Privatisation In Lithuania: Expectations, Process and Consequences

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Abstract

The primary emphasis of Lithuania’s economic transition policy has been placed on the restructuring of ownership relations. Lithuania chose one of the most ambitious methods of privatisation compared to other countries in Central and Eastern Europe, privatising two-thirds of state property. The process of privatisation, is the backbone of the Lithuanian transformation process and has a significant impact on the general economic development of the country, the creation of a competitive business environment, and the development of a system of corporate governance and securities market. The paper aims to shed light on the nature and efficiency of the privatisation process, on the emerging problems, obstacles, and results of the privatisation process. The arguments supporting the distributional model of privatisation and the socio-political preconditions and consequences are also analysed. It is argued, that the transfer from public to private ownership brings efficiency related changes in the way a company is run. Private companies are less subject to political interference, and should be more subject to the discipline of commercial and financial markets. After privatisation, problems of enterprise capitalisation and restructuring still remain. The aims of social equity and justice, promoted at the start of privatisation, were not achieved. As a new stage of privatisation (for cash) begins in Lithuania, an analysis of the first stage of privatisation should prove useful in the preparation and implementation of a new model of privatisation.

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1. Introduction

During the initial phase of reforming its economy Lithuania encountered many problems with the transformation of state owned property to private property. After the first attempts at privatisation, it became clear that whereas nationalisation was carried out on the strength of a single legislative act depriving rightful owners of their property, privatisation is an extremely complicated process, entailing complex legal, administrative and social engineering measures aimed at creating the institution of ownership.

A significant feature of the Lithuanian economy (not unlike other countries of Central and Eastern Europe) was the domination of state and state- co-operative ownership. A large number of the most significant enterprises were directly subordinated to institutions of the former Soviet Union (FSU), and the change of jurisdiction took a long time and required serious efforts on the part of the Lithuanian authorities.

The necessity of privatisation was never discussed in Lithuania as it was considered the main sphere of the economic reforms. All political parties and society groups in Lithuania supported this approach. The major dispute concerned the method (or methods) of privatisation, e.g. whether to implement a commercial or distributional privatisation model.

Lithuania chose one of the most ambitious methods of privatisation, in comparison to other countries in Central and Eastern Europe. The fundamental dilemmas of privatisation and their solutions in the case of Lithuania, can be classified in the following way:

<table>
<thead>
<tr>
<th>Dilemmas Of Privatisation</th>
<th>The Case Of Lithuania</th>
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<tr>
<td>Privatisation versus restructuring</td>
<td>Privatisation</td>
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<td>Commercial versus distributional privatisation</td>
<td>Distributional privatisation</td>
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<td>Monetary versus non-monetary goals</td>
<td>Non-monetary goals</td>
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<td>Domestic versus foreign buyers</td>
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<td>Internal versus external buyers</td>
<td>Internal buyers</td>
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<td>Valuation versus market</td>
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<td>Restitution versus no restitution</td>
<td>Restitution</td>
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The compromise solution was to use investment vouchers for privatisation in selected sectors, e.g. in the privatisation of housing, small scale privatisation was also proposed. In this case investment vouchers are a very suitable instrument. Large scale privatisation was proposed to implement the use of cash (the commercial privatisation model). The main argument of the supporters of commercial privatisation is that it is the only scheme which can provide an appropriate corporate governance system.

The Parliament of Lithuania unanimously approved the model of the distributional privatisation. All political parties supported this populist decision, declaring that this model of distributional privatisation ensures “social equity and justice”, allowing the creation of a capitalist class, and also a reduction of social tension in Lithuania. Political reasons were also of importance, as it was stated that using the vouchers would keep the influence of Russian capital out. The distributional approach received wide support from the public in Lithuania, especially as public expectations were strengthened by propaganda, promising high dividend rates, high profitability of the shares and higher living standards.

More detailed arguments supporting the distributional method of privatisation were as follows:

1. Social equity: The model provides equal possibilities for all citizens of Lithuania to participate in the process of privatisation and acquire privatised property. The free distribution of vouchers to the population was preferable for the reason of both political efficacy and equity. It generated more political support than commercial privatisation, which would give too large a share to the former nomenklatura.

2. Social justice: The State must compensate it’s citizens for the low wages which they were paid by the former Soviet regime.

3. Creation of a capitalist class: Acquisition of even small amounts of “capital” (investment vouchers), the necessity to invest them and willingness to do so it in the most effective way, will force common people to use their “creative capability” thus, the process will create a capitalist class. The creation of this class will provide guarantees against the restoration of the former regime.
4. High speed of privatisation: The comparison with British-style privatisation was very popular. It was considered that by adopting such a method, the privatisation process in Lithuania would be extended by more than 400 years and of course, this is not acceptable to Lithuania. Commercial privatisation could take a very long time considering the low purchasing power of potential investors, and the inefficiency of the remaining state-owned entities which would not be compensated by the efficiency of the small number of privatised enterprises;

5. Privatisation is by far the most important element, indeed the backbone of transition from plan to market: The process of privatisation ensures the success and speed of all economic reforms.

6. High speed privatisation creates a favourable image of Lithuanian economic reform and ensures the support of the international business community and financial institutions: The resolution and power of the Government to implement economic reform (privatisation being one of the most important elements) is the main criteria determining the technical and financial assistance of the international financial institutions (such as the IMF and World Bank).

