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# Firm or Private Value: What is Behind the Creation of Multiple Blockholder Structure?

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# Contents

# Summary

The aim of the paper is to delve beyond the mere institutional explanation of the observed ownership dynamics and check whether there are also firm-specific or industry-specific factors that have been driving the transfer of ownership rights in the post-privatisation period. Our empirical analysis focuses on Slovenian firms but provides conclusions that, in our view, can be easily extended to other firms undergoing privatisation. We find that the post-privatization ownership changes in Slovenia can largely be described as a control contest. A battle for power is taking places between inside and outside owners as well as within the outside owners, in particular those with a heterogeneous identity. Firm- and industry-specific factors seem to have some, albeit limited, impact only in listed firms. How then does this influence firm performance? Is this competition for power determined by the lack of investors' protection and thus their desire to gain the possibility to control the management on behalf of other shareholders? Or is this competition for power mainly driven by the owners' desire to extract private benefits? In order to answer this question, in the second step we analyse the impact of the observed ownership trend on firm performance. In non-listed firms, an increase in the relative power of the largest blockholder is on average beneficial to firm performance, regardless of the homogeneity of the largest two owners. In listed firms, lower control contestability is only beneficial when the two largest owners are homogeneous. However, listed firms in which the two largest blockholders have the same identity generally perform worse. Rather than indicating the effects related to decision-making within the owners' coalition, these detrimental effects find a stronger explanation in the identity of the largest blockholders: the rent-seeking behaviour of the investment funds that were artificially created during privatisation. The results also provide empirical evidence to support theoretical predictions regarding the evolution of the ownership structure (Zwiebel, 1995; Bebchuk and Roe, 1999) and the basis for policy recommendations that should be of interest to all countries dealing with privatisation issues.

**Key words**: Slovenia, corporate governance, ownership, privatisation, panel data

# Povzetek

Namen prispevka je dopolniti institucionalno razlago dinamike lastništva podjetij in ugotoviti, ali obstajajo znotraj posameznih podjetij in panog tudi specifični dejavniki, ki vplivajo na lastninsko preoblikovanje slovenskih podjetij v poprivatizacijskem obdobju. Empirična analiza je omejena na slovenska podjetja, vendar je ugotovitve mogoče razširiti tudi na druga podjetja v procesu privatizacije. Rezultati kažejo, da lahko poprivatizacijske spremembe v lastniški strukturi slovenskega gospodarstva v veliki meri označimo kot tekmovanje med delničarji za prevlado v podjetju. Boj za premoč poteka med notranjimi in zunanjimi lastniki ter med zunanjimi lastniki, zlasti tistimi s heterogenimi interesi. Videti je, da dejavniki, ki so specifični za posamezno podjetje ali panogo, v določeni meri vplivajo le na podjetja, ki kotirajo na borzi. Kako torej ti dejavniki vplivajo na poslovanje podjetij? Ali je tekmovanje za vodilni položaj pogojeno s premajhno zaščito vlagateljev in posledično željo posameznih delničarjev po prevzemu nadzora nad upravo v imenu vseh delničarjev? Oziroma, ali je boj za prevlado rezultat predvsem želja posameznih delničarjev po pridobivanju zasebnih koristi kontrole? Odgovor na to vprašanje skušamo podati v drugem koraku s pomočjo analize vpliva lastniških sprememb na poslovanje podjetij. V podjetjih, katerih delnice ne kotirajo na borzi, povečanje relativne moči največjega delničarja v povprečju ugodno vpliva na poslovanje podjetja, ne glede na homogenost največjih dveh lastnikov. V podjetjih, ki so uvrščena v borzno kotacijo, je prevladujoč vpliv največjega lastnika za podjetje koristen le v primeru, ko sta največja lastnika enaka (homogena). Vendar v splošnem javne družbe, katerih največja lastnika izhajata iz vrst istih interesnih skupin, poslujejo slabše. Ti škodljivi učinki niso toliko povezani s posledicami odločanja v koaliciji lastnikov, kot s samo identiteto največjih delničarjev: pojasnimo jih lahko s težnjo investicijskih skladov po pridobivanju oziroma ohranjanju rent in vpliva, pridobljenega v času privatizacije. Rezultati raziskave tudi empirično potrjujejo teoretične napovedi o različnih dejavnikih sprememb v lastniški strukturi (Zwiebel, 1995; Bebchuk in Roe, 1999) in predstavljajo osnovo za priporočila glede oblikovanja priporočil, ki so aktualna za vse države, ki se soočajo z vprašanji privatizacije.

**Ključne besede**: Slovenija, korporacijsko upravljanje, lastništvo, privatizacija, panelni podatki

# I. Introduction

The allocation of ownership and control[1] rights among shareholders is one of the main factors influencing firm governance and behaviour.[2] It determines the decision-making power among various firm shareholders and, as such, largely codetermines[3] the interactions between managers and shareholders, between shareholders and stakeholders and between individuals within the shareholder group itself. Accordingly, the ownership structure influences the functioning of the firm as an internal organisation, the choice of corporate goals and, consequently, the value of the firm (Pedersen and Thomsen, 1997). Given its importance for firm performance, there is a vast body of research documenting and analysing the differences in ownership concentration across countries and firms. The most recently recognised one is the importance of institutions in determining differences in the ownership structure. As argued by La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998), ownership concentration results from being a substitute for poor investor protection. The lower the investors' legal protection the higher the percentage of shares needed the shareholders to control the management and the resulting ownership concentration. Another important contribution to the institutional aspect of ownership dynamics was provided by Bebchuk and Roe (1999). They claimed that an efficient corporate structure is path-dependent and partly varies along with the initial structures with which the company started. On the other hand, the persistence of the initial ownership structure might result from the rent-seeking behaviour of the existing owners. The parties that participate in corporate control within the existing structure in fact have the power and incentive to impede changes that would reduce their private benefit of control even if change would be efficient (p.130).

***The allocation of ownership and control rights among shareholders is one of the main factors influencing firm governance and behaviour***

Recognition of the role of the 'institutional environment' on the evolution of the ownership structure and the impact of the latter on firm performance generally also underlines microeconomic reforms in transition. The separation from the state's direct (or indirect)[4] ownership should provide better management and control of a privatised firm, improve firms' financing by imposing hard budget constraints, provide the inflow of fresh capital to firms, promote restructuring and, consequently, improve firm performance. Privatisation was supported by changes to the legal environment, regulation and market structures which should provide additional mechanisms for ensuring better investor protection and sound corporate practices. It was expected that, notwithstanding the differences in the chosen privatisation model, the post-privatisation changes would lead to a better allocation of ownership rights (Coase, 1960). However, ownership has in fact been concentrating in most transition countries (Berglof and Pajuste, 2003). The observed concentration of control reflects inefficiencies in the institutional and business environments. In theory, however, the optimal level ownership concentration is firm - and industry-specific. The

[1] Dual-class shares, voting caps, pyramiding etc. are examples of mechanisms through which shareholders can obtain different voting rights for the same ownership share.

[2] The distribution of ownership among different shareholders shapes their incentives to make firm-specific investments (Rajan and Zingales, 1998), their voice in corporate affairs and the motivation to monitor the management (Shleifer and Vishny, 1998). It determines their ability to extract private value (Burkat et al., 2001*)* and to reduce risk by efficient trading and portfolio diversification (Holmstrom and Tirole, 1993; Demsetz and Lehn, 1985). Ownership concentration moreover influences the incentives of managers to undertake value-enhancing projects (Jensen and Meckling, 1976; Burkart et al., 1997).

[3] Ownership is only one of the mechanisms that determine the allocation of power within a firm. The access to critical resources (specialised human capital) may be a stronger source of power and a stronger incentive to make firm-specific investments than ownership (Rajan and Zingales,1998).

[4] Prior to privatisation, enterprises In Slovenia (and other countries of ex-Yugoslavia) were socially owned, which meant that society at large owned them although in practice government officials, managers and workers shared control. The state through socio-political institutions (the League of Communists) exercised a significant indirect influence as top managers and others involved in the decision-making process were actually members of the League and implemented party policies in the firms (Prasnikar et al., 2005).

