privatization wave, the funds would bid in the same way as other voucher holders (with some exceptions described later); shares of each fund were distributed proportionally among those who put their points into it.

Within each *privatization wave,* the following procedure applied: after eligible citizens registered their vouchers and privatization funds received their approvals from the ministries of privatization (for registration of citizens and funds, there were certain deadlines), lists of Investment Privatization Funds (IPFs) and of enterprises – joint-stock companies – were offered in a given round. For each enterprise, some essential information on its performance was revealed in the published list, including total sales, profits, employment, book value, outstanding bank loans, net worth for the previous three years (1989–1991 for first wave) as well as the percentage of shares offered for vouchers sold to foreigners or to domestic buyers or, in some cases, left in the hands of one of the Funds of National Property. Based on this information, voucher holders had to decide how many points to allocate on their own, and how many through IPFs. Assigning of points to IPFs was called the 'zero round', and was held before anybody was allowed to bid for shares. At the end of this 'zero round', all the points not given to IPFs had to be allocated individually by voucher holders.

Bidding for the shares of enterprises was organized within several *privatization rounds*. Each round had several phases:

- announcing the number and price of shares for each company (given in shares offered for 100 points) in a given round. In the first round, the price was uniform and published in the list of enterprises with all other information mentioned above. The published list of prices (from the 2nd round on) also summarized results of the previous round – the size and ratio of supply and demand in shares;

- ordering shares of particular companies by voucher holders: several hundred 'registration places' collected the orders and sent them to the central authority;
- processing of orders by the Center for Voucher Privatization in the following way:
  (a) if demand was below or exactly equal to supply, all orders were met at the price valid for a given round;
  (b) if demand exceeded the supply by less than 25%, the excess could be removed by a proportional cut in the demand of IFPs. However, this cut could not exceed 20% of the order of any mutual fund;
  (c) if demand exceeded the supply and the provisions described above were not applicable, the orders were cancelled and points used in them were left to the voucher holders for the next round;
- the last phase was setting prices for the next round based on the performance of this 'market' for companies not yet fully sold; then a new round could start.

The way prices were cooked by the price commission of the Center is one of the little secrets of the process; estimations of price equations by Singer and Svejnar (1994) and Hanousek and Lastovicka (1993) show that the most important factors for setting the price of shares in a particular round were their price in the previous round, the ratio between demand and supply (both with positive coefficients) and the size of total supply (with a negative coefficient). According to both studies, each round had its own different set of coefficients; the exact formula for prices seems not to be retrievable by econometric estimations.

Conclusion of the process was left to the discretion of the Ministry of Finance: if it decided that it had converged enough, it could declare a particular round as being final; after this round ended, all points used for orders which were not satisfied were declared void, the results of all rounds were aggregated and each voucher holder got the shares for which he had successfully bid.

The Voucher Scheme at Work: First Wave

On the supply side, a total of 1,492 enterprises was offered in the whole Czechoslovak Federation (see Table 1.7). There were significant differences between privatization projects for voucher privatization in the Czech Republic and in Slovakia: whereas in the Czech Republic most projects combined the voucher method with other methods (only 39.7 % of them used vouchers as the only method), in Slovakia 90.1% of projects were based on only one method. (Federally-owned property was also mostly privatized with a combination of at least two methods.) Many projects combined the voucher method with sales to domestic or foreign investors or through the creation of a joint venture.

Table 1.7 Structure of privatization of joint-stock companies participating in the first wave of voucher privatization

	Number of privatization units into which privatized state-owned enterprises were divided[1]				
	1	*2–4*	*5–9*	*10 and more*	*Total*
Czech JSC	600	248	99	41	988
Slovak JSC	320	108	70	5	503
Total CSFR	920	356	169	46	1,491
Second wave	324	160	74	118	676

Note
(1) In some cases, more than one unit was privatized within voucher privatization. Each company was then counted separately. 1,491 joint-stock companies were established from 1,309 originally state-owned enterprises.

Source Database published by the Center for Voucher Privatization

In some cases, the Fund of National Property kept part of the property. There were two main reasons for this. First, the Fund wanted to preserve a domestic majority or even influence the state in some important enterprises, i.e., major banking institutions (see Table 1.8). Second, pending negotiations with foreign or domestic investors, the Fund kept some of the property as part of a contract for a joint venture, passing shares of an FNP to a foreign partner when it actually provided the agreed number of investments. Such was the case with, for example, the monopoly producer of tobacco products Tabak, later sold to Philip Morris.

Table 1.8 Major financial institutions: state preserves influence

Institution	*Book value*	*Vouchers*	*Other investors*		*FNP*
Komerčni banka	4.56	53%	–		44%
VUB	2.04	52%	–		45%
Czech S&L	5.60	37%	Municipalities	20%	40%
Czech Insurance Co.	1.64	15%	CS Trade Bank	15%	23%
			Interbanka	7.7%	
			Komerčni banka	10%	
			Investični banka	10%	
			Savings Bank	10%	
			Employees	5%	
Investični	1.00	52%	–		45%

Source Kuponova privatizace 6, 1992

On the demand side, development was rather dramatic in the first wave: between November 1992 and early January, only several hundred thousand persons registered their voucher books. Government estimates were that around 2.5 millions inhabitants would do so before the deadline for registration. This goal was roughly achieved by mid-January. Had the property been divided between the voucher holders registered at that time, each voucher book worth 1,035 crowns would have yielded property at a nominal value of 70,000 crowns. At that time, several private as well as state-owned bank-sponsored Investment Privatization Funds started aggressive campaigns to attract voucher holders to give their shares to them. One of the private companies controlling several funds, Harvard Capital & Consulting[6] focused on those who had not decided whether to take a part in voucher privatization by offering 10,035 crowns (ten times more than the cost of registration) to those who gave their vouchers to the fund. This strategy, copied by several funds (the Czech Savings and Loans bank offered immediate credit of 10,000 crowns to voucher holders who gave their points to its IPF), attracted far more citizens than anyone expected: 8,565,642 citizens, approximately 75% of those eligible, registered by the end of February 1992. This, of course, proportionally reduced the value of assets going to each participant to 35,000 crowns.

Four hundred and thirty-four IPFs founded by various entities entered into the zero round; those which turned out to be most successful were funds connected with large financial institutions, but all sorts of other funds tried their luck, too. The fact that many citizens decided to register for voucher privatization only because of the IPF campaign was reflected in results of the zero round. At least 72% of all voucher points were put into IPFs, leaving only 28% in the hands of individual voucher investors.