7. There is insufficient capital in Lithuania to carry out commercial privatisation, the only possibility is to sell state property to foreign investors: This problem was considered a question of national security. Two negative consequences of commercial privatisation were emphasised: (i) the possible participation in the privatisation process and consequently the political and economic influence of Eastern neighbours (especially Russia); and (ii) the necessary capital for commercial privatisation is acquired by representatives of the “shadow” economy, former nomenklatura. In both cases their participation in the privatisation process is dangerous, especially as Lithuania was in the rouble zone at that time (national currency was only introduced in 1993).

8. Private firms have shown a better performance compared with state owned firms. Managers and employees of a private company, being co-owners of such a company, will be more interested in running a successful business, to earn greater profits and dividends: This argument was widely supported by the Parliament, because if compared, the performance
of two companies other conditions being equal, private persons are running businesses more efficiently. However, other conditions essential for the success of companies performance, such as corporate governance, state regulation, tougher operation conditions for state-owned enterprises, internal restructuring of companies to eliminate structural drawbacks, were not considered.

The shortcomings of the distributional privatisation approach (lack of investors and capital inflows, widely dispersed ownership), were assumed to be compensated by the introduction of a hard currency privatisation programme. Possibilities for foreign investors to participate in this process could also be provided.

This dilemma in one or another way had to be solved in all transition economies. Germany and Hungary chose a purely commercial privatisation model unlike most other countries in Central and Eastern Europe and former Soviet Union. Various types of mass privatisation programmes together with other privatisation methods have been implemented in Poland, Czech Republic, Russia, Ukraine and are starting in Latvia and Estonia. These programmes included the introduction of vouchers (certificates), though the core investor principle as the main direction has been adopted in most countries.

1.1 The voucher system

The investment vouchers in Lithuanian can be considered a specific mechanism in comparison with vouchers, coupons, certificates used in other countries. Perhaps the most important factor in the fast pace of ownership change in Lithuania is the dominant role played by vouchers. The mass privatisation programme implemented in Lithuania differs from those in other countries in a few aspects:

- investment vouchers were not treated as securities, initially vouchers were legally transferable only to relatives;
- vouchers were used not only for the privatisation of industrial and agriculture enterprises, but also for the housing and land privatisation; and
- about two thirds of state-owned property is to be privatised using investment vouchers.
Investment vouchers or other forms of compensation may only be utilised for the acquisition of objects of privatisation (shares). An additional form of agricultural compensation was paid out for persons who had worked in agricultural enterprises since 1944 and who are working there now.

A person upon acquisition of an entity scheduled for privatisation (or shares) had to pay 1.25% of the value of the acquired property in cash. Money, included in fixed money quota, also had to be used for this purpose.

Special investment accounts were opened in the Savings Bank of Lithuania, where sums of vouchers, compensation and money utilised for investment according to the fixed quotas had to be deposited. Each citizen of Lithuania who was 18 years of age and older on the 31st of December, 1991 had the right to open an investment account in the relevant branch of the Saving Bank starting from April, 1991 until June, 1992. The investment vouchers of citizens younger than 18 years old, were placed in the accounts of their parents.

The initial value of vouchers varied from former USSR Roubles (SUR) 1,000 to 5,000 depending upon the age of the citizen. Further, due to inflation and the indexation of the book value of fixed assets, these sums were indexed twice; first the value was doubled, and the second time quadrupled, resulting in an eight fold increase.

Since 1993, the Government has adopted a new decision on State one-time payments and other special compensation alienation. Namely, the means of investment account (investment vouchers and cash or the part of it) may now be transferred to other citizens of Lithuania.

It is difficult to define the dynamics of the voucher market price during the period 1991-1994, due to indexations, hyper-inflation and currency changes. Up to the middle of 1992 the sale of vouchers was prohibited, and even after that, there was no uniform market for investment vouchers. In every city and region their price differed depending on demand at that time and place. However, during this period the price fluctuated between 3 to 10 cents per voucher. In December 1994 the selling price was 0.075 litas, while supply was four times higher than demand. In January 1995 the selling price of vouchers increased in Vilnius to 0.089 litas, while remaining the same in other regions of Lithuania.
The use of investment vouchers reduced the existing shortage of capital, but did not create the conditions for investment into privatised enterprises. Investment vouchers created the conditions for:

- the indirect redistribution of property;
- cheap or inexpensive acquisition of State property without using cash money;
- hiding real owners (those who illegally acquire extra vouchers) with investment vouchers and manipulate the administrative nature of privatisation;
- creating the illusion of social justice; and
- creating investment stock companies without capital (only accumulating investment vouchers).

The first stage (voucher) of privatisation was finished in July 1995. About 7 per cent of investment vouchers were not used up at this time. The Law on Initial Privatisation of State Property was provided to change vouchers and other special compensations that were not used in the process of privatisation into special obligations of State (local government) - bonds. However, according to the Lithuanian Government and officials of the privatisation institutions this was not a reasonable solution.
2. The legal basis and organisational structure of privatisation

2.1 The legal basis

Property relations in Lithuania were transformed in two ways:

- by rehabilitating the rights of the former owners and heirs to their previously nationalised property; and
- by privatising property, that belonged to the state by property rights.