***The differences in the level of concentration should reflect the differences in the benefits of shareholder monitoring and their potential for the expropriation of private value from holding control***

differences in the level of concentration across firms and industries should somehow reflect the differences in the benefits of shareholder monitoring and their potential for the expropriation of private value from holding control. Apart from the institutional features, the adjustment to ownership structures should thus also reflect the firms' or their owners' tendency to maximise the firm's value (shared benefits of control) or their private value (private benefits of control).

It is the aim of this paper to delve beyond the mere institutional explanation of the observed ownership dynamics and to check whether there are other firm-specific or industry-specific factors that have been driving the transfer of ownership rights in the post-privatisation period. Our empirical analysis focuses on Slovenian firms but provides conclusions that, in our view, can easily be extended to other firms undergoing privatisation. We rely on a unique sample of more than 500 non-financial firms whose shares are registered at the Central Securities Clearing Corporation in a five-year period (1999-2004) following the conclusion of the privatisation process.[5] Despite the compulsory distribution of the largest stakes at the very beginning of transition, the distribution and size of stakes and the owners' identity today varies across the firms. These differences imply that not all privatised firms have been approaching the model of one large shareholder as in other transition economies. There is a large sample of firms that have a multiple blockholder structure with no controlling shareholder. The substantial dynamics of the ownership of Slovenian firms,[6] moving from exogenous to firm-specific, and precise data on the ownership stakes and owners' identity allow us to identify those factors leading to different levels of control concentration. In the first step, the analysis of these changes allows us to make some evaluations of their optimality. Do the owners adjust their ownership participation according to firm-specific or industry-specific characteristics? Is the increase of power driven by a mere competition for control, regardless of its impact on firm value? Do these changes still somehow reflect the characteristics of the chosen privatisation model?

***We find that the post-privatisation ownership changes in Slovenia can largely be described as a control contest***

We find that the post-privatisation ownership changes in Slovenia can largely be described as a control contest. A battle for power is taking place between inside and outside owners as well as within the outside owners, in particular those a with heterogeneous identity. Firm- and industry-specific factors seem to have some, albeit limited, impact only on listed firms. How then does this influence firm performance? Is this competition for power determined by the lack of investors' protection and thus their desire to gain the possibility to control the management on behalf of other shareholders? Or is this competition for power mainly driven by the owners' desire to extract private benefits? In order to answer this question, in the second step we analyse the impact of the observed ownership trend on firm performance. In non-listed firms, the increase in the relative power of the largest blockholder is on average beneficial for firm performance regardless of the homogeneity of the two largest owners. In listed firms, lower control contestability is only beneficial when the two largest owners are homogeneous. However, listed firms in which the two largest blockholders have the same identity generally perform worse. Rather than indicating the effects related to decision-making within the owners' coalition, these detrimental effects find a stronger explanation in the identity of the largest blockholders: the rent-seeking behaviour of the investment funds that were artificially created during privatisation. The results also provide empirical

[5] The Agency for Restructuring and Privatisation approved the first privatisation programme in July 1993 and gave its last authorisation at the end of October 1998. In these six years, more than 1,300 companies successfully completed their ownership transformation and were entered in the Court Register.

[6] The total number of shareholders in these firms declined from 931 to 662, while the largest shareholders increased their voting share by more than 14 percentage points on average (from 38.58% at the end of 1999 to 52.03% at the end of 2004).

evidence to support theoretical predictions of the evolution of the ownership structure (Zwiebel, 1995; Bebchuk and Roe, 1999) and the basis for policy recommendations that should be of interest for all countries dealing with privatisation issues.

The paper is structured as follows. The main theoretical and empirical assumptions that form the basis of our hypotheses are presented in the next section. The empirical analysis constitutes the third section. The fourth section closes with an extensive discussion and some legal implications.

# II. Ownership dynamics: ownership concentration, sharing control and the impact on firm performance

***The privatisation process brought firms several institutional owners, along with the dissemination of shares among inside owners and the general public***

While there is a range of theoretical models discussing the various reasons for the emergence and existence of shareholder blocks in firms, blockholders in Slovenia emerged exogenously. The privatisation process[7] brought firms several institutional owners, along with the dissemination of shares among inside owners[8] and the general public. Rather than having the perspective of the impact of such a structure on firm value in mind, the creation of multiple blocks was due to a political decision assigning significant but non-controlling stakes to artificially created institutions: the state-controlled funds (KAD, SOD) and the privatisation investment funds (PIFs). This relative 'balance' of power initially characterised all the firms undergoing privatisation, irrespective of their eventual listing on the Stock Exchange. With their relatively dispersed ownership structure, Slovenian firms somehow 'stood out' against the group of Central and Eastern European countries (CEECs). Moreover, significant percentages of shares were assigned to inside owners that potentially constitute a strong inside coalition. As shown by Pagano and Volpin (2002), if the private benefits of control are high and management owns small equity stakes[9] managers and employees might act as natural allies and 'protect' each other's interests at the cost of non-controlling shareholders.

***We first want to analyse whether these changes are driven by a concern for value maximisation***

We start with the assumption that, in terms of ownership concentration, the initial allocation of ownership rights in Slovenian firms was prevalently exogenous and thus mostly inefficient. The allocation of the largest stakes to institutional owners was in fact compulsory and did not vary across firms. We believe that, despite the eventual institutional obstacles[10], the post-privatisation ownership changes should lead towards a more effective allocation of firm ownership and control. In this regard, we first want to analyse whether these changes are driven by a concern for value maximisation. To put it differently, we first want to see whether the observed changes reflect the following firm-specific fundamentals. The ownership concentration should be lower in larger firms since purchasing the same percentage of ownership in a large company costs more than doing the same in a smaller firm. This inverse relationship between firm size and ownership concentration is consistent with stockholders' utility-maximising behaviour, in particular when stockholders are risk-averse (see Demsetz and Lehn, 1985). The efficient allocation of risk-bearing should also imply more dispersed ownership in firms that operate in high-risk environments (Fama, 1980; Bolton and Von Thaden, 1998). A risky environment moreover requires greater flexibility in decision-making and thus higher managerial discretion and initiative. This implies a lower concentration of ownership (Burkart et al., 1997). The owners might be less inclined to concentrate in the presence of

[7] The 1992 Slovenian Privatisation Law allocated 20 percent of firm shares to insiders (employees, former employees and their relatives), 20 percent of shares to the Slovenian Development Fund that auctioned the shares off the Privatisation Investment Funds - PIFs, 10 percent to each of the state-controlled funds (Capital of Pension Fund - KAP and Restitution Fund - SOD). In addition, the workers' council of each enterprise was empowered to allocate the remaining 40 percent of shares for sales to insiders or outsiders (through a public tender). Based on the decision on the allocation of this remaining 40% of shares, firms can be classified as being privatised to insiders (internal method) or outsiders (external method). Among the 1,300 privatised firms, more than 90 percent chose internal distribution and buy-out as one of the privatisation methods.

[8] Inside owners consist of firm employees (including managers), former employees and their relatives.

[9] At the end of privatisation, managers (within the group of inside owners) on average held between 4 and 7 percent of the capital in non-listed firms; the percentage of shares in firms listed on the capital market is significantly lower (1.45 percent).

[10] Such as limitations on share transfers through companies' Articles of Association, obstacles to share transfers created by the existing institutional owners etc.

other disciplining mechanisms such as pressures from product markets or a listing on the stock exchange. In this regard, high growth opportunities in non-listed firms could signal prospects of going public in the near future and hence result in a lower concentration of ownership (Bloch and Hege, 2001). Further, the level of ownership concentration is related to the control potential, namely the profit potential associated with more effective shareholder control (Demsetz and Lehn, 1985). Shared benefits of control are higher in firms with a higher level of intangible assets that are difficult to monitor and increase the scope for managerial spending (Boszcuk-Ersoy and Lasfer, 2000). Exercising control might be more beneficial and thus the concentration of control higher when there is a high level of instability in the firm's environment. Higher ownership concentration might also result from capital needs related to excessive leverage, new investments in firm growth (Mygind et al., 2006 ).