Table 1.9 The zero round: funds stand high

Millions of points	*Czech Republic*	*Slovak Republic*	*Total*
Held by citizens	5.980	2.580	8.560
Given to IPFs	4.320	1.820	6.130
– Czech IPFs	4.290	0.180	4.470
– Slovak IPFs	0.030	1.630	1.660

Apparently, the citizens of both republics tended to invest their points domestically, but Slovak citizens invested more in the Czech Republic than vice versa (see Table 1.9). This trend was even stronger in real bidding for shares in the first to fifth rounds. Another significant trend – possibly very important for the future role of funds in the Czech and Slovak economies – was the tendency to put points into large, well-known funds instead of funds specializing in some particular branch or region. Among the nine most

successful, only one fund was not connected with a major financial institution: Harvard Capital & Consulting, and one of the others was founded by a foreign bank (Creditanstalt, an affiliate of a major Austrian bank). The thirteen largest IPF founders controlled over 56% of all points given to funds. The degree of concentration is illustrated in Table 1.10.

Table 1.10 Structure of IPFs according to size

Size of IPF in points received (million)	< 1.0	1–5	5–10	10–50	50–100	> 100
Number of IPFs	191	122	43	59	6	13

Table 1.11 shows the distribution of shares allocated to IPFs during the first privatization wave. The shares were distributed by a founder of the IPF.

Table 1.11 Distribution of shares allocated to IPFs, by founder (wave 1)

Founder	*No. of points allocated*	*Market share*	*Cumulative market share*	*No. of IPFs*
Česká státni spořitelna	950,918,800	15.494	15.494	1
První investiční, a.s.	713,837,100	11.631	27.126	11
Harvard capital and consulting	565,170,000	9.209	36.334	6
V+B INVEST, i.a.s.	500,668,100	8.158	44.492	1
IKS KB spol. s r.o.	465,708,300	7.588	52.081	1
Kapitál. invest. Společnost, a.s.	334,234,900	5.446	57.527	1
SLOVENSKÉ INVESTICIE, s.r.o.	188,041,300	3.064	60.591	1
CREDITANSTALT, a.s.	138,924,800	2.264	62.854	1
PRVÁ SLOVENSKÁ INVESTIČNÍ, a.s	136,348,000	2.222	65.076	11
Správce prvního privatiz. fondu	117,681,800	1.918	66.993	4
Živnostenská banka, a.s.	117606100	1.916	68.910	1
SLOVENSKÁ POISŤOVŇA, a.s.	108,710,600	1.771	70.681	5
Investiční společnost BOHEMIA	85,363,700	1.391	72.072	6
AGROBANKA PRAHA, a.s.	85,035,000	1.386	73.457	13
VSŽ, a.s. Košice	78,409,000	1.278	74.735	1
HC and CS, a.s.	73,454,900	1.197	75.932	2
LINH ART spol. s r.o.	72,141,000	1.175	77.107	1
DIVIDEND, a.s.	55,264,000	0.900	78.008	10
SLOVHOLDING, a.s.	50,553,900	0.824	78.832	1
O.B.INVEST, spol. s r.o.	48,644,900	0.793	79.624	2
C.S. Fond, a.s.	46,154,000	0.752	80.376	3
Panok - Knight, a.s.	42,971,500	0.700	81.076	1
GUMÁRNE BARUM, a.s., Púchov	39,764,200	0.648	81.724	1

Table 1.11 (continued)

Founder	*No. of points allocated*	*Market share*	*Cumulative market share*	*No. of IPFs*
VSŽ, a.s., Košice + SŠTSP, š.p.	37,815,400	0.616	82.341	1
CZECH INVESTMENT COMPANY	35,944,400	0.586	82.926	1
SKLOEXPORT, a.s.	34,803,800	0.567	83.493	1
Evrobanka, a.s., Praha	32,321,300	0.527	84.020	2
SLOVENSKÁ ŠTÁTNA SPORITEĽŇA	31,525,300	0.514	84.534	1
Pivovar RADEGAST, a.s.	31,153,600	0.508	85.041	1
COOPEX INVEST, a.s.	29,103,100	0.474	85.515	1

Source Authors' computations

The largest IPF, created by Česká státní spořitelna, captured almost one billion of the allocated points, which is more than 33 times the amount allocated to the least successful IPF. This is a strikingly high amount and, in reality, represents 15.5% of the market share. It is also evident that the second largest fund founder (První investiční) does not lag far behind with its 11.6% market share, which is divided among its 11 funds.

Thus, the two strongest IPF founders accounted for more than 27% of the market with allocated points in the first wave. The next three fund founders can be regarded as similar in size with about 8% of the market share each. However, Harvard Capital and Consulting spread its 9% share among its 6 different funds while První investiční created 11 funds. Altogether, the five largest IPF founders captured more than one half of the voucher scheme market. Such an uneven but understandable result is illustrated by Figure 1.3.

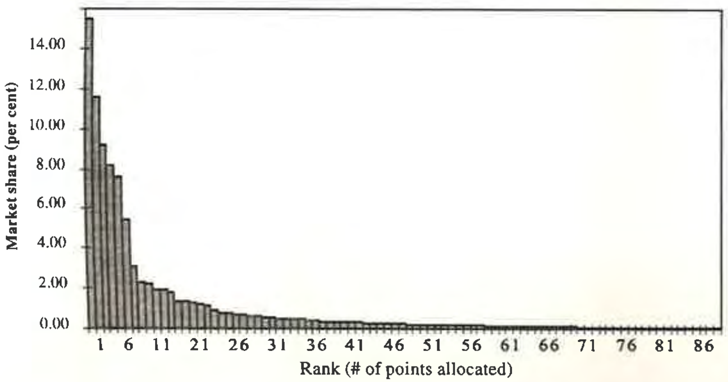

Figure 1.3 Wave 1: market shares of the managers of the biggest funds

The bidding procedure for both individual voucher holders and IPFs took five rounds, lasting from May 18 until December 22, 1992. All economic agents involved (with one small exception on the side of the price committee) behaved quite rationally: in the beginning, the prices of shares of all firms were set uniformly at 30 shares per 1,000 points (a whole voucher book). Bidders tried to get the most attractive shares at a low uniform price: this resulted in a very poor rate of allocation (only 29.9% of offered shares were sold with an extremely high participation of bidders). The second round was a round of waiting: prices of poor enterprises were still quite high (a maximum of 100 shares per 1,000 points), participation the lowest ever and the rate of allocation moderate. The third round was marked by the above mentioned irrationality of the Price Committee: prices for the cheapest firms were set as low as 970 shares per 1,000 points, with relatively high prices for the best firms. This resulted in the most active participation of bidders in the process (running into the cheapest firms) and, due to widespread excess demand, in the poorest result in terms of proportion of offered shares sold. Out of 132.1 million shares, only 32.4 million were sold, and total demand exceeded supply by 107.3 %. The fourth round, with lower extremes cut back, showed relatively good results with 93% of investment points used and 78.8% of shares sold, so that the next round was declared to be the last one. Participants were urged not to change their selections dramatically – in firms where excess demand had been observed in the previous round, prices were increased so that if all bidders were consistent in their demand, no excess demand would arise – and, surprisingly, this suggestion worked quite well. The last round had a record rate of allocation of points (93% of points used for bidding were successfully allocated) as well as shares: (40.9 million shares out of 62.5 million shares left were sold). During the whole bidding procedure, 99% of points available were used and 92.8% of shares offered were sold.