The main laws regulating the privatisation of state owned property in Lithuania are as follows:

- Provisional Law on the Accumulation of private capital of workers at the State enterprises (1990.12.04).
- Law on the Priority of the Employees to Acquire Shares of Privatised Enterprises (1992.04.07) and it's amendments.
- Law on Privatisation of Apartments (1991.05.28).

The very designation of the Law on the Order and Conditions of Rehabilitation of Property rights of Citizens to the Real Estate Survived shows that property rights are being rehabilitated for the citizens of Lithuania who have claims to property that was not destroyed during the last 50 year period. Land constitutes the bulk of this property. Property rights are also being rehabilitated to persons who owned houses and apartments as well as objects intended for commercial and household purposes. A citizen may decide to take back his property in-kind or accept monetary compensation for it. The process of property rights rehabilitation may generate conflict between the owners and current occupants of a house. The legal solution is quite straightforward. The current occupants may remain in the house after signing a new rental contract, with the owners agreement. In other cases, where for example the owner wants the house back, municipalities are obliged to provide new flats for the tenants. This
problem is not very acute in Lithuania, partly due to the limited amount of restituted property, and partly because consensus between owners and tenants is usually sought. In accordance with the Law on Privatisation of Apartments Lithuanian residents also have the possibility of becoming owners of the state owned apartments they are renting.

The Law on the Initial privatisation of State property regulates the privatisation of manufacturing industries, construction industry, transport, power engineering, commerce, consumer service and public catering establishments as well as institutions of culture, education, pharmacy, medicine and rehabilitation run on a commercial basis, and other state owned property, excluding: natural resources; agriculture; forestry; communication establishments or their property; and public housing.

The initial stages of privatisation have not involved entities: of vital importance to the state or to the basic functions of social welfare; entities which the state deem it important to maintain its monopoly or where demonopolisation is currently impossible (energy generation, public transport, communication, utilities industries, mining); and non-profit entities and entities of public use that will not be involved in competition under market conditions. Specific legislation prohibits the privatisation of specific enterprises (objects) in natural monopoly sectors; although in rare exceptions people working at these enterprises may buy 10 per cent of the shares. This is primarily determined by political priorities. There is a prevalent opinion that it is in the interests of Lithuania’s national security to maintain full state control of the natural monopoly sectors, especially in the fuel and energy sectors. Lithuania imports 98% of all energy resources from Russia and has no alternative supply sources. Russian enterprises could, through privatisation, potentially purchase these entities, establish their own conditions and bring political pressure to bear on Lithuania. A negative attitude towards private capital capable of dictating it’s own conditions still prevails. Infrastructural objects could also be privatised by industrial financial groups connected with the former nomenclature. Economic policy is formed and implemented in the sector of natural monopoly on the basis of this motivation. At the same time, the state is trying to attract foreign investors into this area.

Privatised entities (shares) may be acquired by the citizens of the Lithuanian Republic and by the persons who had the right to acquire citizenship of Lithuania according to the Law on
Citizenship of Lithuanian Republic. Persons, eligible for the rehabilitation of Lithuanian citizenship, may acquire a privatised entity for convertible currency.

The Law on the Land Reform regulates the process of privatisation of land. The property of former collective and state farms is being privatised according to the Law on Privatisation of the Agricultural Enterprise Property. The transformation of property relations in agriculture strongly depends upon the successful process of rehabilitation of property rights to land, therefore privatisation in agriculture is even more complicated, than in other sectors of economy. The analysis of this process should be the topic of a separate study, thus the problems of privatisation in agriculture will not be discussed in this paper.

All the laws mentioned above defined only the main principles and methods of privatisation and the restoration of property which have subsequently been specified by the decrees and by-laws of the Government. More than 400 government decrees and by-laws regulating the privatisation process were adopted. According to the Law on the Initial Privatisation of State Property (LIPSP), \( \delta \) of the total value of state property has been slated for privatisation. Privatisation is going to be carried out in two stages:

1. The entities privatised in accordance with the Law on Initial Privatisation of State Property (LIPSP) for investment vouchers, litas and convertible currency; and
2. State enterprises privatised for litas and convertible currency.

Despite frequent amendments and changes (introduction of new privatisation methods, expansion of the preferences for insiders, etc.) the legislation concerning the privatisation process remained unchanged. This feature of the Lithuanian privatisation process is considered an advantage, as compared to strategic changes in the privatisation process of neighbouring countries.
2.2 Organisational Structure

The structure of State privatisation organisation institutions has been defined by the Law on the Initial Privatisation of State Property. The main body is the Central Privatisation Commission which is appointed by the Supreme Council of the Republic of Lithuania on the recommendation of the Prime Minister. The Central Privatisation Commission approves privatisation programs of entities (with the exception of entities that are under jurisdiction of local governments) as well as national privatisation program and controls the implementation of these programs. This Commission makes all the important decisions concerning privatisation and those adopted by it are executed by Ministries, privatisation commissions of towns and districts, privatisation agencies of local governments and administrative bodies of enterprises subject to privatisation. The privatisation commissions of towns and districts work out privatisation programs for entities that are under the jurisdiction of local governments, coordinates them with the Central Privatisation Commission and controls their implementation.

