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*Emerging institutional order?
National Investment Funds in Poland*

Abstract

The paper analyses the mass privatisation program (MPP) implemented in Poland in mid-1990s from the perspective of transition reforms and corporate governance system development. Although the program covered only 512 companies the collected evidence provides an unique opportunity to compare the Polish MPP to the schemes implemented in other post-socialistic economies of the Czech Republic, Slovakia and Russia as well as to other privatisation methods applied in Poland. The Polish MPP created intermediary in the form of National Investment Funds (NIF), which were granted the leading and minor status in the ownership of their portfolio companies. The clear ownership and the incentive structure appeared to be important mechanisms that help minimizing the control vacuum and stimulated restructuring and privatisation of the portfolio companies. Despite the restructuring efforts the financial results remain relatively blurred and the performance of privatised companies as well and the funds appear to be disappointing.

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Introduction

Since 1989 Poland belongs to transition economies shifting from the central planning to the market economy. The transition process includes significant changes in the most fundamental areas affecting political, social and economic systems. Although the political changes are indisputably an important part of the transition, the development and the direction of changes can be only sustained and reinforced by the economic success, or at least improvement. It is widely agreed that the creation of the more efficient governance mechanisms in the crucial aspect of the transition reforms.

The privatisation process is one of the most crucial reforms from the perspective of transition as well as of the development of corporate governance structure. At the end of 2006 private sector generated ca. 80% of GDP. Out of 8,453 state owned companies in 1990, 7,147 have been privatised by the end of 2004². 2,885 companies were privatized via direct privatisation that appeared to be the dominant ownership transformation scheme, 1,545 companies were commercialized, 352 underwent indirect privatisation, 512 were included in mass privatisation program and 1,853 were covered by liquidation procedure. However in the register as of January 2005 there were 1,306 state enterprises and the state still is involved in 15% of privatised companies in Poland.

The goal of this paper is to present the mass privatisation scheme introduced in Poland in mid-1995 in the form of National Investment Funds and on the basis of collected evidence to answer questions on the effectiveness of the mass privatisation program in Poland. The assessment of the Polish MPP is kept within two levels of the study: the comparative analysis of the NIF programs versus other privatisation methods applied in Poland such as direct sale to foreign and domestic investors, MEBOs and sub-stage of commercialisation, and the international comparative analysis of mass privatisation programs implemented in other CEE countries of Russia, the Czech and Slovak Republics as well as East Germany or Estonia. Using the framework of the previous research as well as the most common problems of transition economies the criteria of the NIF scheme assessment would be the following:

1. Shifting the ownership of the assets from state to private hands;

² Ministerstwo Skarbu Państwa (State Treasury), Ocena przebiegu prywatyzacji majątku Skarbu Państwa w 2004 roku (The report on privatisation reforms in 2004), 2005, Warsaw, p. 10.

2. Enhancing the performance of the companies by privatisation to strategic investors, restructuring of the companies and reducing the control vacuum and looting carried out mostly by powerful opportunistically behaving insiders;
3. Acceleration and increasing the scope of the privatisation process;
4. Reducing costs of the ownership change from the perspective of the state;
5. Distribution of at least part of the 'national' wealth to Polish citizens;
6. Development of corporate governance mechanisms;
7. Boosting the public interest and participation in the stock market.

The remainder is organized as follows. In the first section the paper discusses the designing process of the program, the goals and the stages of the program. The second section analyses the functioning of the NIFs and their role in the corporate governance. The third section discusses the results of NIFs restructuring activity. The fourth section concludes the paper with the overall assessment of the mass privatisation and its contribution to the development of corporate governance system in Poland.

1. The mass privatisation program

After 1989 Poland applied the radical approach to macroeconomic reforms (so called shock therapy), the mass privatisation program was however significantly delayed. Main reasons behind this delay were rooted mostly in the political changes and the unwillingness of political parties to formulate goals of the mass privatisation scheme precisely³. The authors of the Polish MPP could rely on the experience of other countries, especially Russia, Slovakia and the Czech Republic and prevent the privatised companies from mushrooming and expropriation by insiders, the political turmoil and the insecurity however did not provide good environment for the foreign investors. The delay also affected the attitude of workers of companies chosen to join the program and led to the further deterioration of NIFs portfolio companies that were in the desperate need for capital and restructuring.