Empirical studies (Hanousek and Lastovicka, 1993; Singer and Svejnar 1994) also indicate that the investment behavior of funds and individuals was significantly different in each round. This was caused (apart from other factors like mis-specification of equations, which both groups of authors estimated) by the strategic considerations bidders had to take into account. The first and most straightforward factor determining demand in each round was the expected value of shares of each firm: those who value some particular title most, so that its relative expected value exceeds the relative price (compared to other firms offered) should bid for it. However, since the final round was not announced before its start (in the fourth round, nobody knew that the fifth one would be final), with each round, bidders had to consider the probability of placing their points. If they valued some firm a lot, they had to consider what the probability was of too many bids from others for the same firm, in order to prevent excess demand (and, therefore, zero allocation of points).

The Voucher Scheme at Work: Second Wave

Whereas in the first wave, shares representing CSK 212.5 billion of the book value of Czech enterprises were sold (the remaining 86.9 billion came from Slovakia), the second wave sold shares representing only 145 to 147 billion. Moreover, 21.1 billion came from unsold shares from the first wave. On the other hand, the participation of Czech citizens was high compared to the previous wave: in the first one, 5.83 million citizens registered their vouchers; in the second this number exceeded 6 million.

The second wave of large privatization offered quite modest outcomes in comparison with the first. Table 1.12 shows that the market share with respect to point allocation was somewhat more evenly distributed.

Then the 10 founding institutions with their 48 funds were needed to capture more than half of the market. However, roughly half of this portion could be credited to the first three funds, which were very similar in size (A-INVEST, Expandia, and Harvard). These three funds attracted around 300 billion points each. The combined number of points allocated to fund founders was, however, still less than that of the single leading founder from the first wave (Česká státní spořitelna), which formed one large IPF. Again, as in the first wave, Harvard Capital and Consulting spread its 7.5% share over a large number of funds – 23 this time.

Table 1.12 Distribution of shares allocated to IPFs, by founder (wave 2)

Founder	No. of points allocated	Market share	Cumulative market share	No. of IPFs
A-INVEST, investiční společnost, a.s.	309,243,300	7.896	7.896	2
Investiční společnost Expandia, a.s.	306,290,600	7.820	15.716	3
Harvard Capital and Consulting, a.s.	292,170,900	7.460	23.176	23
O.B.Invest, investiční společnost, s.r.o.	198,351,200	5.064	28.240	3
KIS, a.s., Kapitálová investiční společnost České pojišťovny	186,697,800	4.767	33.007	3
Investiční společnost podnikatelů, a.s.	159,263,500	4.066	37.073	2
Investiční společnost Linh Art, s.r.o.	156,432,100	3.994	41.067	3
Czech investment company investiční společnost, spol. s r.o.	151,666,300	3.872	44.939	1
Spořitelní investiční společnost, a.s.	124,161,800	3.170	48.110	1
Investiční kapitálová společnost KB, a.s.	124,063,500	3.168	51.277	1
PPF investiční společnost, a.s.	119,703,700	3.056	54.334	2
První investiční akciová společnost	97,629,000	2.493	56.826	5
C.S. FOND, a.s., investiční společnost	94,007,200	2.400	59.226	7
Moravská agrárně potravinářská investiční společnost, akciová společnost	89,932,800	2.296	61.523	1
Creditanstalt investiční společnost, a.s.	78,201,900	1.997	63.519	1
ŽDB, a.s., Bohumín	67,782,700	1.731	65.250	1
KREDITAL, a.s.	65,407,500	1.670	66.920	1
CS FIRST BOSTON investiční společnost, a.s.	65,213,900	1.665	68.585	1
Montované stavby Praha, a.s.	64,533,300	1.648	70.233	1
ŽB - Trust Investiční společnost, s.r.o.	59,538,200	1.520	71.753	1
SHD SPOLEČNÝ PODNIK MOST	56,214,600	1.435	73.188	1
Tradeinvest, investiční společnost, s.r.o.	49,514,000	1.264	74.452	1
Investiční společnost EVBAK, a.s.	46,952,500	1.199	75.651	5
Moravskočeská investiční společnost, a.s.	45,692,500	1.167	76.818	1
Plzeňská investiční společnost, s.r.o.	38,479,400	0.982	77.800	3
Kontinentální sdružení pro investice a obchod, investiční společnost, a.s.	35,255,500	0.900	78.700	2
Investiční společnost Bohemia, a.s.	32,140,500	0.821	79.521	2
Mercia, spol. s r.o.	29,658,300	0.757	80.278	1
COOP INVEST investiční společnost, a.s.	28,599,200	0.730	81.008	1
Česko-kalifornská investiční společnost, Praha, s.r.o.	25,692,500	0.656	81.664	3
České investice, s.r.o.	24,128,000	0.616	82.280	2
Region Invest investiční společnost, a.s.	23,922,300	0.611	82.891	1
Poštovní investiční společnost, a.s.	21,237,100	0.542	83.433	2
ZEMAP-INVEST, první kuponová investiční společnost, s.r.o.	20,282,300	0.518	83.951	3

Source Authors' computation

Figure 1.4 presents the different market shares among the fund founders in the second wave.