Second, we want to test whether the observed concentration can be associated with an alternative explanation of the existence of share blocks in the world, namely the private benefits of control (Zwiebel, 1995). By holding substantial ownership stakes, shareholders also get the opportunity to extract some benefits that are not shared with other shareholders. These benefits might take the form of synergies obtainable through mergers, favours conferred by a firm, access to inside information, perquisites of control, utility derived from the power of control[11] etc. The existence of these benefits is in fact believed to be one of the main reasons for the existence of large blocks in the world and we expect the post-privatisation adjustments to reflect the shareholders' contest for control benefits. The access of a shareholder to these benefits is determined by its relative power, namely the importance of its block in forming controlling coalitions. A single shareholder can hence either concentrate its voting power above the point where it becomes unchallengeable by other shareholders[12] or, when the benefits are dividable, by forming controlling coalitions that can divide these benefits (Zwiebel, 1995). These claims find confirmation in the empirical evidence. Most firms listed on stock markets in Continental Europe have one dominant or controlling owner, while the rest of their shares are dispersed or divided into significantly smaller blocks (Becht and Barca, 2001)). However, there is a large number of firms off the market[13] that are characterised by the presence of two or three significant blockholders that co-exist to share monitoring and the benefits of control.[14] The decision-making in these firms is realised through a coalition of multiple shareholders, each of which holds less than a controlling share but at the same time, when taken together, their fraction is large enough to control the company (Gutierezz and Tribo, 2004).

***Second, we want to test whether the observed concentration can be associated with an alternative explanation of the existence of share blocks in the world, namely the private benefits of control***

We expect the control contest to be less strong in those firms where the existing multiple blockholders obtain control by forming coalitions with other owners. First, significant non-controlling blocks are more likely to co-exist in closely-held firms since the limitations on share transferability increase the stability of the coalition. Second, multiple blockholders are more willing to join a coalition when their respective ownership stakes do not differ much in size. Third, shareholder coalitions are more common in firms with large financing requirements, with investment opportunities that are difficult for the outsiders to evaluate (Gomes and Novaes, 2005). We

***We expect the control contest to be less strong in those firms where the existing multiple blockholders obtain control by forming coalitions with other owners***

[11] Zwiebel (1995): 162, 1995.

[12] The largest shareholder is unchallengeable when he holds the majority of voting rights or, even when not a majority, his block largely exceeds the block of other owners.

[13] Among these, closely-held firms with limited or no transferability of shares in particular.

[14] For example, for a sample of 136 Finnish firms over 8-year period Maury and Pajuste (2005 find a single large blockholder in about 52% of firm-year observations. Two large blockholders are present in 31.7% of the observations, while only 16.3% of all cases have three large blockholders. For a sample of closely-held Spanish firms, Gutierrez and Tribo (2004) report that in 17% of cases the largest controlling block is accompanied by a significant second block.

***We further assume that the efficiency of sharing control depends on the structure of the coalition***

further assume that the efficiency of sharing control depends on the structure of the coalition. Here we rely on the work of Hansmann (1996). As he showed, homogeneous owners have similar interests and incentives. This homogeneity in our view potentially reduces the 'disagreement effect' in ex-post coalition bargaining and hence improves the efficiency of the coalition. Gomes and Novaes (2005) similarly claim that large blockholders are prone to share control with owners that have common backgrounds. Thus, the likelihood of coalitions co-existing should depend on the level of homogeneity in the identity of the multiple outsider blockholders.

With regard to the control contestability, the incentives for strengthening control might depend on the relative position of the outside owners towards the inside owners. The latter emerged as the outcome of the Slovenian privatisation process and most often provide hidden support to firm managers. The managers might use the support of these inside owners to participate in the control game (Zwiebel, 1995). This should then increase the outside shareholders' incentives for concentration so as to override the management. We expect this collusion to be less likely in those firms that have been reducing employment levels over the analysed period since in these firms the managers are less likely to enjoy employee support. On the other hand, inside owners might collude with managers to block changes to the corporate ownership and hence reduce the speed of ownership concentration. As argued by Bebchuk and Roe (1999), initial structures might persist since those players that enjoy rents under them (inside owners in our case) might have the incentive and power to impede changes in these structures.

We further control for the absolute size of the largest owner's share. As shown by Zwiebel (1995), there will be a threshold size beyond which large investors will not be challenged. While approaching this 'ultimate' threshold, the owners should have the incentive to concentrate their power. The question is which other legally-determined thresholds (besides the 'ultimate' one) are important for shareholder power.[15] Since all the main decisions require a 75% majority of the votes cast, we expect the incentives for further concentration to be lower in cases where the incumbents already hold the majority of voting rights out of the total votes cast at the shareholders' assembly.

***Finally, we seek to "evaluate" the impact of the observed changes from the perspective of firm value***

Finally, we seek to 'evaluate' the impact of the observed changes from the perspective of firm value. Is the observed competition for control only driven by investors' need to expropriate corporate funds on their own behalf? Or is this investors' need to gain a stronger position in firms driven by the aim to provide better monitoring and hence higher firm value? The concentration of control in the hands of a single owner provides companies with a blockholder willing to monitor the firm's manager. Minority investors consequently free ride on the blockholders' efforts' and share in the benefits. In corporate governance theory, these benefits are referred to as the 'shared' benefits of control. However, in the absence of efficient minority investors' protection controlling shareholders might make decisions for their own benefit and at the expense of the minority shareholders. In the literature, these positive effects of being in control and the possibility of the shareholders enjoying some value without sharing it among all the shareholders are referred to as the private benefits of control. Several theoretical models discuss the efficiency of the presence of multiple large blockholders with regard to their role in limiting the extraction of corporate resources by the largest owner. Additional blockholders

[15] On average, 72.5% of votes are cast at the Shareholders' General Meetings in Slovenian firms. In order to obtain this data we followed participation at the shareholders' general meeting in 35 selected Slovenian firms in July 2001.

may provide monitoring over the largest shareholder and hence reduce the diversion of the firm's profits. Ex-post bargaining among members of the controlling group could in fact prevent business decisions that are in the collective interest of the controlling group but which harm a minority investor. The existence of multiple non-controlling blocks might also be the result of the blockholders' commitment not to over monitor, providing sufficient discretion and incentives of corporate managers (Pagano and Roel, 1998). However, providing for an additional monitor has no role if the controlling owner (entrepreneur) can pay-off other large blockholders and enforce them to enter into collusive agreements in order to expropriate the private benefits of control. This might explain the existence of many closely-held firms with a few large investors and no incentive to go public. The efficiency of the additional blockholders moreover depends on the composition of the controlling coalition, namely the relative size of the ownership block (Leaven and Levin, *2004)*, the identity (Maury and Pajuste, 2004), the number of coalition members (Gutierez and Tribo, 2004) and heterogeneity in monitoring costs and owner competencies in defining corporate strategies (Bloch and Hege, 2001). In respect of the latter, the theoretical models refer to two different but related effects: the coalition formation effect and the coalition alignment effect. The former relates to shareholder equilibrium behaviour at the time of constituting the coalition, leading to the formation of a coalition of shareholders that (altogether) control the minimal percentage of voting rights necessary to control the firm. The latter effect refers to the impact of the coalition on firm value once the coalition is constituted. The greater the percentage of shares owned by the coalition, the more the coalition members will internalise the cost of dilution and the lower will be the extraction of the private benefits of control (Bennedsen and Wolfenson, 2000). There is, however, an additional detrimental effect related to large coalitions. Ex-post bargaining among the coalition members may lead to the loss of profitable projects due to the disagreement of one (or more) blockholders in the coalition. If the disagreement effect and/or desire to collude (rather than monitor) so as to extract private benefits prevails, coalitions harm rather than benefit the minority shareholders.