The main goal of the program was to assist the assets shift from state owned companies to private ones and to intensify and extend the range of ownership transformation. The initial plan was to create open public investment funds for the mass privatisation program that would become private funds. The mandate of the NIFs was to promote the development of profitable and valuable companies operating in Poland and to permit the public to participate by

³ Stanisława Teresa Surdykowska, *Prywatyzacja*, Wydawnictwo Naukowe PWN, Warszawa, 1997, p. 140..

enabling them to acquire shares in the NIFs. Moreover, selling companies through the intermediary and not directly by the state was to reduce costs of the ownership change process. Finally, in many cases the government realized there were not enough investors with substantial capital interested in buying out state owned companies.

1.1. The scheme

The Polish MPP covered 512 large and medium mostly manufacturing state owned enterprises (SOEs) with about 10% of industrial sector sales to participate in 15 National Investment Funds. Each SOE was corporatised as a joint stock company, 60% of the shares were allocated to the NIF scheme, 15% was given free to employees and 25% was retained by the state⁴.

The NIF privatisation stage

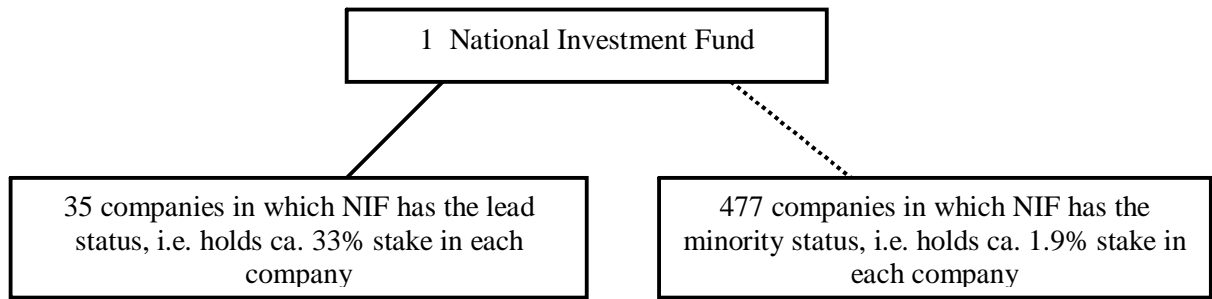
In December 1994 the supervisory boards of NIFs were officially appointed and started negotiations with management companies. By July 1995, NIFs established as companies of Company Act with the capital of 100,000 PLN provided by the state as subsidize have selected their fund management companies and signed 10-year agreements with them⁵. In March 1995 portfolio companies were distributed amongst NIFs on a random basis to ensure that all funds would end up with the approximately equal amount of assets under their control. The distribution of the share was carried out in a number of rounds on four occasions. As a result many funds ended up with diversified portfolios not concentrated on any particular industry. In the end each NIF got the lead status in 34-35 firms and minority status (of 1.93% shares) in ca. 477 firms. NIFs hold 60% of a company's shares and was to manage or sell the shares⁶. In order to ensure that NIFs would play an active role of the companies they had in their portfolios, provisions on the MPP stipulated that leading stakes had to be sold only as the whole, whereas the minority stakes were subject of unrestricted trade. Figure 1 illustrates the structure that each NIF ended up with.

⁴ Wolfgang Aussenegg, 'Going public in Poland: Case-by-case privatisation, mass privatisation and private sector initial public offerings', *William Davidson Institute Working Paper*, no. 292, 1999, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd292.pdf>, [accessed on 2 April, 2002] (para. 8 of 44).

⁵ Malwina Szczepkowska, 'Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych', Uniwersytet Szczeciński, 2001, p. 5..

⁶ Szczepkowska, 'Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych', p. 6.