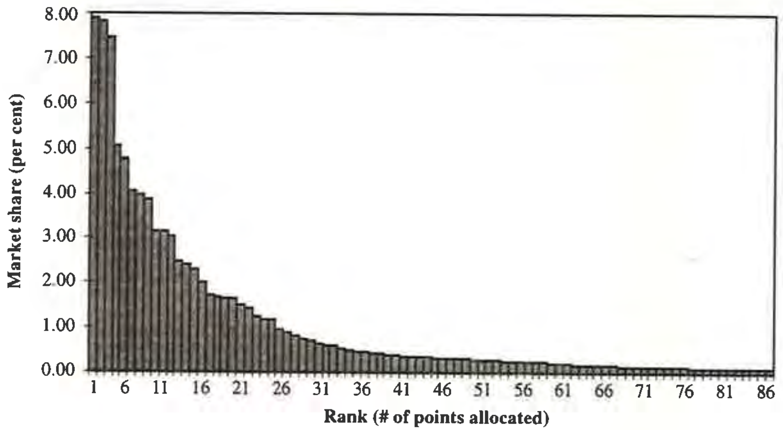

Figure 1.4 Wave 2: market shares of the managers of the biggest funds

The domination of the market by a small number of fund managing institutions in the first wave was then replaced by a somewhat strong leading tier, closely followed by a large group of fund managers of relatively similar size. In other words, the market became more dispersed. This was most probably a result of the learning process citizens underwent during the first wave (in particular, they became more adept at bidding) combined with the better marketing strategies of the fund founders, designed to attract much needed points.

Voucher privatization in the Czech Republic was remarkably successful in allocating shares of the targeted state enterprises quickly and efficiently. The bidding process was crude in many ways, especially in the administration of share prices and in the attempts by the privatization authority artificially to speed the process by over-adjusting prices. But in spite of the artificial price jolts, the market reacted logically, even predictably. In five or six short rounds over a few months almost all shares were allocated and almost all voucher points were spent. Individual investors, taking their cues from the mutual funds (to whom they attributed better information), tried to get the most value for their vouchers. However, these individuals paid less attention to the IPFs in the second wave than in the first, indicating growing investor self-confidence. The IPFs, guided by considerations other than short-term portfolio maximization, tried to acquire shares even at premium prices.

The open and public way that shares were transferred from the state to private hands ensured that no individual or group of investors could reap windfall gains at the expense of the general populace.

THE GOVERNANCE OF IPFs

Mass Privatization: Achievements and Problems

The extent of mass privatization undertaken in Czechoslovakia is globally unprecedented. As a result, it is impossible to evaluate the process and its outcome comparatively. Nevertheless, it is indisputable that the Czechs and Slovaks have proved that a program involving large-scale transfer of ownership of this kind is feasible and can be carried out in a relatively short period of time. The main problems associated with the Czechoslovak scheme appear to have been the following:

The legislative framework for mass privatization, especially for the voucher component, was too vague. Most of the laws spelled out general principles, relegating details to government decrees and *ad hoc* administrative decisions. This gave the governments a lot of discretionary power, which led to abuse. For example, the timing and method of concluding the first wave of voucher privatization was fully determined by a handful of officials. Investors were told that the voucher scheme could be concluded at any time with an *ex post* announcement from that group, with their leftover voucher points becoming worthless.

Voucher privatization also turned out to be difficult to organize. One of the important advantages anticipated by the Czechoslovak authorities when the method was accepted was that this method could turn the difficult decision process of 'who to sell to' into an easier approval process of 'whether to privatize this enterprise or not'. However, as soon as the method started to compete with and be combined with other standard methods, this expected advantage disappeared. The result was a laborious process that led to corruption.

On the other hand, one may argue that using the voucher method as a single privatization tool would have been too risky and that the benefits of diversification more than outweighed the complications brought about by the use of a combination of methods.

Forced Administration and Transformation of IPFs

How did the funds actually perform? Qualitatively, the worst situation was evident in the case of several funds being 'tunneled out'. This means that the real assets of the companies forming a fund's portfolio were to a greater or lesser extent sold and the resulting profits were extracted through various channels that would, in most cases, be illegal in any civilized country. This tunneling out of funds resulted in a forced administration regime. Tables 1.13 and 1.14 offer a breakdown of the funds that were put into forced administration.

Table 1.13 Wave 1: forced administration

Founder	No. of points allocated	Market share	Cumulative market share
Investiční společnost BOHEMIA	85,363,700	1.390918	1.390918
C.S. Fond, a.s.	46,154,000	0.752034	2.142952
CNIS, spol. s r.o.	20,358,400	0.331720	2.474672
Montované stavby Praha, a.s.	13,772,400	0.224408	2.699080
Mercia spol. s r.o.	507,500	0.008269	2.707349

The first wave resulted in five funds being put into forced administration. They represented less than 3% of the market and, thus, forced administration may have simply been due to mismanagement, competition, etc. However, in the second wave 10 'tunneled out' funds captured altogether more than a fifth of the market share, suggesting fraud of a much more pervasive nature than in the first wave.

Table 1.14 Wave 2: forced administration

Founder	No. of points allocated	Market share	Cumulative market share
A-INVEST, investiční společnost, a.s.	309,243,300	7.896	7.896
C.S. FOND, a.s., investiční společnost	94,007,200	2.400	10.296
Investiční fond AGB, a.s.	88,991,700	2.272	12.568
Creditanstalt investiční společnost, a.s.	78,201,900	1.997	14.565
CA-český infrastrukt. IF, a.s.	78,201,900	1.997	16.561
TREND-VIF a.s.	64,533,300	1.648	18.209
Moravskočeská investiční společnost, a.s.	45,692,500	1.167	19.376
Investiční společnost Bohemia, a.s.	32,140,500	0.821	20.196
IF Mercia, a.s.	29,658,300	0.757	20.953
NIS Litomerice	7,266,100	0.186	21.139

The privatization funds started to be transformed over time and based on legislation. Changes to the form of holding companies were by far the most important transformation of this type.

Figure 1.5 shows that 28% of IPFs from the first wave were transformed into holding companies and 3% of IPFs were put into forced administration, which obviously precluded any type of transformation until the authorities decided to remove the forced administration. The remaining IPFs were transformed into different structures or have not yet been transformed.

The second wave resulted in a different picture. Figure 1.6 is quite illustrative of the lower percentage of transformed funds. Roughly 21% of the IPFs were transformed into holding companies. An almost identical portion was, however, put under a regime of forced administration preventing their further transformation. This left the IPFs remaining from the second wave untransformed or transformed into other forms. In other words, the results of the second wave were less favorable than those of the first wave in that the number of IPFs transformed into holding companies decreased and the number of forced administration cases increased.