The executive bodies of the Central Privatisation Commission are: the Government’s Privatisation department; the Privatisation department of the Ministry of Economy; and the privatisation departments in the ministries, whose jurisdiction includes particular entities of privatisation and local privatisation agencies. In accordance with the law, the role of local privatisation commissions in privatisation was defined by the division of municipal and central government property. During the process of privatisation, local privatisation commissions were allowed to make decisions concerning: the privatisation of objects that were under their jurisdiction (service enterprises, shops, etc.); and the methods and procedures of enterprise privatisation. The Central Privatisation Commission prepared and approved the privatisation programs of entities and objects, lists of which were presented by ministries (light, food, wood, machine industry, etc.).

Although decentralised management of the privatisation process was appropriate in some cases (especially in cases of the participation of municipalities), the influence of branch ministries may be considered a drawback. Due to the specific interests of each ministry, the most valuable entities were not included in the privatisation programmes. They were not privatised in accordance with the Law on Initial Privatisation of State Property, but transferred to private property using methods such as increasing private capital from enterprise profits.
The idea of the establishment of a State Property Agency was rejected by the ministries that were trying to preserve the functions of enterprise management.

3. The privatisation process

At the beginning of the privatisation process the following methods of enterprise privatisation were foreseen:

- public share subscription (large and medium-size enterprises);
- auctions (small enterprises or the part of the enterprise); and
- tenders in privatisation for hard currency.

Later a new method of privatisation was established; namely, that of the tender with the best business plan. This method is to be applied when the public subscription of shares does not take place. The aim of this method is to attract core-investors, maintaining the possibility of reorganising an enterprise to make it viable. In most cases it is a management by-out.

An entity with an initial selling price exceeding 10,000 litas is usually sold by announcing a public subscription of shares. The local privatisation commissions have the right to select the method of privatisation for the entity if the initial selling price is between 10,000 and 30,000 litas.

State corporations and state enterprises possessing share capital are only privatised by announcing a public subscription of shares. The state owned property of a liquidated enterprise can only be sold at auctions. Property is evaluated according to its book-value and this is the initial guideline for purchasers. Such an evaluation method was used in order to avoid very low selling prices for the assets, however opposite results were usually achieved. The market value of some assets was significantly lower than book value, and there were difficulties to sell them. Prices of such assets had to be reduced.

On the other hand, the fixed assets of some privatised enterprises were devalued due to a lower indexation rate, than the rate of inflation. As of October 1995, 86 per cent of all
enterprises slated for privatisation (8044 enterprises) and 83 per cent of the state capital slated for privatisation was privatised. That comprised 3.5 billion litas, e.g. about 30 per cent of all state capital. The total proceeds from privatisation amounted to 130.5 million litas, received by the State privatisation fund, and 18.5 million litas received by the Municipal privatisation funds. The proceeds from privatisation were scarce when compared to privatised assets. This was due to the specific privatisation model adopted - only 5 per cent of share prices were paid by cash and the rest by vouchers. According to opposition party estimates about 10 billion litas (2.5 billion USD) were lost by the state budget (due also to the manipulation of the privatisation process).
Table 1. Privatisation of state owned enterprises 1991 -1995 (in per cent)

<table>
<thead>
<tr>
<th>Sector of economy</th>
<th>By number of privatised enterprises as of</th>
<th>By the share of privatised state capital as of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>66</td>
<td>78</td>
</tr>
<tr>
<td>Industry</td>
<td>61</td>
<td>77</td>
</tr>
<tr>
<td>Transport</td>
<td>68</td>
<td>77</td>
</tr>
<tr>
<td>Construction</td>
<td>72</td>
<td>85</td>
</tr>
<tr>
<td>Trade</td>
<td>68</td>
<td>76</td>
</tr>
<tr>
<td>Public utilities</td>
<td>47</td>
<td>69</td>
</tr>
<tr>
<td>Services provided for</td>
<td>82</td>
<td>92</td>
</tr>
<tr>
<td>households</td>
<td>52</td>
<td>68</td>
</tr>
</tbody>
</table>


Note(s):
* After several large-scale energy sector enterprises were included into privatisation lists at the end of 1994, the share of privatised capital decreased.

The process was carried out quickly. However, most small entities in the sphere of construction, trade and service, having better demand, were privatised at the beginning. Auctions were carried out more actively than the public subscription of enterprise shares. The privatisation of industrial enterprises was a considerably longer and more complicated process.

As the credo of privatisation was “as fast, as possible”, no preparation time for the soon to be privatised enterprises was foreseen. The problem of inter-enterprise indebtedness was not solved and the issue of the multi-functionality of the enterprises’ was not addressed. Social assets, such as sport, catering facilities, summer houses, kindergartens, as well as supplementary departments (transport, construction, repair, and instrumental shops) were part of the enterprise structure and were privatised together with the main production departments. Most of them were financially non-viable, and thus it is not surprising that the debts of privatised enterprises are growing even now.

The privatised enterprises operate in the same environment as newly established private entities. In most cases, their position is even worse due to the unresolved debt issue. Huge amounts of debt to the state budget and social security fund caused the insolvency of many
potentially viable enterprises. Even some signs of re-privatisation can be observed, as enterprises manage to pay their debts to the state budget or municipalities by transferring some social assets to them.