***Ex-post bargaining among the coalition members may lead to the loss of profitable projects due to the disagreement of one (or more) blockholders in the coalition***

# III. Empirical analysis

## 1. Data

***The econometric analysis relies on a rich data set of firms with dematerialised securities and consequently ownership over the 1998-2004 period***

The econometric analysis relies on a rich data set of firms with dematerialised securities and consequently ownership changes recorded by the Central Securities Clearing Corporation over the 1998-2004 period. There are around 900 issuers of shares (the number refers to end of 2004) registered in the Central Registry of the Central Securities Clearing Corporation.[16] Financial and other data are obtained from the Agency of the Republic of Slovenia for Public Legal Records and Related Services. Regression models are reported separately for listed and non-listed firms. Several explanations apply to this distinction. First, theoretical and empirical evidence document that the sharing of power is more common in an environment with lower investor protection or in the case of institutional or other obstacles that make the exchange of blocks more difficult and thus ensures the greater stability of shareholder coalitions. These conditions are more likely to characterise the trading of shares, if any, in closely-held firms. Second, Pagano and Roe (1998) argued that listing is an alternative to the distribution of ownership among a few private investors. Third, having more large blocks in listed firms reduces the liquidity of firm stock but contributes nothing to monitoring and is thus more likely to be detrimental to these firms (Bolton and Von Thadden, 1998).

***The Slovenian post-privatisation period has been characterised by an increasing concentration of ownership and control***

The Slovenian post-privatisation period has been characterised by an increasing concentration of ownership and control (also see *Table 1* below). The evolution of ownership differs across firms. There is a group of firms (20%) that are today owned by one significant blockholder, which in 90% of cases holds the majority of voting rights. Due to the chosen privatisation model, on the other hand, the importance of the multiple blockholder structure is still stronger than that reported by other empirical studies. The majority of firms in our sample (52%) have two or more shareholders with none of them holding the majority of ownership rights. The remaining (29.6%) of firms have both the largest controlling and additional non-controlling blocks. The percentage of such firms has been increasing over the last few years (from 17% in 1999). In terms of the investors' identity, the largest block transfer is mainly from the privatisation investment funds towards domestic non-financial firms (see *Table 2*). Descriptive statistics for the size of the largest blocks and the identity of their owners are presented separately for listed and non-listed firms in Table 1.

***The dependent variable is the first difference of the percentage share of the largest shareholder in firm i in time t, i.e.***

We analyse the determinants of the ownership dynamics (***REGRESSION 1***) by regressing the increase in the size of the largest stake to a number of explanatory variables. The dependent variable is hence the first difference of the percentage share of the largest shareholder in firm *i* in time *t*, i.e. a change in variable *C1* between periods *t* and *t-1*. Firm-specific and industry-specific characteristics are captured by several variables. The variable *DEX* is an export dummy indicating whether a firm is an exporter or not, *LEVERAGE* is the relationship between a single firms' capital-to-debt ratio and the median industry capital-to-debt ratio. The *SAL_MS* variable indicates the firm's market share (in the total of industry sales) and captures the effect of product market competition. On the other hand, firms

[16] According to the Dematerialised Securities Act (Official Gazette of the Republic of Slovenia, No. 23, 1999) */ni v literaturi/* all issuers of serial securities whose firms' sale was carried out by a public offering pursuant to the Securities Market Act are required to issue dematerialised securities. Moreover, all issuers of shares issued on the basis of the Slovenian Privatisation Law, whose ownership transformation included a public sale as one of the forms of privatisation or who had more than 50 shareholders that are share subscribers, should issue shares in a dematerialised form (Article 96, Dematerialised Securities Act).

Table 1: **Percentage shares of the three (C1, C2 and C3) largest shareholders**[1]

| | | Listed | | | | Non-listed | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | **C1** | **C2** | **C3** | **sum** | **C1** | **C2** | **C3** | **sum** |
| **1999** | *mean* | **23.7** | 13.0 | 8.6 | 45.3 | **39.2** | 15.4 | 9.3 | 63.9 |
| | *n* | 69 | 69 | 69 | 69 | 388 | 388 | 388 | 388 |
| **2000** | *mean* | **24.5** | 12.7 | 8.5 | 45.7 | **40.2** | 15.6 | 8.7 | 64.5 |
| | *n* | 76 | 76 | 76 | 76 | 469 | 469 | 469 | 469 |
| **2001** | *mean* | **28.6** | 13.4 | 9.2 | 51.2 | **43.5** | 15.9 | 8.1 | 67.6 |
| | *n* | 80 | 80 | 80 | 80 | 476 | 476 | 476 | 476 |
| **2002** | *mean* | **23.5** | 13.4 | 9.0 | 54.8 | **46.8** | 15.5 | 8.1 | 70.3 |
| | *n* | 90 | 90 | 90 | 90 | 543 | 543 | 543 | 543 |
| **2003** | *mean* | **33.3** | 13.5 | 8.8 | 55.6 | **48.7** | 15.4 | 7.7 | 71.8 |
| | *n* | 88 | 88 | 88 | 88 | 527 | 527 | 527 | 527 |
| **2004** | *mean* | **36.9** | 12.5 | 8.2 | 57.6 | **52.2** | 14.9 | 7.4 | 74.5 |
| | *n* | 89 | 89 | 89 | 89 | 506 | 506 | 506 | 506 |

**Note**: The Slovenian organised market is divided into the official and semi-official markets. Within the former, there is a special group of securities that satisfy certain liquidity and qualitative criteria that are included in the prime market. The only difference between the official and semi-official markets is in the strength of the reporting requirements applying to both markets.

Table 2: **Percentage of firms with a given investor group as the largest blockholder**

| | Owners | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **IND** | **FOR** | **STATE** | **NF** | **BANKS** | **STATE FUNDS** | **PIFS** | **OTHERS** |
| **1999** | 6.7 | 2.6 | 8.3 | 24.5 | 1.9 | 9.8 | 36.9 | 9.6 |
| **2000** | 8.1 | 3.8 | 7.5 | 30.5 | 1.1 | 7.9 | 32.6 | 8.6 |
| **2001** | 9.0 | 4.2 | 6.3 | 37.6 | 2.7 | 6.1 | 25.4 | 8.7 |
| **2002** | 8.8 | 4.2 | 4.6 | 43.1 | 2.4 | 5.9 | 23.9 | 7.0 |
| **2003** | 11.6 | 5.1 | 4.4 | 43.3 | 2.7 | 5.7 | 19.7 | 7.6 |
| **2004** | 10.5 | 5.3 | 4.4 | 46.8 | 2.2 | 3.4 | 19.8 | 7.7 |

**Note**: IND stands for individuals, FOR for foreigners, STATE for the state as owners, NF for non-financial domestic firms, BANKS for banks and insurance firms, SFUNDS for state-controlled funds, and PIFs for privatisation investment funds.

with a higher market share are more visible and provide greater private value or amenities for their owners. Growth potential is measured by the median industry firm sales' growth (*GROWTHP*). We measure firm risk (*RISK*) as the ratio of the standard deviation of sales for firm *i* and the standard deviation of sales of the median firm in the two-digit industry. Standard deviation is measured through a four-year rolling window for the 1995-2004 period. For example, the standard deviation of sales for firm *i* in 1999 is calculated as the standard deviation of sales for this firm in the 1995-1998 period; the standard deviation of sales in 2000 is measured for the 1996-1999 period and so on until 2004 where the standard deviation of sales is calculated for the 2000-2003 period. We further control for firm size (*LNSALES*). The contestability of control is proxied by the size of the second largest block (*C2)*. We capture the outsider-insider contest by controlling for the percentage of shares owned by inside owners (*INSIDERS*). This variable was constructed as a residual variable from the sum of the total shares held by entities other than individuals (foreigners excluded). The probability of insiders' collusion with the management is measured through interactions with dummies for the reduction of employment (*DEMP*) and product market competition (*DEX*). We add controls for the different thresholds that make the power of the largest owner

***The contestability of control is proxied by the size of the second largest block. We capture the outsider-insider contest by controlling for the percentage of shares owned by inside owners***

unchallengeable, namely a dummy for the controlling, majority or supermajority share of largest owner (variables *K1*, *K2* and *K3*).[17] The variable (*HOM)* is a dummy variable measuring the homogeneity[18] of the first two owners. All regressors are dated in *t-1* (one-year lags). The descriptive statistics for the selected variables used in the regression models are presented in Tables 3 and 4 below.