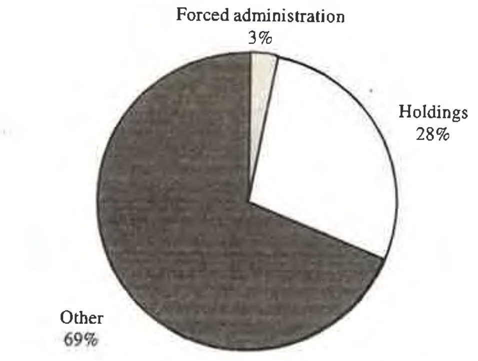

Figure 1.5 Wave 1: fund transformation

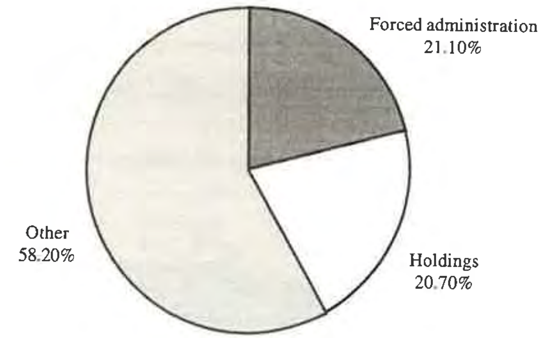

Figure 1.6 Wave 2: fund transformation

An interesting question is what was the actual market share of the privatization funds that underwent transformation? Figures 1.7 and 1.8 present some answers for the first and second waves, respectively. It is evident that the second wave resulted in more dispersed market control among the funds. In the first wave, seven funds captured 20% of the market, contrasting sharply with the fact that all transformed funds from the second wave were needed to capture one fifth of the available market. If we look more closely at the picture, we can see that one single leading fund took 9% of the market in the first wave, whereas its second wave counterpart was able to capture only half of that percentage share. There are several possible explanations for this trend: (1) individuals had learned how to bid from their experience in the first wave, (2) individuals had started to see the benefit of investing in companies that they were personally involved with, and (3) individuals had become distrustful of the privatization funds.

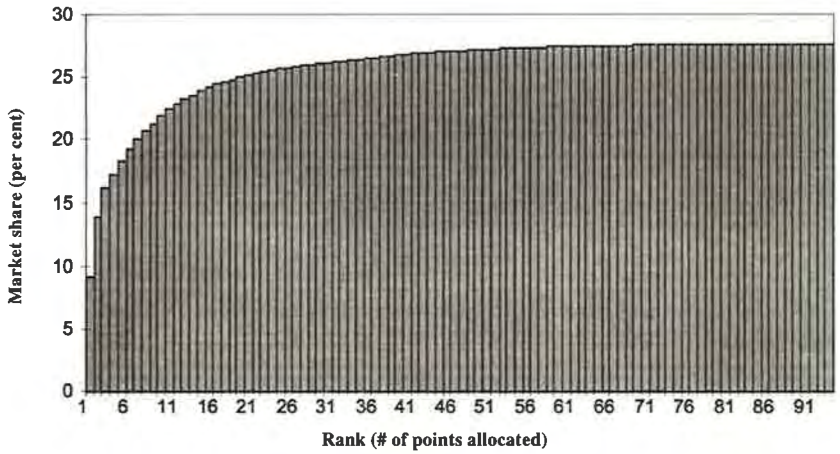

Figure 1.7 Wave 1: cumulative market share of the transformed funds

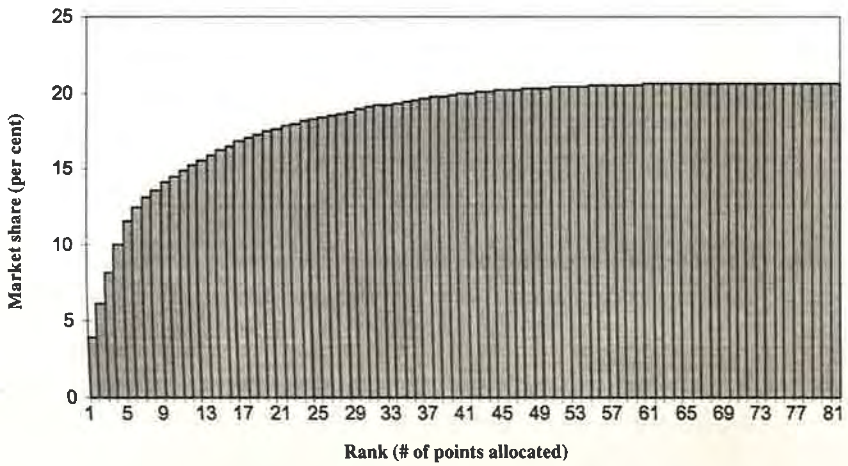

Figure 1.8 Wave 2: cumulative market share of the transformed funds

Managers vs. Managed IPFs

The founders or managers of privatization funds established different numbers of funds. Obviously most of them founded only one IPF. However, multiple funds created by the same manager were not at all infrequent. Naturally, there were some extreme cases. For example, in the first wave Agrobanka Praha created 13 IPFs and, in the second wave, Harvard Capital and Consulting founded an unbelievable number of funds – 23 in total (see Tables 1.15 and 1.16 for details).

Table 1.15 Portfolio structure by number of IPFs: wave 1

No. of fund founders	*No. of IPFs*	*Average no. of firms in IPFs portfolio*	*Minimum no. of firms in IPFs portfolio*	*Maximum no. of firms in IPFs portfolio*
301	1	39.46	1	514
20	2	144.95	1	1,420
6	3	51.17	19	92
2	4	513.5	15	1,012
1	5	202	202	202
2	6	222	47	397
1	10	80	80	80
2	11	210	154	266
1	13	249	249	249

Table 1.16 Portfolio structure by number of IPFs: wave 2

No. of fund founders	*No. of IPFs*	*Average no. of firms in IPFs portfolio*	*Minimum no. of firms in IPFs portfolio*	*Maximum no. of firms in IPFs portfolio*
191	1	70.15	1	854
29	2	44.72	2	202
11	3	98.72	18	680
4	5	66.75	17	107
1	7	54	54	54
1	17	65	65	65
1	23	13	13	13

As suggested before, the number of founders that created the numerous funds was rather low in both the first and second waves. In the first wave, 301 companies founded only one fund each. The portfolios of these funds consisted of 40 firms on average. In one extreme case, a portfolio consisted of only one firm, when an IPF was created for the sole purpose of buying a stake in a company to be founded and eventually privatized. At the other end of the spectrum, one portfolio consisted of over 514 firms. This excessive diversification was most likely the result of legislation, which limited a single fund within a company to a maximum 20% share of ownership. The huge number of points entrusted to the founder, Česká státní spořitelna, had to be spread among an inordinate number of companies, which in reality precluded any reasonable model of corporate governance. Naturally, all funds that encompassed such extensive portfolios happily reduced them later on because they encountered difficulties stemming from minority position problems and the inability to effect active corporate governance. Table 1.16, which presents the results of the second wave, offers a similar picture and suggests parallel conclusions.