Since the new method of privatisation, tender with the best business plan was introduced, 15 enterprises (the capital of 499 million litas) were sold this way by tender up to October 1995. Large-scale enterprises in machine building, electronics and chemical industry were also privatised using this method. They comprised 10.1 per cent of the privatised state capital. Only 46 enterprises, mostly in retail trade and service, with a capital value of 28 million litas, were sold for hard currency for 24.6 million USD (nominal value of 5.4 million USD). Among them, only 4 enterprises were privatised by foreign investors.

In accordance with the legislation the first stage of privatisation had to be finished by the end of 1992. However, it turned out that a large number of vouchers were not invested and a lot of enterprises were not privatised at this time. The introduction of the national currency was postponed (at the second stage entities had to be privatised for litas and convertible currency) and a National Stock Exchange was established in September 1993. Therefore, the first stage of privatisation was prolonged until the end of 1994 (actually until the middle of 1995). The Government has taken the following definite steps to make privatisation easier:

- the number of persons, having the right to take part in privatisation, was enlarged. Privatised entities could be acquired by citizens of Lithuania, closed joint-stock companies, and agricultural enterprises. Investment stock companies received the right to take part in privatisation from 1991;
- according to the amendment of the legislation, it was allowed to buy and to sell investment vouchers; and
- in April 1992, privatisation restrictions applied to foreign investors were reduced, with the exemption of a short list of forbidden activities.

Nevertheless, the process of privatisation had been stopped from the 12th December 1992, to 15th January 1993. The main publicly announced reason for this was the negative aspects of privatisation and difficulties encountered by the public to invest their vouchers and participate in privatisation process due to corruption and the influence of organised criminal groups. The
negative features of the privatisation process, such as agreements on prices between potential
buyers, the distribution of the objects (assets) before auctions, payments to the organised
criminal groups for the right to acquire particular objects, selling of “insider” information by
officials and their participation in privatisation process, had quite a significant impact on the
privatisation process.

However, there were no detailed suggestions on this issue and a new law has not been
prepared. The single change in the process of privatisation was the Law which came into force
in February of 1993. It allowed people working at the enterprise to buy out 50 per cent,
instead of the previous 30 per cent of shares. Many enterprises were not privatised in
accordance with the Law on Initial Privatisation:

- Employees of the enterprise, according to the decree of the government, increased
  authorised capital from enterprise profits and transformed enterprise into closed joint-stock
  companies (CJSC), buying out the rest of the estate at below market prices. These cases
  were highlighted, when the founders had established low selling prices and presented
  unmotivated applications to exclude enterprises from the list for hard currency
  privatisation.

- The government decree of 9th October 1992, allowed state owned enterprises to invest
  their capital into other enterprises. According to their decision, state property could be
  transferred to closed joint-stock companies avoiding the privatisation of state property, e.g.
  shareholders of CJSC to buy it out. Besides, blocks of shares of insolvent enterprises were
  usually sold for a lower than nominal price.

- The government decree of 12th April 1992, legalised the transfer of leased premises to state
  owned enterprises as a contribution of state property. Such a contribution is most
  frequently carried into CJSC, shares of which cannot be sold in public. Furthermore, this
  property contribution turned into shares, is being bought out by CJSC shareholders.

About 7 per cent (12 per cent in the trade and catering sectors) of state capital was acquired
using the methods mentioned above, avoiding the Law on Initial Privatisation of State
Property. In the meantime, political discussions began concerning these issues. The question was raised, as to whether these methods were legal or not.

The main public questions at the end of the first stage of privatisation were as follows:
- what should be done with investment vouchers beyond 1994 ?; and
- how would the privatisation process be developed and which concepts for the second stage of privatisation should be pursued ?

As was mentioned earlier, the Government of Lithuania and privatisation authorities declared, that investment vouchers would not be changed into government securities. The main reason provided is that internal debt is increasing rapidly (90 issues of short-term governmental securities - treasury bills in 1995, requirements to compensate deposits at the Saving Bank etc.) and Government can not afford to increase this debt.

In order to decrease the amount of unused investment vouchers large enterprises were included into the privatisation programme of November-December 1994. Such strategic enterprises as \textit{Mašiukio Nafta} (oil refinery), Ignalina Nuclear Power Plant, Lithuanian Gas and some others were slated for privatisation. Though employees of these companies have preferential treatment, the public subscription of shares will take place also. On the other hand, the selling prices of shares for most enterprises have increased (earlier selling prices of shares were equal to their nominal value). So, investment vouchers will be valid until the end of the privatisation of these enterprises.

Under the Corporation Act adopted in June 1994, state ownership rights in state or state-stock companies, with some exceptions, should be converted into ordinary stocks, which later could be traded on the Stock Exchange, as a means of a second stage of privatisation. A new Law on the Privatisation of State Property defined the strategy of the second stage of privatisation and was adopted in July 1995. The law defines the legal basis and institutional structure for commercial privatisation. A new institution; the Privatisation Agency, was established and new methods of privatisation introduced.
4. Emerging structures of corporate governance

Though the introduction of investment funds and their participation in the privatisation process is common to most countries in transition, investment companies (Ics) in Lithuania can be treated as a specific feature of the privatisation process.