Figure 1: Illustration of the initial NIF structure

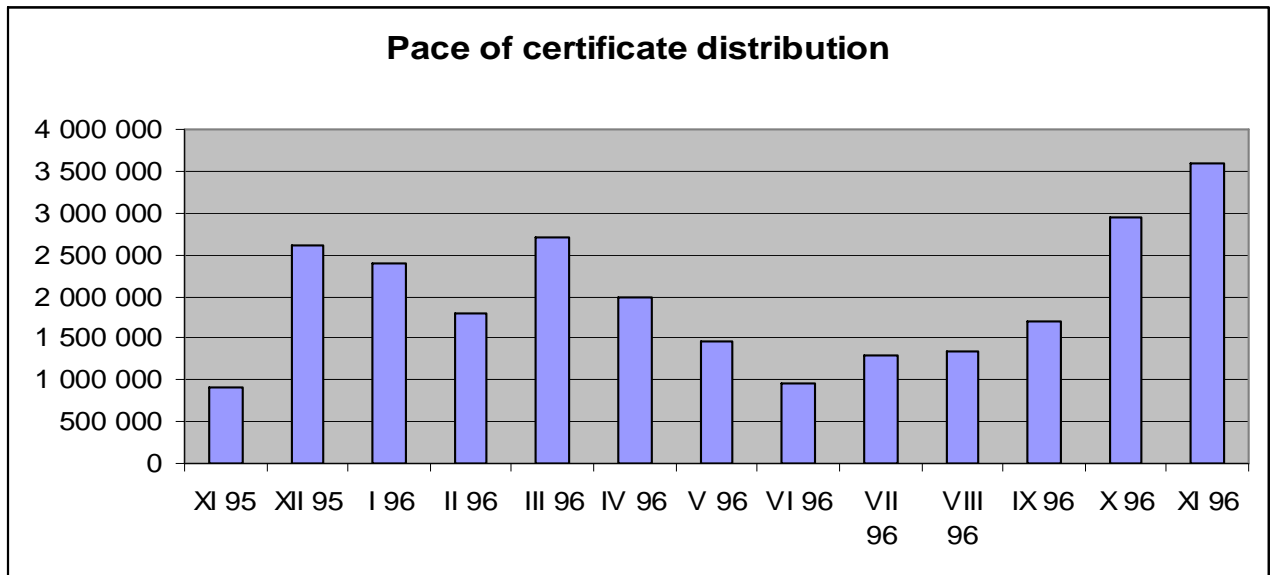


————— lead status
 minority status

Source: based on www.magnapolonia.com.pl

From November 1995 until November 1996 the state owned bank PKO BP started to distribute the ownership certificates for a fee of PLN 20 (\$7-8). The certificate functioned as a claim to the ownership of funds. Each adult Pole could take a certificate and then convert in into 15 shares (1 share per each NIF)⁷. Figure 2 presents the pace of certificate distribution.

Figure 2: Pace of certificate distribution



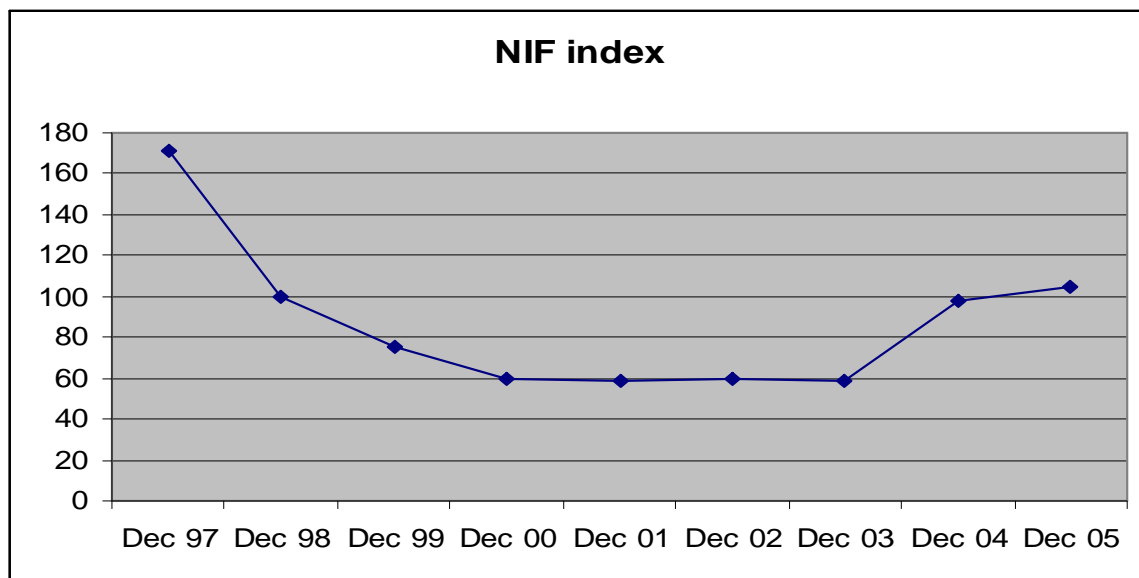
Source: Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p.

⁷ The initial public interest in the mass privatisation program was striking: 25 855 417 out of 27 395 000 eligible Poles (94.5%) took part in that program, although the authors of the MPP predicted far lower participation of about 10 million citizens.