Results of the Survey of Czech Investment Funds

As we needed to have a clear picture of the size, means and results of trading, together with the focus of the individual investment funds active in the Czech Republic, we sent questionnaires out to their managers. The questions therein were based on a survey used by our Slovenian partners, although some of them were modified to reflect the situation in the Czech Republic. The questions fall into five major groups:

- questions relating to the asset portfolio of the fund;
- questions relating to portfolio trading;
- questions relating to the fund's investment policy and to the supervision of investment companies;
- questions relating to the supervision of privatization funds; and
- questions relating to the investment company.

We are sorry to say that the response rate was very low. Out of more than 150 funds whose managers were asked to fill in our questionnaires, we received only 16 responses. Although this number may seem very low indeed, we still think valuable information about the investment funds sector of the Czech Republic can be retrieved from the data we have.

Individual investment funds can obviously be very different, particularly in terms of the amount of assets under control. It is, in our opinion, desirable to divide the investment funds into two distinct groups according to the amount of assets they manage. The first group, say, of small funds (12 in our sample), includes funds with a net asset value (NAV) below CZK 1 billion, and the big funds group (4 in our sample) consists of the funds with a NAV exceeding this value. The choice of this benchmark is a result of our subjective opinion based

on the situation in the market. We are convinced that it is appropriate to analyze the characteristics of the small and the big funds separately, as there are some significant differences between these two groups.

Assets and Portfolio

Assets managed by the investment funds

The average net asset value managed by the small funds is CZK 135.710 million. The average book value for this group is CZK 146.903 million. The value of assets managed by small funds has, therefore, decreased on average since the end of voucher privatization. Only one fund out of twelve exhibits an increase in the value of assets (this increase amounts to 16.8%).

The average net asset value managed by the big funds is CZK 5,024.255 million. The average book value for this group is CZK 5,059.047 million. Hence, the value of assets under the management of big funds has on average stayed at the same level since the end of voucher privatization. Two of the big funds showed increases in the value of their assets, one of them being only minor, but the other revealed an increase of 32.4%.

Portfolio

Figure 1.9 shows that on average, the small funds invested 76.3% of their portfolio in shares (ranging from 65.2% to 88.5%).[7] The average investment in bonds was 7.9% (ranging from 0% to 18%). The average investment made by the small funds in receivables was 4.9% (ranging from 0% to 22%). The average investment in other assets was 10.9% (ranging from 0% to 30%).

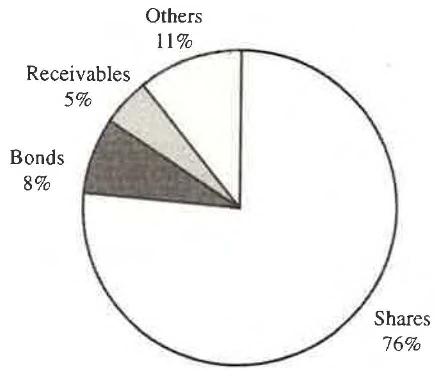

Figure 1.9 Assets in portfolio – small IPFs

The situation in the big funds group is relatively similar (see Figure 1.10). On average, the big funds invested 66.5% of their portfolio in shares (ranging from 48% to 85%). Bonds represent 13.75% (ranging from 0% to 45%) of their portfolio, receivables 6% (ranging from 0% to 18%), and other assets 13.75% (ranging from 7% to 30%). The only distinction worth noting is probably a higher proportional investment in bonds by the big IPFs. As bonds are a more complex instrument to understand (for example, they have higher sensitivity to macro-economic indicators such as interest rates), a comparison among the representative group of big investment funds may offer an explanation.

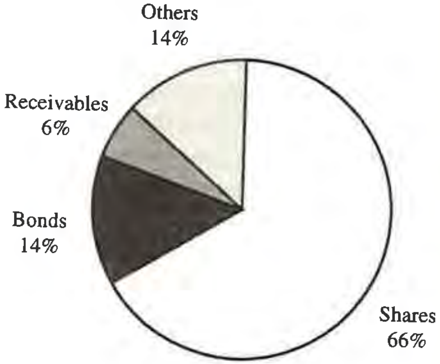

Figure 1.10 Assets in portfolio – big IPFs

Number of Companies Invested in by IPFs

The small privatization investment funds invested, on average, in 41.6 companies (ranging from 15 to 67) whereas the big investment funds invested, on average, in 82.25 companies (ranging from 50 to 113).

On average, small investment funds are co-owners of 35.3 companies they invested in. This number represents 85% of all the companies in the small investment funds portfolio. In the case of the big investment funds, the average number of companies where they share ownership with other investment funds is 82.25. This number represents 100% of the companies in their portfolio.

It is interesting that the average number of companies where the small investment funds are majority owners is zero. The big investment funds hold a majority in companies, on average, in 21.75 cases, or 26.44% of all the companies in their portfolio.

Structural Composition of Investment Fund Portfolios

The portfolio of small investment funds consists, in terms of NAV, of an average 65.3% (ranging from 40% to 93%) of mining, manufacturing industry and construction, 5.5% (ranging from 0% to 15%) of trade and the travel industry,

21.2% (7% to 44%) of financial services and 8% (0% to 31%) of others. The situation is illustrated by Figure 1.11.

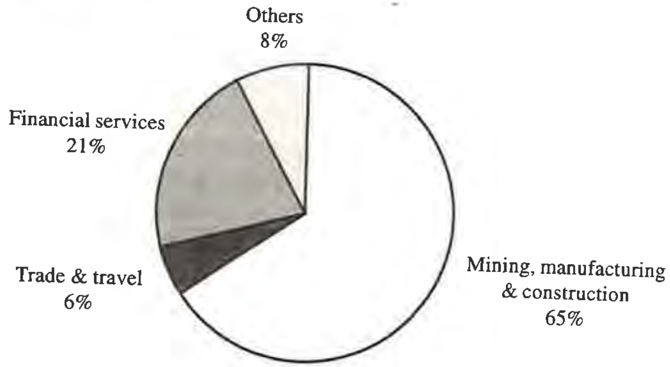

Figure 1.11 Assets by sector – small IPFs

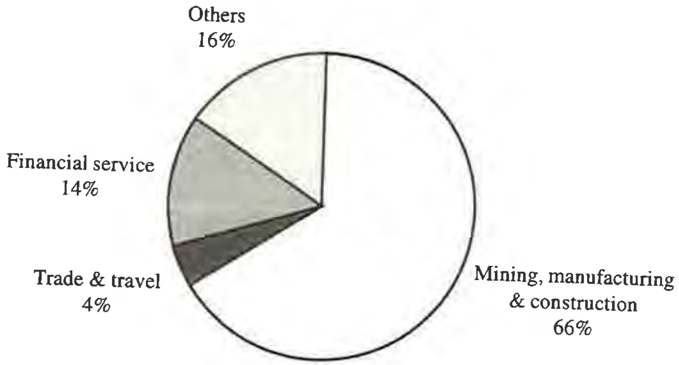

Figure 1.12 Assets by sector – big IPFs

The portfolio of big investment funds consists on average of 65.9% (ranging from 52.93% to 76.71%) of mining, manufacturing industry and construction, 4.3% (ranging from 2.30% to 7.51%) of trade and the travel industry, 14.1% (11.63% to 17.85%) of financial services and 15.7% (8.76% to 22.27%) of others (see Figure 1.12).