Table 3: **Descriptive statistics**

| Year | Variable | LEVERAGE | RISK | GROWTHP | INSIDERS |
|---|---|---|---|---|---|
| **1999** | Mean | 1.9 | 3.7 | 0.1 | 32.8 |
| | Std. Dev. | 3.7 | 16.1 | 0.2 | 23.0 |
| **2000** | Mean | 2.0 | 3.9 | 0.1 | 33.6 |
| | Std. Dev. | 4.8 | 14.3 | 0.2 | 24.9 |
| **2001** | Mean | 2.6 | 4.1 | 0.1 | 30.6 |
| | Std. Dev. | 14.6 | 16.0 | 0.2 | 25.0 |
| **2002** | Mean | 2.5 | 3.7 | 0.1 | 28.9 |
| | Std. Dev. | 13.3 | 11.8 | 0.2 | 24.4 |
| **2003** | Mean | 2.6 | 3.2 | 0.1 | 34.8 |
| | Std. Dev. | 13.8 | 8.9 | 0.2 | 30.7 |
| **2004** | Mean | 2.7 | 3.3 | 0.1 | 33.7 |
| | Std. Dev. | 14.4 | 9.2 | 0.2 | 31.4 |

Table 4: **Dummy variables**

| Year | Dummy value | DEX | HOM | DEMP | K1 | K2 | K3 |
|---|---|---|---|---|---|---|---|
| **1999** | 0 | 166 | 232 | | 257 | 343 | 388 |
| | 1 | 291 | 225 | | 200 | 114 | 69 |
| **2000** | 0 | 205 | 297 | 305 | 311 | 415 | 448 |
| | 1 | 340 | 248 | 240 | 234 | 130 | 97 |
| **2001** | 0 | 206 | 325 | 258 | 348 | 419 | 428 |
| | 1 | 350 | 231 | 298 | 208 | 137 | 128 |
| **2002** | 0 | 224 | 387 | 314 | 423 | 468 | 453 |
| | 1 | 409 | 246 | 319 | 210 | 165 | 180 |
| **2003** | 0 | 220 | 375 | 246 | 432 | 456 | 422 |
| | 1 | 395 | 240 | 369 | 183 | 159 | 193 |
| **2004** | 0 | 208 | 378 | 251 | 437 | 442 | 381 |
| | 1 | 387 | 217 | 344 | 158 | 153 | 214 |

[17] The (*K1)* is a dummy variable indicating whether the share of the first owner is greater than 25 percent. Variable (*K2)* is a dummy variable controlling if the first owner's share is between 25 percent and 50 percent. The variable (*K3)* controls if the first owner controls more than 75 percent. These percentages refer to the owners' nominal ownership share, corrected by the average percentage of votes cast at the shareholders' assemblies.

[18] We assign a value of 1 to the dummy *HOM* if the first and second largest blockholders have the same identity (any) or if they are the KAD, SOD or PIFs. In 1995, these institutions signed a 'general' (although non-binding) co-operation agreement. The two state-controlled funds are one of the main players in Slovenian corporate governance. Together, they hold from 25-75% (and on average, 30%) of shares in (almost) all Slovenian firms.

## 2. Regression models and results

In order to describe the evolution of the growth in the ownership concentration we exploited not only the cross-section dimension of the data but also the time dimension and so a panel data estimation technique was used. An estimation using panel data has several advantages over a pure cross-section estimation. First, besides exploring the cross-company relationship between the growth of concentration and firm-specific characteristics we also capture how the evolution of these characteristics in time affects the growth of concentration of the largest shareholder. Moreover, it is desirable to work with panel data from a purely statistical point of view as adding the time dimension considerably increases the degrees of freedom. Adding the time-series dimension of the data substantially augments the variability of the data. Second, in a pure cross-sectional regression any unobserved firm-specific effect would be part of the error term, potentially leading to biased coefficient estimates. This does not happen in the panel context because we are able to control for unobserved firm-specific effects and thereby reduce the potential bias in coefficient estimates.

***In order to describe the evolution of the growth in the ownership concentration, a panel data estimation technique was used***

We treat the unobserved firm-specific effects as fixed since the Hausman test (Hausman, 1978) confirms the assumption that they are not orthogonal to the

Table 5: **Determinants of ownership concentration (REGRESSION 1)**

| | model 1 | | model 2 | |
|---|---|---|---|---|
| | non-listed | listed | non-listed | listed |
| C2 | 0.34***<br>(0.07) | 0.12<br>(0.26) | 0.34***<br>(0.07) | 0.13<br>(0.33) |
| C2*HOM | -0.05<br>(0.09) | 1.12<br>(0.32) | -0.09*<br>(0.05) | 0.13<br>(0.33) |
| HOM | 1.17<br>(1.61) | -2.45<br>(4.85) | 1.12<br>(1.61) | -2.59<br>(4.83) |
| DEX | 1.37*<br>(1.66) | -11.17*<br>(6.03) | 1.41<br>(1.65) | -11.32**<br>(6.00) |
| LEVERAGE | 0.03<br>(0.06) | -0.04<br>(0.11) | 0.03<br>(0.06) | -0.04<br>(0.11) |
| RISK | -0.06<br>(0.06) | 0.01<br>(0.03) | | |
| SAL_MS | 0.35<br>(6.83) | -4.63<br>(14.7) | | |
| INSIDERS | 0.09**<br>(0.03) | -0.002<br>(0.12) | 0.08**<br>(0.31) | 0.001<br>(0.12) |
| INSIDERS*DEX | -0.03<br>(0.03) | 0.12<br>(0.14) | -0.03<br>(0.32) | 0.11<br>(0.14) |
| INSIDERS*DEMP | -0.07**<br>(0.02) | 0.09<br>(0.08) | -0.07**<br>(0.02) | 0.09<br>(0.08) |
| DEMP | 2.91**<br>(1.01) | -6.30**<br>(2.80) | 2.89**<br>(1.01) | -6.21**<br>(2.82) |
| K1 | -7.46***<br>(1.42) | -6.09**<br>(2.04) | -7.38***<br>(1.42) | -6.06**<br>(2.04) |
| K2 | -20.63***<br>(1.63) | -17.87***<br>(3.02) | -20.55***<br>(1.64) | -17.89**<br>(3.04) |
| K3 | -33.39***<br>(1.87) | -27.50***<br>(4.68) | -33.35***<br>(1.88) | -27.39***<br>(4.73) |
| GROWTHP | | | 1.9e-06<br>(4.1e-06) | 3.8e-07<br>(7.4e-06) |
| $R^2$ | 0.29 | 0.23 | 0.29 | 0.23 |
| Haus $\chi$<br>(prob)# | 540.10<br>(0.00) | 45.24<br>(0.00) | 534.70<br>(0.00) | 45.63<br>(0.00) |
| No. of Observs. | 2219 | 388 | 2219 | 388 |

Notes: Dependent variable: increase in the size of the largest block in % points, year dummies included in all models.
#Hausman specification test for, under the null hypothesis the random and fixed effect estimators do not differ.
*, **,**** indicate significance at the10%, 5% and 1% levels.

independent variables and thus rejects the choice of the random-effects specification of the models, except for Model 3 (see Robustness Check below) for the listed companies. Since the estimated model is static and because the regressors enter the equation lagged by one period there is no endogeneity problem. Taking these features into account we use the within estimator as appropriate (Wooldridge, 2002).The estimation results are presented in Table 5.