Funds commercial phase

In March 1997 NIFs shares were listed on Warsaw Stock Exchange. The Treasury, which held 100% of shares of NIFs at this point, began to transfer 85% of these shares to certificate holders who applied for the conversion of their certificates through a brokerage house. The remaining 15% was kept by the Treasury for the payment of performance and loyalty fee of fund management companies. In June 1997 the certificates and shares of NIFs were listed on Warsaw Stock Exchange. Certificates prices went significantly up starting from PLN 50, reaching PLN 175 (the highest price ever) by February 1997 and then falling back to about PLN 150 by June 1997. During the last day of quotation (last session in December 1998) certificate was worth 62 PLN which makes it 40% lower than the IPO price. The NIF index reached its top value during the first weeks of quotation and ever since the NIF shares prices were falling from that moment reaching ca. 1/3 in 2005. Figure below presents NIF index 1997-2005.

Figure 3: NIF index (points) 1997-2003



Source: own calculations based on reports of NIF program and database of Bank Ochrony Środowiska (available at www.bossa.pl)

As shown in figure 1 the value of the index was falling since the listing date. The increase in 2004 and 2005 was connected with the dividend payout and the upward trend on the stock exchange. Since 2006 Warsaw Stock Exchange does not produce NIF index due to the end of the program.

1.2. Companies selected for MPP

According to estimations of the Ministry of Ownership Transformation there were ca.1100 companies, which could join the program at the time the scheme was under construction. However, the anti-privatisation lobby became strong and many companies were not included in the scheme due to the political reasons. Additionally, the delay of the introduction of the program also affected the number of companies selected. Some of the potential company candidates were being privatised or had a different status – i.e. large companies such as PKP (Polish railways) or LOT (Polish airlines) and therefore did not qualify to the program⁸. Additionally, alcohol and tobacco manufacturers, power plants, wood processing companies and sugar manufacturers were excluded from the MPP mostly to political reasons and anti-privatisation lobbies pressure. In August 1992 ca. 600 companies of PLN 150 billion in value (15% of the value of state-owned companies) were to join the program since that number was meant to be ‘breakeven point’ of the scheme. Since 16 largest companies were excluded, the value of companies in the MPP dropped to 6.56% of state-owned companies. In result, many companies selected to the program represented “problematic” sectors as food processing or textile industries.

Companies selected for the NIF program were, by Polish standards, large and medium, though not the largest and were recruited mostly from industry.

Table 1: Characteristics of companies involved in NIF program

Sector	Percentage	Number of employees			
		Up to 200	201-500	501-1000	More than 1000
Industry	80.5	9.2	23.6	25.8	21.9
Construction	14.6	1.4	6.1	5.9	1.2
Others	4.9	2.8	0.9	1.1	0.2
Total	100	13.4	30.6	32.8	23.2

Source: Szczepkowska, *Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych*”, Uniwersytet Szczeciński, p. 7

In terms of financial conditions the bottom line was profit equal to zero, with the minimal turnover of \$10 million. As a matter of fact however the financial position of the companies varied significantly ranging from highly profitable to loss making: 1/5 of the portfolio companies were sound enough to be listed on WSE in a short period of time but 31% of them

⁸ Szczepkowska, *Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych*’, p. 6; Surdykowska, *Prywatyzacja*, p. 239-240.

were recording losses⁹. The approximate book value of their assets was over PLN 7 billion (\$3 billion at the end of 1994) although varying again from more than \$43 million to \$4.3 million.

1.3. Fund management companies

15 cases fund management companies sponsored by institutional investors both Polish and foreign were usually contracted for 2 years with the option of contract extension up to 10 years. The compensation of funds managers was based on:

1. one fixed fee paid annually in dollars and adjustable annually for inflation and certain changes in the portfolio of the NIF and it was fixed for the 10-year life of the fund management agreement. The management fee was fixed for each fund separately via negotiations between the supervisory board and the fund management company and it usually accounted for 2-3% of the value of assets. The aggregate fee for all funds was \$42 million per annum¹⁰.
2. Fees for a performance-based bonus included the annual performance fee from the sale of 1% of the NIF's assets and the loyalty fee of 5 % of the NIF's assets at the end of the 10-year contractual period.

The total remuneration of funds managers accounts for approximately 3.5-4.5% of the value of the assets, which in the Western standard is rather generous¹¹ to provide the fund managers' focusing on the value of their portfolio companies and on value-increasing policies.