4.1 Background

According to the Law on Initial Privatisation of State Property initially the possibility to participate in the privatisation process was granted to natural persons or groups of natural persons only. At the same time investment vouchers were not treated as securities, the sale of them was prohibited. It was only possible to accumulate enough vouchers for the privatisation of a particular entity, through establishing groups. Usually fictitious groups were established, members of which sold investment vouchers illegally.

The introduction of the investment companies allowed the accumulation of investment vouchers legally, more efficiently, and provided some guarantees for small investors. It also created the possibility to introduce core-investor principles into the privatisation process. Investment companies became one of the major players in the privatisation process.

The investment companies were legalised on 30th October 1991 by government decree. However, only the most common principles of their activity as well as requirements were determined. Neither the status nor functions of investment companies were precisely defined.

Investment companies were treated as a means of privatisation but not as a financial institution. The strategy of further development of Ic was not clear: should they work as mutual funds or as holding companies, actively participating in the management of the companies. The requirements for financial institutions such as prospectuses, diversification and management qualification requirements were not adopted. This attitude towards Ics was caused by a lack of institutional supervision and enforcement. The Lithuanian Securities Commission was only established in September 1992 by government decree.
On the other hand, it was mistakenly concluded that the stock market would automatically cure the problems. The mistake arose from a failure to distinguish between buying stocks and buying the company. People optimistically assumed that the equity market would serve as a market of corporate control, that is, as an instrument for corporate governance and, hence, as an effective mechanism for raising the external finance much needed by privatised enterprises for their restructuring projects. The restrictions applied to Ic include the following:

- limit of the accumulated authorised capital was 8 million litas. This limit was clearly too low for some structures; and groups of Ics owned by the same persons emerged;
- Ic’s investments into other investment companies could not exceed more than 10 per cent of it’s authorised capital;
- investments into enterprises, being privatised by public subscription could not exceed 30 per cent of authorised capital of those enterprises. This restriction caused opposition on the part of Ic, strengthening of competition and informal agreements between Ic. A lot of Ic faced difficulties because of the large amount of unused investment vouchers, when the possibilities to acquire control of enterprises declined;
- no less than 80 per cent of investments had be used to acquire the shares of privatised enterprises (this limited the participation of investment companies in auctions); and
- investment companies, having acquired the shares of privatised enterprises could sell them only at the Stock Exchange. This restriction froze legal trading between Ics, because the National Stock Exchange began operating in September 1993.

About 400 investment stock companies were registered. The most active period of Ic establishment was at the end of 1992 and then the process of their mergers and liquidation began. In 1993 the assets acquired by Ic comprised one third of the privatised capital, though the share of entities was considerably smaller. This could be explained by Ic joining the privatisation process later and participating mostly in the privatisation of large scale industrial enterprises.

In 1994 the situation changed slightly, since most of the Ics were not very active in the process of privatisation. Most of the investments were made in 1992-1993. As the process of privatisation continued, the share of assets acquired by Ic decreased to 21 per cent. On average, capital of 100-300 thousand litas was accumulated per Ic, few were able to increase
their capital to 1-8 million litas. Nevertheless, most Ics comprise informal groups with much large amount of the capital.

Informally all Ic can be divided into categories depending on the type of founder and the type of activities pursued. In practise almost all Ic were founded by natural persons however, their relations with other structures (closed joint stock companies, banks, insurance companies) is clearly seen. Thus, Ics may be divided into:

- Ics representing the interests of particular structures; and
- Ics founded by natural persons, whose main function is intermediation.

Regarding Ic activities, several groups of Ics may also be distinguished:

- Ic or groups of Ics participating actively in the process of privatisation. They acquired control of enterprises and are involved in the management of the enterprises. Usually, the founders of these Ics are representatives of other entities (banks, insurance companies, other enterprises). They form concerns or groups, diversifying their activities. Some of them are active throughout the country, some only in regions where they were established.
- Ic that participated in privatisation, but did not acquire control of an enterprise. They have no possibility to influence the activities of enterprises, their only option is to trade at the securities market. In the meantime their only source of income are dividends, paid by privatised enterprises.
- Ic founded for the purpose of acquiring some part of enterprise shares in order to sell them to owners of the control package, their trading activities were considered illegal.
- Ic founded for the acquisition of one particular enterprise. The process of their liquidation is continuing.

4.2 Activities and strategy of the development of investment companies

Looking at the prospectuses of the Ic, it becomes evident that Ic up to now were not prepared to act as mutual funds. They have participated in the process of privatisation, commerce, manufacturing, provided insurance and credit services. However, the only activity permitted by legislation for an Ic is participation in the process of privatisation. Indeed, the main goal of
an Ic was primarily the accumulation of property. The main spheres of investment are those with quick and permanent return possible and/or those not requiring major investments. Such spheres include, first of all, trade and catering (see figure 1).

**Figure 1.**

![DISTRIBUTION OF ENTITIES ACQUIRED BY Ics ACCORDING TO THE SECTORS (percent)](image)

Although the largest amount of privatised entities belong to this sector, the other major sphere is industry, and the privatised assets of industrial enterprises comprise almost 70 per cent of all the privatised assets (see figure 2).
Major investments in the industrial sphere are channelled towards profitable (or potentially profitable) sectors, such as light industry, construction materials, food processing, wood processing and furniture industries. Buildings and sites of enterprise, as well as social assets, serve as other incentives for privatisation of certain entities. Most Ics lack an investment strategy, and portfolios of their investment are formed accidentally. The main reasons are constant changes in the privatisation programme and the impossibility of predicting the entities to be included in privatisation bulletins.