***In the second step we analyse the impact of control consolidation on firm performance***

In the second step (***REGRESSION 2***) we analyse the impact of control consolidation on firm performance, measured by an approximation of the *PROFIT MARGIN* or *NET INCOME* over *REVENUES*. As claimed by Gutierezz and Tribo (2004), accounting measures are more appropriate for estimating the minority investors' expropriation since they are backward looking and, as such, reflect the effective (past) inefficient transfers of funds. Due to low liquidity, closely-held firms are not likely to be influenced by short- or medium-term expectations about firm earnings, as reflected in the stock price (Tobin Q). We regress firm performance on the different variables reflecting the contestability of control and some other variables suggested by the literature. First, we estimate the impact of the size ratio of the two largest blocks (*C1/C2*) on firm performance. In order to control for the homogeneity of the two largest owners, we interact the *C1/C2* with the dummy variable *HOM*. We include controls for firm size (*LNSALES*), *LEVERAGE* (measured by a firm's debt-to-assets ratio), export orientation (DEX), risk (*RISK*), growth potential (*GROWTHP*) and assets' tangibility (*TANG*) as a measure of the potential for managerial misbehaviour.

***We assume that those will form the controlling coalitions among the four largest blockholders that are homogeneous in their identity***

Apart from the influence of the largest single shareholders, we further explore the impact of a potential shareholders' coalition on firm performance. Following the theoretical model of Bloch and Hege (2001) and the results of *REGRESSION 1*, we define a potential controlling coalition as follows. Given the differences in goals and heterogeneity of interests potentially accelerating the disagreement effect, we assume that the controlling coalitions will be formed by those among the four largest blockholders[19] that are homogeneous in their identity. For each firm, we thus define the sum of the stakes held by non-financial owners or, alternatively, the stakes held by investment and state-controlled funds. We construct an additional coalition by aggregating the stakes of the inside owners since they are likely to form coalitions to support the management. We then assume that the formulation of coalitions is efficient. That is, the winning coalition is the coalition formed by the homogenous shareholders whose joint ownership stake is a minimum stake larger than 50% of the average votes cast at the shareholders' assembly.[20] If none of the potential coalitions has at least 50% of the voting rights, the winning coalition is the one with the maximum percentage of total votes. Since coalitions are more likely to expropriate private benefits when holding relatively small voting stakes (the alignment effect)[21], we particularly focus on those coalitions that own between 50% and 75% of the average votes cast at the general meeting. Hence, the following variables are constructed: the variable *S* indicating the percentage of votes held by the winning coalition and the dummy *DS* indicating the firm in which the winning coalition holds between 50% and 75% of the votes cast. In order to control for the disagreement

[19] The size of the fourth largest block in the sample amounts on average to 5 percent, while the fifth largest block slightly exceeds 3 percent. Thus, when forming a coalition we only consider the top four largest owners. Among these, we then formulate the coalitions by aggregating those with a homogeneous identity. Again, the state-controlled funds and privatisation investment funds are considered homogeneous.

[20] The approach partly follows that proposed by Guiterezz and Tribo, 2004. The only difference is that they assume that coalitions will form among any of the largest blockholders, while among those we consider all the homogeneous owners.

[21] See, Bennedsen and Wolfenson (2000).

effect, we interact the variable *DS* with the number of coalition members: *DS*1* for a 1-member coalition; *DS*2* for a 2-member coalition; *DS*3* for a 3-member coalition; *DS*4* for a 4-member coalition. The reference group here is the coalition of inside owners.

In order to describe the impact of control consolidation on firm performance we employ a dynamic framework. Although the coefficient of the lagged dependent variable is not of direct interest, allowing for dynamics in the underlying process can be crucial for recovering consistent estimates of other parameters. The dynamic panel data regression is characterised by two sources of persistence over time. Autocorrelation due to the presence of a lagged dependent variable among the repressors and individual effects characterising the heterogeneity among the firms. The OLS estimator is biased and inconsistent even if the error time is not serially independent because of the correlation between the lagged endogenous variable and the error term. The within-group estimator where the cross-section dimension is large and T is fixed is also biased and inconsistent because the within transformation induces a non-negligible correlation between the transformed lagged

Table 6: **Determinants of firm performance (REGRESSION 2)**

| | Model 1 | | Model 2 | | Model 2 | |
|---|---|---|---|---|---|---|
| | **Non-listed** | **Listed** | **Non-listed** | **Listed** | **Non-listed** | **Listed** |
| **Y_I** | 0.14*** | 0.05*** | 0.163 (0.024)*** | **0.037*** (0.006)** | 0.168*** (0.027) | 0.042*** .003 |
| **C1/C2** | 0.002*** | -0.0003 | | | | |
| **C1/C2*HOM** | -0.002 | 0.005*** | | | | |
| **HOM** | 0.03* | -0.46*** | | | | |
| **DEX** | 0.15*** | -0.13*** | 0.045 (0.0395) | -0.008 (0.031) | **0.133** .0576853** | -0.094*** (0.021) |
| **LEVERAGE1** | 0.21* | -0.64*** | -0.438 (0.201)*** | -2.072*** (0.181) | -0.196 (0.273) | -2.811 (0.11) |
| **RISK** | -0.0001 | 0.0002*** | | | | |
| **LNSALES** | 0.16*** | -0.05*** | 0.243*** (0.0522) | -0.029*** (0.010) | **0.270*** (0.059)** | 0.013*** (0.006) |
| **TANG** | -0.004 | 1.26*** | -0.121 (0.1722) | 1.774*** (0.187) | -0.175 (0.203) | 1.494*** (0.078) |
| **GROWTHP** | -9.3e-08 | -4.4e-08*** | 4.57e-08 (1.36e-07) | -8.38e-08 (5.79e-08) | 3.79e-08 (1.66e-07) | 5.90e-08* (3.68e-08) |
| **S** | | | 0.003*** (0.001) | **0.004*** (0.001)** | 0.001 (0.001) | .004*** (0.001) |
| **DS** | | | 0.949 (0.038) | **-0.04** (0.02)** | 0.016 (0.054) | **-0.106*** .013** |
| **DS* 1** | | | -0.034 (0.059) | -0.058 (0.042) | | |
| **DS* 2** | | | 0.032 (0.080) | -0.044 (0.03) | | |
| **DS*3** | | | -0.053 (0.062) | **-0.219*** (0.038)** | | |
| **DS*4** | | | -0.053 (0.087) | 0.012 (0.036) | | |
| **FUNDS** | | | | | 0042465 (0.074) | 0.0189 (0.014) |
| **DS*FUNDS** | | | | | -0.07 (0.083) | **-0.029** (0.015)** |
| **m2#** | -0.73 | -1.27 | -1.32 | -1.33 | -1.12 | -1.36 |
| **Sar## (prob)** | 0.7 | 0.6 | 0.9 | 0.9 | 0.9 | 0.76 |
| **N** | 1703 | 307 | 1776 | 314 | 1776 | 314 |

**Note**: Dependent variable is net income/revenues, year dummies are included in all models.
#The null hypothesis is that the errors in the first-difference regression exhibit no second-order serial correlation.

dependent variable and the transformed error term (Bond, 2002),. This correlation does not vanish as the number of individuals in the sample increases.[22]

***We employ the GMM dynamic panel estimator developed by Arellano and Bond (1991)***

We employ the GMM dynamic panel estimator, which is specifically designed to address the econometric problems induced by unobserved firm-specific effects and joint endogeneity of the explanatory variables in lagged-dependent-variable models. We use a differenced dynamic-panel estimator developed by Arellano and Bond (1991). We first difference the regression equation to remove any omitted variable bias created by unobserved firm-specific effects and, second, instrument the right-hand-side variables (the differenced values of the original repressors) using lagged values of the original repressors to eliminate potential parameter inconsistency arising from simultaneity bias. The consistency of the GMM estimator depends on the validity of the instruments. To address this issue, we consider two specification tests suggested by Arellano and Bond (1991), Arellano and Bover (1995), and Blundell and Bond (1997). The first is the Sargan test of over-identifying restrictions which tests the overall validity of instruments by analysing the sample analogue of moment conditions used in the estimation process. The second test examines the hypothesis that the error term is not serially correlated. In the difference regression we test whether the differenced error term is second-order serially correlated. The results of the empirical analysis are presented in Table 6.

## 3. Robustness check

Table 7 presents some additional results regarding the determinants of ownership concentration. First, alternatively to firm market share we capture the size variable through the logarithm of firm sales (*LNSALES*).