2. Corporate governance in the MPP

The mass privatisation by the definition leads to diffused ownership (shares/ vouchers distributed amongst millions of citizens) and results in the vacuum of monitoring and supervision and the increased discretion of managers who are likely to pursue self-dealing at the expense of shareholders. The Polish mass privatisation program was designed to create a dominant owner for enterprises and to provide the appropriate incentives for them that would

⁹ Iraj Hashi, „The Polish National Investment Fund Programme: Mass privatisation with a difference”, Working Paper no. 99.5, Staffordshire University, 1999, <http://www.staffs.ac.uk/schools/business/economics/papers/ec1999-05.pdf>, [accessed 15 April 2002] (para. 10 of 37).

¹⁰ Hashi, „The Polish National Investment Fund Programme: Mass privatisation with a difference”, (para. 15 of 37).

¹¹ Hashi, ‘The Polish National Investment Fund Programme: Mass privatisation with a difference’, (para. 16 of 37).

in result lead to the restructuring of the companies and speeding up their transfer to the private sector. The Polish MPP tried to overcome potential problems of investment funds identified in the case of Czech and Slovak mass privatisation programs¹². The characteristics and the role of investment funds participating in mass privatisation in CEE countries faced harsh criticism as those lacking incentives for restructuring. Since funds in Czech or Russian (at the early stages before concentration in hands of insiders) MPP usually owned 20-30% of the company, they were likely to utilize its power without restructuring and through a set of special contracts and non-transparent side deals with firms related to the fund management companies went for self-dealing such as tunnelling or siphoning¹³. Additionally the leading funds were monitored by other minority funds and were to consider high reputation of the fund management company. The governance as well as the incentive structure of the MPP was believed to reduce principal-agent problems at the company level and thus in the Polish program, the corporate governance problem was partly shifted from the 'enterprise level' to the 'fund level', i.e. how funds monitored and controlled themselves¹⁴.

2.1. The ownership of the portfolio companies

Portfolio companies faced significant change from the initially dispersed towards more concentrated ownership what enabled funds to pursue their strategies. To improve the efficiency of governance structure NIFs decided to enter mutual agreements for the consolidation of shares:

- The first consolidation took place in October 1996 and 6 funds joined the agreement¹⁵ – V NIF SA Victoria, VI NIF SA Magna Polonia, VIII NIF SA Octavia, X NIF SA Foksal, XI NIF SA, XII NIF SA Piast. It referred to shares of leading companies – the exchange

¹² Coffee John C. Jr., 'Inventing a Corporate Monitor for Transitional Economics: The Uncertain Lessons from the Czech and Polish Experiences' in Frydman Roman, Gray Cheryl W., Rapaczynski Andrzej (eds.), Corporate Governance in Central Europe and Russia, World Bank/CEU Press, 1996, 1, chap. 4, p.134.

John C. Jr. Coffee, 'Privatisation and corporate governance: The lessons from securities market failure', Columbia Law School, Center for Law and Economics Studies, Working Paper, no. 158, 1999, <http://www2.law.columbia.edu/law-economicstudies/papers/workp158.pdf> [accessed on 2 April, 2002] (para. 20 of 71); Jan Svejnar, 'Transition economies: Performance and Challenges', William Davidson Institute Working Paper, no. 415, 2001, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd158.pdf> [accessed on 5 April, 2002] (para. 12 of 45); Saul Estrin, 'Competition and corporate governance in transition', William Davidson Institute Working Paper, no. 431, 2001, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd431.pdf> [accessed on 2 April, 2002] (para. 12 of 42).

¹³ David Ellerman, 'Voucher privatisation with investment funds: An institutional analysis', World Bank, 1997, <http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1900series/wps1924/wps1924.pdf> [accessed on 11 April, 2002] (para. 3 of 12).

¹⁴ Hashi, „The Polish National Investment Fund Programme: Mass privatisation with a difference”, (para. 17 of 37).

¹⁵ Szczepkowska, 'Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych', p. 10.

included 5 different packages of 1.93% in different companies for one of 9.65% of one company focusing on sectors in which they have already owned companies. All together 162 companies were subject to this exchange process. In result the six funds had two types of minority stakes: 9.65% (so called super-minority) in 27 companies and 1.93% in the rest of them. The ownership structure of these 162 companies faced the significant concentration: one leading NIF (33%), one fund with 9.65% stake and nine minority funds-owners with stakes of 1.93%. From the perspective of NIFs super-minority holdings were expected to have a premium value over minority holdings as they would reduce the monitoring as well as transaction costs. The reduction was probably insufficient as they still have minority holdings in about 350 companies and in result funds tended to sell these minority stakes;

- In February 1998 the same six NIFs signed another agreement for share consolidation aimed at further reducing the number of minority companies in their portfolios.