So far, Ics have been engaged in the activities of accumulating investment vouchers and exchanging them into shares of privatised enterprises. However, Managers of Ics understand the problems that need to be faced, which are as follows:

- insolvency in the main part of industry.
- the beginning of the restructuring process.
- a lack of capital by Ics.
- underdeveloped securities market.
- changes in legal and regulatory environment.
- a lack of portfolio management skills.
The activities and existence of Ics will be highly influenced by new legislation adopted in 1995-1996. Existing laws were adopted two years after the Ics existence and created a lot of problems for them. Especially the part that requires an Ic, which control an enterprise, to transform into an open-end mutual fund. In order to fulfil this requirement, they will have to sell a large part of the enterprise shares which is difficult in the underdeveloped securities market and will thus have difficulty retaining control of an enterprise.

A large number of Ics cannot survive in the long run. Anecdotal evidence suggests that about 20 Ics will remain. Ics that are able to accumulate financial resources for enterprise restructuring and are not only interested in property, but in actively monitoring the management of enterprises may survive. On the other hand, very few Ics are interested in becoming open-end mutual funds. Others will sell their shares to the real owners of enterprises and will be liquidated, merge with other Ics, or go bankrupt.

The main groups of Ics control more than half of the assets acquired by all Ics, though the number of entities acquired by their groups comprise only 45 per cent of all privatised entities. Taking into account their control over a majority of the enterprises, it could be stated that in reality they control a much greater amount of assets. It should be remembered that there was no real evaluation of enterprises’ assets at the beginning of privatisation and their market value could be much higher. Groups of Ics control such sectors as electronics, construction, wood and food processing industries. The chief groups of Ics have the possibility to survive in the long run, due to the prospect of attracting investment being the core-investor. Comprising a strong lobbying group they can assure a more favourable legislative framework.

4.3 Results of the privatisation process

Results of the privatisation process can be evaluated not only by the share of private (privatised) enterprises in various sectors of the economy, but by the gains and/or losses of the different groups of the society as well. The main groups can be analysed on the basis of the following criteria: possibilities to participate in the process of privatisation, the benefits from privatisation, their status in society during the post-privatisation period.
4.3.1 Losers: the general public

This group comprises the largest share (about 70-85 per cent) of the population. The typical representatives are pensioners, large number of workers, and people engaged in such sectors as education, agriculture (most are non industrial sectors). This group of the population was mainly passive during the discussion of privatisation. It generally supported the distributional approach mistakenly assuming that the introduction of vouchers would increase their living standards. The process of restitution was well supported, as restitution mainly concerned land and dwellings.

Though preferential treatment for insiders (first of all workers) was introduced, most privatised enterprises have huge structural drawbacks and at the time of transformation they became insolvent. The value of such enterprises was close to zero, in cases of bankruptcy owners have nothing to gain. Several possibilities were provided for the representatives of this group to participate in the process of privatisation:

- to sell investment vouchers for cash in auctions or the black market (and thus earn between 40-80 USD per person).
- to participate in the public subscription of shares, often without knowing the real economic and financial situation of the enterprise.
- to buy shares of Ics and become their shareholders. The analysis of Ics current activities proves that dividends paid by Ics are scarce, their financial situation is complicated and their future prospects are not clear.

Most of the Lithuanian citizens being the shareholders of the investment companies, encountered a lot of problems:
- insufficient information on the activities of Ics.
- no possibility to participate in management or decision making of Ic.
- low rate of dividends (or no at all).
- low liquidity of Ic shares, impossibility to sell them at the stock exchange.
- a lack of legal protection for investors in the case of bankruptcy or liquidation of Ics (and as previously noted, possibilities of founders or managers to manipulate the privatisation process).
It may be argued that the expectations of this group of citizens was not satisfied. They did not acquire capital or improve their living standards due to the privatisation process.

4.3.2 Winners: the general public.

Winners may also be found among the general public, though their number is not very high. This group comprises employees of in various sectors of the economy or separate enterprises. First, in the service sector: hotels, catering, other services, premises for retail and wholesale trading as well as profitable industrial enterprises (see box 1).

This example shows that employees will only be winners in cases where investment for the refurbishment of a hotel could be attracted, therefore increasing the value of shares. At the

<table>
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<td><strong>Lietuva</strong> is the largest hotel in Vilnius. Although it is in reasonably good condition, investment for refurbishment is necessary. Hotel Lietuva was included in the list for hard currency privatisation. According to the legislation, 30 per cent of its equity was acquired by managers and employees by investment vouchers. The international tender was launched for the remaining 70 per cent. Foreign investors proposed to pay 10 million USD to the Privatisation Fund, an investment of 15-25 million USD for renovation and inclusion, free of charge, in the “Radisson Hotels” international reservation system. In this case, the value of employee shares could be quite high and their participation in the privatisation process might be considered a success. However, the Government cancelled the transaction under pressure from local lobbying groups willing to privatise the hotel. At the same time, the example demonstrates the drawbacks of the privatisation process.</td>
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Of course, some people, due to their personal characteristics (ability to catch up), were able to find possibilities for more or less profitable investment. It was a difficult task because of the lack of information concerning enterprises, and rather bureaucratic procedures of investment. However, Overall results were not very significant in most cases as there are few possibilities to attract finance for restructuring and the further development of enterprises.