The only significant distinction between the portfolios of the small and big IPFs in terms of structural composition is the higher proportion of financial services securities in the big funds' portfolios. The only suggestion we can give the reader, by way of interpretation of this, is to point out that the four big investment funds originated in the financial sector.

Portfolio Trading

The small investment funds reduced their share in the companies in their portfolio on average 28.9 times (from 10 to 81 times). The average total value of these transactions was CZK 76.7 million, i.e., CZK 2.65 million per transaction. The small funds, on the other hand, increased their share in the companies on average 23.5 times (from 2 to 115 times). The average total value of these transactions was CZK 70.2 million, i.e., CZK 2.99 million per transaction.

The big investment funds decreased their share in the companies in their portfolio on average 71.25 times (from 22 to 163 times). The average total value of these transactions was CZK 3,037.5 million, i.e., CZK 42.63 million per transaction. The big funds, on the other hand, increased their share in the companies on average 21.5 times (18 to 25 times). The average total value of these transactions was CZK 2,070 million, i.e., CZK 96.28 million per transaction.

Investment Policy and the Supervision of Companies

All of the small funds view portfolio diversification as their major investment policy. Only two out of twelve small funds also include ownership concentration in their investment policy. Hence, not surprisingly, most funds (10 of 12) rely on a more passive market strategy based on selling shares according to market conditions. Only two funds implement an active policy based on their 'voice', i.e., enforcement of their interests. These are the same two funds, which include ownership concentration in their 'strategic package'.

The above data may offer an explanation for the very low average number of investment fund members on the supervisory boards of the portfolio companies, 0.9 (from 0 to 4). It is quite logical that the two funds relying on their 'voice' have nominated the highest number of representatives, 3 and 4, respectively. The average number of cases where the investment funds initiated or cooperated with other funds in replacing management is also very low, 0.5 (0 to 2).

The prevailing investment policy of the big funds lies, on the other hand, in concentrating their share in the companies. All four big funds chose this option. All the big funds also indicated that the potential sale of the share and the 'voice' strategy are of equal importance. The big investment funds were much more successful in placing their representatives on the supervisory boards or boards of directors of the companies in their portfolio than the small funds. On average, they nominated their representatives on the supervisory board or the board of directors in 42 cases (from 32 to 52). The average number of cases where the big investment funds initiated or cooperated with other funds in replacing management is 5.75 (from 4 to 8). We may therefore conclude that the big investment funds are much more active in the process of controlling the companies and imposing pressure on the companies' management.

As far as the goals of the investment funds are concerned, the opinions of the small funds' managers were surprisingly in accord. They were asked to choose from seven options and they did so in the following way:

- 'Value maximization through active portfolio trading and optimization' ranked first with an average rank of 1.08.
- 'Profit maximization through capital gains (interest rates and dividends)' took second place with an average rank of 2.0.
- 'Value maximization through active supervision of the companies (representation in the supervisory boards)' took third place with an average rank of 4.08.

Whereas the ranking of the above three options was quite clear, the ranking of the remaining four options – 'Value maximization through restructuring', 'Value maximization through investments (venture capital)', 'Support of progressive and successful management in selected companies', and 'Founding of a real estate investment fund' – was different from fund to fund.

The ranking of the options by the big investment funds was quite similar to the ranking by the small investment funds. 'Value maximization through active portfolio trading and optimization' and 'Profit maximization through capital gains (interest rates and dividends)' were placed first and second, respectively. The only difference between the opinions of the small and the big fund managers appeared at the third place where 'Value maximization through restructuring' replaced 'Value maximization through active supervision over the companies (representation in the supervisory boards'. This is a rather paradoxical result given the rate of representation in the supervisory boards discussed above.

None of the small fund managers surveyed viewed any of the above listed seven goals as contradicting the goals of the fund. In the case of the big funds, one of the four managers considered some of the seven options contradictory to his or her fund's goals.

None of the surveyed funds, neither big nor small, invests only locally. All the funds invest throughout the Czech Republic.

The managers of the investment funds were asked for their opinions on the ownership share of management, employees, and state in the companies they invested in. Tables 1.17 and 1.18 summarize their opinions.

Table 1.17 Co-owners welcome? – small investment funds' view

Opinion of the small investment fund managers on the ownership share of	*Management*	*Employees*	*State*
Positive	5	3	2
Negative	0	2	5
Indifferent	7	7	5
Not encountered	0	0	0

Table 1.18 Co-owners welcome? – big investment funds' view

Opinion of the big investment fund managers on the ownership share of	Management(1)	Employees	State(2)
Positive	4	0	0
Negative	4	4	4
Indifferent	0	0	1
Not encountered	0	0	0

Notes
(1) All the big fund managers chose 'positive' as well as 'negative' claiming that their approach is case-by-case.
(2) One manager chose 'negative' as well as 'indifferent'.

Supervision of Investment Privatization Funds

The funds were asked about the dividend policy they pursue. Eight of the twelve small fund managers opted for constant and regular dividend payments, three for constant and regular dividend payments plus extra dividends and only one for retained earnings. Half of the big funds (2 of the 4 respondents) pursue a policy of constant and regular dividend payments and the other two pursue a policy of constant and regular dividend payments plus extra dividends.

The other question concerned trading of the investment funds' shares. The shares of one small fund are already traded on the Prague Stock Exchange (PSE). The remaining eleven small funds managers think that the shares of their fund will never be traded on the PSE. Also none of them expressed an interest in publicly trading shares of the funds. All the big funds' shares are already on the Prague Stock Exchange.

Three managers of the small investment funds think that the amount of dividend payments affects the market price of investment fund shares. The remaining nine managers do not agree with this opinion. All of the small investment fund managers consider that the market price of the funds does not reflect their relative performance. In the opinion of the managers of the big investment funds, the amount of dividend payments does affect the market price of the fund. They also believe that the relative price of a fund's shares reflects the performance of the fund.