***We further construct an alternative measure of control contestability: the variable* RC *as the ratio between the ownership share of the first and second largest blockholders* (C1/C2)**

We further construct an alternative measure of control contestability: the variable *RC* as the ratio between the ownership share of the first and second largest blockholders *(C1/C2)*. We add an additional variable that should capture the potential pressure of small shareholders, namely the total number of firm shareholders (*NSHAREH*). We also check the identity of the largest owner since we expect that non-financial firms as the major shareholders have on average the largest ownership shares (variable *NF)*. In order to further control for the initial conditions, the dependent variable in Model 5 is determined as the increase in the size of the largest share, standardised by the size of the largest ownership block at the end of 1999 $((C1_t - C_{t-1})/C1_{1999})$.

Table 8 provides some further results on the efficiency of the different ownership structures. Here we construct additional variables reflecting the contestability of the largest block: the size of the largest block related to the aggregate size of the other four largest blocks *C1/(C2+C3+C4+C5)* indicated as the variable *RELATION1*. The variable *RELATION2* is determined by the theoretical model of Bloch and Hege (2001) and relates the size of the largest block to the size of the other four largest blocks, being a max (0, *((C1-(C2+C3+C4))/(100-C1-C2-C3-C4)*. Similarly, the variable *RELATION 3* relates the size of the largest block to the shares held by insiders (minority investors) defined as the max *(0, (C1- INSIDERS)/(100-C1-INSIDERS)*.

[22] However, the contribution of each time period to the individual means becomes negligibly small as the number of time periods gets larger. Consequently, this correlation induced by the transformation vanishes, and the within estimator is consistent in the case of a large T panel.

Table 7: **Determinants of ownership concentration**

| | Model 3 | | Model 4 | | Model 5 | |
|---|---|---|---|---|---|---|
| | **Non-listed** | **Listed** | **Non-listed** | **Listed** | **Non-listed** | **Listed** |
| **C2** | 0.66*** | 0.51* | | | 0.008* | 0.01 |
| **C2*HOM** | -0.08 | -0.07 | | | -0.018*** | -0.002 |
| **C1/C2** | | | -0.20*** | -0.54*** | | |
| **C1/C2*HOM** | | | -0.09* (0.05) | 0.07 (0.25) | | |
| **HOM** | 3.29* | 2.7 | 2.58*** | 1.20 | 0.462*** | 0.14 |
| **DEX** | 3.50** | -12.01* | 2.78 | -10.00* | 0.27*** | -0.40** |
| **LEVERAGE** | 0.02 | 0.04 | 0.04 | 0.04 | -0.001 | 0.002 |
| **RISK** | | | -0.08 | 0.001 | | |
| **SAL_MS** | | | 3.78 | -1.41 | -0.04 | -0.15 |
| **INSIDERS** | 0.27*** | 0.08 | 0.22*** | 0.11 | 0.01*** | 0.002 |
| **INSIDERS*DEX** | -0.08** | 0.30** | -0.07** | 0.21 | -0.01*** | 0.01*** |
| **INSIDERS*DEMP** | -0.07** | 0.05 | -2.95*** | 0.02 | -0.01*** | -0.01 |
| **DEMP** | 3.22** | -4.11 | | | 0.16 | 0.01 |
| **K1** | | | | | | |
| **K2** | | | | | | |
| **K3** | | | | | | |
| **GROWTHP** | -1.9e-06 | 1.2e-05 | | | | |
| **LNSALES** | 0.33(0.94) | -2.32(1.75) | | | | |
| **NF** | | | 10.89*** | 7.44*** | 0.25*** | 0.43*** |
| **NSHARES** | | | 0.01*** | 0.001 | | |
| **R2** | 0.11 | 0.10 | 0.15 | 0.16 | 0.04 | 0.10 |
| **Haus c.$\chi$· (prob)#** | 150.20 (0.00) | 16.97 (0.26) | 185.6 (0.00) | 24.5 (0.08) | 526.3 (0.00) | 45.24 (0.00) |
| **No. of Observs.** | 2219 | 388 | 2219 | 388 | 2219 | 388 |

**Notes**: Dependent variable: increase in the size of the largest block in % points year dummies included in all models.
#Hausman specification test for, under the null hypothesis the random and fixed effect estimators do not differ.
* , **,**** indicate significance at the 10%, 5% and 1% levels.

Table 8: **Determinants of firm performance**

| | Model 2 | | Model 3 | | Model 4 | |
|---|---|---|---|---|---|---|
| | **Non-listed** | **Listed** | **Non-listed** | **Listed** | **Non-listed** | **Listed** |
| **Y_I** | 0.14*** | 0.05*** | 0.22*** | 0.07*** | 0.07* | 0.02*** |
| **DEX** | 0.21*** | -0.22*** | 0.11*** | -0.07*** | 0.14** | -0.15*** |
| **LEVERAGE1** | 0.19 | -0.75*** | 0.15 | -2.67*** | 1.59*** | -2.59*** |
| **RISK** | -0.0001 | 0.001*** | 0.0002 | 0.0002* | 0.0002 | 0.0002*** |
| **LNSALES** | 0.22*** | -0.08*** | 0.7*** | -0.11*** | 0.21*** | -0.11*** |
| **TANG** | 0.11 | 1.55*** | 0.32 | 2.51*** | 1.27*** | 2.64*** |
| **GROWTHP** | 1.9e-07* | 8.1e-07*** | 4.3e-07** | 3.1e-07*** | 0.00 | 1.5e-07*** |
| **RELATION1** | 0.01*** | 0.001*** | | | | |
| **RELATION1*HOM** | -0.002 | 0.002*** | | | | |
| **RELATION2** | | | 4.4e-08 | -0.001*** | | |
| **RELATION3** | | | | | -7.7e-08 | -1.4e-08 |
| **m2#** | -0.66 | -1.29 | -0.55 | -1.46 | -0.72 | -1.24 |
| **Sar## (prob)** | 0.6 | 0.5 | 0.5 | 0.4 | 0.2 | 0.5 |
| **Obser.** | 1703 | 307 | 1703 | 307 | 1703 | 307 |

**Note**: Dependent variable is net income/revenues, year dummies included in all models. #"The null hypothesis is that the errors in the first-difference regression exhibit no second-order serial correlation.

# IV. Discussion and Conclusions

***The results show some importance differences in the evolution of the ownership structure between listed and non-listed firms***

The results of the empirical analysis underline some importance differences in the evolution of the ownership structure between listed and non-listed firms. This is the first confirmation of the complementarily of different corporate governance mechanisms: listed firms are exposed to the pressure of the market for corporate control, the media and more stringent regulation, which all influence the importance and role of the ownership itself. With regard to firm- or industry-specific characteristics, the only significant impact in listed firms is the effect of product market competition and firm size. The increase in the ownership share of the largest blockholder is on average lower in exporting firms, implying that stronger competition in foreign markets provides an additional disciplining mechanism on managers and acts as a substitute for blockholder control. Moreover, exporting firms might require more managerial initiative, that is, more managerial discretion in decision-making and consequently a lower concentration of control (Burkart et al., 1997). The impact of firm size is also consistent with the theoretical predictions. Larger firms listed on the Stock Exchange have on average a lower concentration of ownership. On the other hand, the fight for control seems to have no effect on the ownership concentration in listed firms.

Yet the effect of firm- and industry-specific variables in non-listed firms is different. The only effect that is in line with the theoretical predictions and that is robust across the different specifications is the effect of firm leverage. Consistent with our expectations, over-indebted firms experience on average a stronger concentration of ownership. On the other hand, exporting firms show a stronger increase in the size of the largest stakes. This somewhat contradicts the theoretical predictions. However, two main explanations apply. First, a large percent of exporting firms could actually be controlled by foreign companies and hence characterised by a higher ownership concentration. Second, exporting firms provide more amenities to their owners and thus increase their appetite for control.