4.3.3 Managers
This group can be identified as people, who had more favourable opportunities to participate in the privatisation of enterprises due to their position. The method of privatisation for the best business plan could be, in fact, treated as management by-out. Other methods (avoiding formal privatisation procedures among them) were widely used. In most cases managers of enterprises were able to acquire control or a significant amount of equity in the most prospective enterprises.

4.3.4 Owners of the largest investment companies

The owners of investment companies were the most active participants in the process of privatisation. In legal or sometimes semi-legal (using drawbacks or shortages of the legislation) ways, they were able to privatise the most prospective and profitable enterprises or real estate and, (most importantly), to acquire their control. Most of them have comparatively significant amounts of capital allowing them to buy substantial amounts of investment vouchers. The main sources of capital were trading activities between the East-West and vice versa.

As a result, the emergence of corporations or groups may be observed, although they are informal in a legal sense. These corporations comprise closed stock companies, investment stock companies, banks, insurance companies and other entities. The consequences of these processes are rather complicated. The financial groups comprise a new political bloc, although their political doctrine or ideology is not very clear. A concentration of property and money creates strong monopolistic effects in the local market, hampers the establishment and activities of smaller companies and influences price levels.

The concentration of capital also affects the social structure of Lithuanian society. The representatives of the new elite are closely connected with the state bureaucracy, forming the new strata of the society, and producing a negative impact on the safety and stability of the society as the whole. Minor shareholders of major investment companies, as well as financial groups have the possibility to gain in the long run, though negative tendencies of their elimination in semi-legal or illegal ways may be observed.
Conclusions

The scheme of distributional privatisation enabled the authorities of Lithuania to carry it out quickly. The representatives of Lithuanian privatisation institutions as well as foreign experts (the World Bank and the International Monetary Fund) consider the Lithuanian privatisation model is quite successful, compared to the privatisation models of other East European and FSU countries.

However, it should be emphasised that such a point of view is rather formal, since only one side of privatisation, the speed of the process, is taken into account. The option of restructuring prior to privatisation was never discussed. Indeed, it was only discussed recently. At the present stage of privatisation most attention is being paid to the formal transformation of ownership from state-owned to private ownership It is expected that private ownership will improve enterprise performance without any additional means.

The transfer from public to private ownership certainly brings efficiency related changes in the way the firm is run:

- private firms are less subject to political interference than state owned enterprises;
- private companies should be more capable of offering decent incentives and salaries to attract good managers;
- private enterprise should be more subject to the discipline of commercial financial markets, than public enterprise;
- these are better possibilities to attract external financing for restructuring through equity markets; and
- the significant pre-privatisation period can cause valuable asset stripping.

However, problems of enterprise capitalisation and restructuring still remain, under the new conditions following privatisation. The crucial problem is the restructuring of enterprises seeking to increase their profitability, rationalise their management structure and develop the future strategy of business.
On the whole, the privatisation program in Lithuania has resulted in too little corporate governance by strategic owners with the necessary skills and financing to bring about enterprise recovery, although examples of some private enterprises indicate that some restructuring is occurring.

Insider control has virtually blocked the development of equity markets. Managers (and employees) are often conservative shareholders, reluctant to sell their shares for fear of losing control. On the other hand, shares in insider-controlled enterprises are no longer attractive to potential foreign investors because of low dividends and the impossibility of obtaining large blocks of shares. The share of foreign investors among all the participants of the privatisation process is insignificant.

The companies, that are being sold to Lithuanian citizens and investment companies, are not prepared for privatisation and buying them is very risky. Most investors in Lithuania have financial resources solely for purchasing the entity, but the restructuring of an enterprise needs more and more capital. The shortage of credit resources and high interest rates are also a tremendous obstacle for the owners and managers of the privatised companies.

Following privatisation, enterprises are often non-viable in a monetary framework, which means the transfer of ownership rights does not constitute a rationale for restructuring. The creation of enterprise specific policies have to be developed. Without any doubt, the privatisation procedure is one of these, but it has no direct impact on the capitalisation process. Nevertheless, it creates an environment in which the capitalisation process is modified.

On the other hand, it is very difficult to predict the rapid changes in taxation, licensing, pricing, export-import restrictions, so the owners and managers can hardly estimate the profitability of the business, even in the near future. For that reason the guarantees for the purchasers of shares of investment companies are very poor. There is no special legislation or regulations for protecting investors interests.

The price which the investor can pay for an entity is the only criteria for selling it, but now in Lithuania it is not the most successful criteria for selecting the investment. The most
substantial problem now is "who and how will this person run the privatised business". Adequate management is also a very important problem, when one takes into account the fact that citizens of Lithuania (as natural persons), can only afford small investments. The citizens are expecting to receive dividends from their investments, but they do not wish to be involved in running the business.

The process of privatisation which is now being carried out, has a very narrow comprehension of the legal problem. It is the privatisation of an estate, as an object of property alone, that is brought to the technocratic procedures of turning State property into private property. Therefore, problems of privatisation are solved when isolated from the general context of economic reforms, and are not co-ordinated with the process of capitalisation or other systemic economic reforms.
References