The average structure of the supervisory boards of the small funds is the following: one representative of the investment company, one representative of the shareholders of the fund, and one independent individual. It is interesting that the board of directors (BD) and the supervisory board (SB) of all the big funds consist only of independent individuals (both the BD and SB having three members).

The general shareholders' meeting of the small funds took place on average four times (from 3 to 7). In the case of the big investment funds, general

shareholders' meetings took place on average 6 times (from 3 to 7). The average representation of shareholders of the small fund is 22% (from 14% to 59%). All the supervisory boards of the small funds have changed during their existence. The average presence of the shareholders of the big funds (in terms of number of votes) at the shareholders' meeting was 41.25% (from 35% to 50%). All of the supervisory boards of the big funds have also changed during the course of their time with the funds.

In the opinion of 10 small fund managers, the investment company represents the interests of the fund shareholders. Two other managers do not share this opinion. In the opinion of all four big fund managers, the investment company does not represent the shareholders of the funds.

To end the management contract in the case of the small funds, 31% of shareholder votes are needed.[8] In the case of the big funds, 76.25% (from 75% to 80%) of shareholder votes are needed to conclude the management contract with the investment company.

The Investment Company

The owners of the investment companies managing the small investment funds are mostly individuals and privatization companies. One hundred per cent of the investment companies who responded to our questionnaire are owned by financial institutions.

The compensation of the managers of the investment companies managing the small funds can be broken down in the following way: fixed (9), a percentage of the net profits of the fund (2), or a percentage of net profits of the investment company (1). The salaries and bonuses of the managers of the investment company are fixed plus a percentage of the portion by which the company exceeds expected results.

In the case of the small funds, the length of management contracts is either not determined (8), or averages at 3 years and 5 months in the remaining four cases. The average contract length for the big fund managers is 5 years and 3 months (from 3 years and 7 months to 5 years 10 months).

CONCLUSIONS

The extent of mass privatization undertaken in Czechoslovakia is globally unprecedented. As a result, it is impossible to evaluate the process and its outcome comparatively. Nevertheless, it is indisputable that the Czechs and Slovaks have proved that a program involving the large-scale transfer of ownership of this kind is feasible and can be carried out within a relatively short period of time.

There is no doubt that the process suffered from certain shortcomings. The legislative framework for mass privatization, especially for the voucher component, was too vague. Most of the laws spelled out general principles, relegating details to government decrees and *ad hoc* administrative decisions. This over-endowed the governments with discretionary power, which led to abuse. Voucher privatization also turned out to be difficult to organize. One of the important advantages the Czechoslovak authorities anticipated when the method was accepted, was that this method could turn the difficult decision process of 'who to sell to' into an easier approval process of 'whether to privatize this enterprise or not'. However, as soon as the method started to compete with and be combined with other standard methods, this expected advantage disappeared. The result was a complicated process that led to corruption. On the other hand, one may argue that using the voucher method as a single privatization tool would have been too risky and that the benefits of diversification more than outweighed the complications brought about by the use of a combination of methods.

There has indeed been a turbulent evolution in the investment privatization fund sector since July 1996 when rigorous regulation came into effect. A number of investment privatization funds were spontaneously converted into non-regulated holding companies, leading to sharp declines in their share prices and causing several disputes. Later on, this sort of conversion became possible only by buying out minority shareholders at the NAV. With the introduction of stricter supervision of capital markets in late 1996 and early 1997, forced administration was imposed on several funds and licenses were withdrawn from several others.

Issues of governance of IPFs are discussed in detail and supported by various data. The data come from two sources. The first source is the statistical data from the Ministry of Finance that have just been released for the first time and we have thus presented the first work on Czech investment privatization funds underscored by reliable statistical evidence. The second source consists of responses to questionnaires distributed to the managers of numerous IPFs. Unfortunately, the situation was not conducive to this type of research and management companies were reluctant to take part in our survey. The response rate was only about 10% and can be viewed as an almost complete failure. Nevertheless, there is still a certain amount of valuable information to be retrieved from the data.

Concerning the performance of the individual IPFs as asset managers, the big IPFs seem to have outperformed the small IPFs – the value of assets under small fund management has decreased on average while the value of assets under the big fund management has on average stayed at the same level since the end of voucher privatization. This fact may be attributed to better information being available to the big fund managers, as well as to their superior qualifications since they often have significant experience from the financial sector.

There is quite a difference between big and small Czech IPFs. While the small funds do combine their assets with other investment funds in order to control a majority share in any company, the big investment funds, together with other IPFs, control over 26% of the companies in their portfolio. This is partly due to the amount of assets. The big IPFs manage sufficient assets so that their stakes in some companies remain significant in spite of their dilution due to portfolio diversification. However, it remains a mystery as to why the investment choices made by small IPFs and big IPFs were so different that the two groups did not 'meet' in any company where the IPFs hold a majority share.

Given the size of the stakes in the companies, the strategy of the individual funds differs between the two groups of IPFs. The small IPFs are generally only involved in trading their stakes in an effort to optimize their portfolio, without any significant interest in controlling the companies. The big investment funds, on the other hand, are much more proactive when it comes to controlling companies and imposing pressure on their management. The slow pace of restructuring in the Czech economy, however, suggests that the level of exercising ownership rights by owners in general, and the IPFs in particular, in Czech companies is quite poor. We hope that in the years to come there will be a significant shift in the big IPFs' strategy away from speculative trading towards active supervision and control over the companies in their portfolio.

The comprehensive results of the study corroborate the positive role of the investment privatization funds during privatization but simultaneously highlight the fact that the institutional and legislative set-up is still far from optimum.

NOTES

1. CSK stands for the Czechoslovak crown (koruna).
2. The 'Lists of Enterprises' were published in *Tydenik Hospodarskych novin* 31, 32, 37, 39 and 40/1991.
3. The Ministry of Privatization of the Czech Republic issued an obligatory plot of the privatization project (government by-law 324/1991), which specified the content and form of the projects in detail. A similar document was issued in Slovakia (*Tydenik Hospodarskych novin* 38/1991).
4. Public notice on the Prices of Immovables was issued by the Ministry of Finance of the Czech Republic on September 5, 1991 (published in *Hospodarske noviny*, September 13, 1991). This regulation increased official prices to a multiple of their former level.
5. For enterprises undergoing voucher privatization there was a strict deadline: the end of April, so that voucher privatization could start at the beginning of May.
6. The fund bears such an enigmatic name because its founder holds an MBA degree from Harvard University.
7. One investment fund did not supply these data.
8. Only two fund managers answered this question.