***Control contestability seems to be driving most of the changes in the ownership concentration of non-listed firms: the higher the size of the second largest block, the higher the increase in the size of the first largest block***

On the other hand, control contestability seems to be driving most of the changes in the ownership concentration of non-listed firms: the higher the size of the second largest block, the higher the increase in the size of the first largest block. The results are consistent when applying different measures of control contestability and additional control variables. On average, the increase in the first largest block was higher in those firms with homogeneous owners. This might be due to the fact that, when homogeneous, they find it easier to trade among each other, making increases in the concentration more likely. However, the pressure of the second largest block is lower when the second largest blockholder has the same identity as the largest. In other words, when homogeneous, the two largest shareholders probably join and form coalitions. The stated homogeneity effects are, however, not significant across all model specifications and require some further research.

The importance of control contestability is further confirmed by the relationship between changes in the ownership concentration and the size of the largest stake in the preceding period. This impact is significant in both listed and non-listed firms. The concentration of the largest block is slower in firms where the largest blockholder already holds 25% of the voting rights out of all votes cast at the Shareholder Assembly. The same holds for the 50% threshold. Concentration is significantly slower in those firms where the largest blockholder effectively holds super-majority control.

The positive and significant impact of the share of inside owners on an increase in the largest stake indicates there is a 'battle for control' between the inside owners and outside owners in non-listed firms. The outside owners have probably been trying to overcome the insiders' coalition by concentrating their ownership shares. This effect seems to be significantly smaller in firms experiencing a reduction in employment. In these firms, the collusion of employees and managers is in fact less likely. Here it must be noted that no such effect has been noted in listed firms where the variable *INSIDERS* also includes outside minority investors.

***The positive and significant impact of the share of inside owners on an increase in the largest stake indicates there is a 'battle for control' between the inside owners and outside owners in non-listed firms***

As already stated, the observed dynamics of ownership changes in Slovenian non-listed firms can mainly be explained by the investors' desire to win control over the other owners. How then does this 'battle for control' affect firm performance? The results of the second empirical model again differ between the two sub-samples of firms (listed and non-listed).

In non-listed firms, the relative power of the largest blockholder (*C1/C2*) is beneficial to firm performance. The same holds for the relationship between the size of the largest and other blocks (*RELATION*). The homogeneity of the first two largest owners also seems to be beneficial to performance in non-listed firms. On average, exporting and more indebted firms perform better.

In the listed firms, the homogeneity of the largest two owners is generally detrimental to firm performance. The only positive effect is related to the fact that the homogeneity of the two owners potentially reduces the detrimental effect of low control contestability of the largest blockholders. The significant and negative sign of the variable *RELATION 2* further confirms that in listed firms incontestable control results in the extraction of private benefits by the largest owner.

In line with the theoretical predictions, listed firms with higher growth opportunities and firms with a higher level of tangible assets (implying a lower potential for managerial expropriation) perform better. On the other hand, on average large and exporting firms perform worse. The latter result is somehow puzzling and requires some further research, in particular by applying other measures of firm performance such as firm market value. Also much clearer than for non-listed firms is the impact of potential coalitions on firm performance. Here, it must be noted that potential coalitions are only defined between homogeneous owners and are assumed to be formed efficiently. In general, the benefits of a coalition increase with its size (*S*), which is in line with the alignment effect. This is further confirmed by the negative and significant impact of the dummy variable *DS*: firms where potential coalition members hold controlling but non-excessive voting stakes perform worse. This holds for both listed and non-listed firms. For controlling coalitions in listed firms, the result leads to the conclusion that the 'disagreement or collusion' effects related to potential coalitions outweigh any positive effect of sharing control. Adding members in coalitions decrease firm performance in comparison to firms in which the controlling coalition is formed by inside owners. The negative effect is particularly significant for 3-member coalitions. Here again it must be noted that in listed firms the 'inside owners' variable might be significantly capturing outside, minority investors.

***Listed firms with higher growth opportunities and firms with a higher level of tangible assets (implying a lower potential for managerial expropriation) perform better***

All of this is in line with theoretical predictions and anecdotal evidence. In listed firms there is no need for additional blockholder monitoring since this role is largely played by small (minority) shareholders, takeover threats and stronger institutional requirements. In Slovenia, the persistence of multiple blockholders in these firms can be partly explained by the lack of 'alternative' investment options and the

identity of the main investors, namely the state-controlled funds and privatisation investment funds. In fact, in 89% of cases a 3-owner coalition was actually a coalition between the state-controlled and privatisation investment funds. These funds seem to be keeping their positions in the firms and expropriating their value. We went one step further and tested whether the negative effect of the 3-member coalitions can actually be explained by the identity of their members. In fact, the results of Model 3 (Table 6) confirm that coalitions of state-funds and privatisation investment funds perform worse than others.

***The 'persistence' of institutional investors in listed firms is partly due to inefficiencies and barriers incorporated in the current legislation that regulates the investments of these funds that need to be eliminated***

***A clear default rule on a firm's goal would then align the interests of those share-holders that aim to identify with the goal***

What then are the policy implications? First, the 'persistence' of institutional investors in listed firms is partly due to inefficiencies and barriers incorporated in the current legislation that regulates the investments of these funds that need to be eliminated (e.g. limitations on investments in foreign markets, on the proper regulation of the organisational form of the successors to the privatisation investment funds). Second, our results show that coalitions could have different goals that reflect the identity of their members. For example, non-financial companies do not have the same goals as PIFs, which is in line with the theory (Hansmann, 1996). However, minority investors do not have available a sophisticated apparatus to figure out what kinds of owners are pursuing a certain goal and how that affects firm performance. Therefore, it is very costly and difficult for them to decide in which company to invest. This is particularly true in smaller markets where the limited liquidity of shares largely hampers the information value of firm shares. Since the owners' goals are directly resulting in the goal of the corporations, we believe that the main problem in Slovenia is the absence of a clear determination of a statutory default rule on the goal of commercial firms. Therefore, we think that in order for investors to get a clear signal of what kind of owners are 'leading' a certain company, the Companies Act should determine that all commercial companies should have as their goal an increase in shareholder value unless they transparently proclaim otherwise in the Articles of Incorporation or by-laws. A clear default rule on a firm's goal would then align the interests of those shareholders that aim to identify with the goal. We would probably end up with firms whose owners have more homogenous goals than now, which in turn would also decrease decision-making costs and improve the efficiency of the firms by diminishing the motivation to collude. Of course, this rule should be supplemented with a clear fiduciary duty of majority shareholders vis-à-vis minority shareholders. Only if large shareholders have such a fiduciary duty would a clear goal statement and policy statement gain some credibility. Credibility would be gained since shareholders could actually sue (or threaten to sue) either the managers or shareholders if they did not pursue either the goal or their announced investment policy. Alternative mechanisms with similar implications could be the imposition of a requirement that those owners reaching a certain ownership threshold (for example 5%) publicly state their investment policy.

To conclude, the results of our enquiry into the determinants of ownership concentration clearly show that the largest blockholders in Slovenian firms have on average been concentrating their power. As shown by La Porta, Lopez-de-Silanes, Schleifer, Vishny (1998), the tendency to concentrate ownership is a consequence of a weak legal system. The weakness of the legal system could either be caused by a deficiency in the rules or by a deficiency in the protection of the rights of shareholders. Even though some indexes show that the company law is pretty good in Slovenia (Heritage Foundation Index, 2005), we also note that indexes show that the protection of shareholder rights in Slovenia is extremely low (Zajc and Trampuž, 2005; and Zajc, 2004). Therefore, there is need for a general improvement in investor protection in Slovenia. We further observe that changes in

the ownership concentration in Slovenia are path-dependent. They are determined by the initial ownership structure, namely the allocation of control power between inside and outside owners and between the outside owners. Apart from stimulating the competition for control in non-listed firms, the existence of multiple blocks hampers the financial performance of listed firms. This certainly calls for further legal improvements, in particular in the law determining the functioning and investment activity of investment funds (privatisation investment funds, state-controlled funds) created during privatisation.

***Changes in the ownership concentration are path-dependent. They are determined by the initial ownership structure, namely the allocation of control power between inside and outside owners and between the outside owners***

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