2.2. *The ownership of the NIFs*

Additionally there was the trend of the ownership concentration on the fund level¹⁶. Financial institutions appeared to prefer gradual purchase of NIFs' shares and opted in many cases for the concentrated ownership in the NIFs. One move toward the trend was the merger of III NIF SA and XI NIF SA into one Jupiter NIF on December 31 2000. Researchers note that it is to be expected that over time the ownership of NIFs becomes more concentrated. The NIF formula applied financial intermediaries managing entrusted shares in the privatised companies in the name of the owners and the costs of heavily dispersed ownership were substantial¹⁷. In result, NIFs were controlled by powerful financial groups.

Table 2: The dominant shareholders of NIFs

The dominant shareholder	Shares in NIF	The management company
PEKAO SA	NIF Jupiter – 32,76%	Trinity Management
BRE BANK SA	I NIF – 14,2% V NIF – 15%	BRE Private Equity

¹⁶ Considering the depth of Polish financial markets and the relatively small size of investment funds, the law has provided some degree of protection against hostile takeovers in the first 4 years of NIFs public trading. According to the provisions no single shareholder might own more than 5% of shares of a fund in the first 2 years of the program. The proportion was increased to 10% and 20% in the third and fourth year. Some institutions predicted takeovers of many NIFs within 6 months after listing funds on the Warsaw Stock Exchange. However for the whole period of time, there was no sign of a takeover attempt.

¹⁷ Izabela Kołodkiewicz, 'The institutional shareholder – best practice: the National Investment Funds' experience, *Corporate governance*, 10, 2002, 3, p. 183.

	XIII NIF – 9,8% XIV NIF – 5%	
PZU S.A.	II NIF – 20,2% IV NIF – 21,34% IX NIF – 21,71%	PZU NIF Management
WBK AIB CA IB	VI NIF – 21,57% XV NIF – 53,73%	AIB WBL Fund Management CA IB Management
Copernicus/ NIF Fund Holdings	VIII NIF – 32% XII NIF – 25,5%	KP Consortium Ltd.

Source: Hashi 'The Polish National Investment Fund Programme: Mass privatisation with a difference', p. 8 and own research.

2.3. Supervisory boards of portfolio companies

The funds together do usually control the supervisory boards of companies since two other stakeholders entitled to the representation on the board have modest number of seats. It was in the interest if NIFs to coordinate their actions and in that way to gain an effective voice on supervisory boards. Thus, right from the beginning, there was an implicit agreement amongst NIFs that the lead fund should also nominate the representative of minority funds. Since the Treasury became a passive investor, the likelihood of the opportunistic behaviour exerted by the lead fund increased. Although the role of the minority NIFs might seem to be marginal, they appear to monitor the lead funds to some extent and therefore to enhance the governance structure, demanding for instance the disclosure of detailed financial information of portfolio companies. Their importance decreased as funds were disposing of minority shareholdings.

3. The assessment of the program

The results of the NIF scheme with respect to restructuring and enhancement of the companies' value remain relatively blurred and non-conclusive. The research evidence differs significantly: some researchers criticize the scheme heavily claiming that the Polish mass privatisation programs failed to provide expected results¹⁸, some others however express positive opinions toward the goals that were to be achieved¹⁹. The assessment of the program is analysed below according to the criteria listed in the introduction part of the paper.

¹⁸ Irena Grosfeld, Thierry Tressel, 'Competition and corporate governance: Substitutes or complements? Evidence from the Warsaw Stock Exchange', *William Davidson Institute Working Paper*, no. 369, 2001, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd369.pdf> [accessed on 10 April 2002], (para. 20-21 of 41).

¹⁹ Simon Commander, Mark Dutz, Nicholas Stern, 'Restructuring in transition economies: Ownership, competition and regulation', World Bank, 2001, http://www.worldbank.org/research/abcde/washington_11/pdfs/stern.pdf [accessed on 6 April, 2002] (para. 30 and 31-32 of 43).

3.1. Shifting the ownership form state to private hands

Since the beginning of the program till the end of 2001 the State Treasury sold its stakes in 115 companies for over ca. \$195 million. In case of 112 companies the state withdraw completely. At the end of 2001 state was still involved in 381 companies, what stands for 74.4% of the initial portfolio with the average stake between 10.7%-16.1%. This numbers are far from impressive and in the opinion of some researchers contribute to negative aspects of the Polish MPP. Table presents the state involvement in NIF at the end of 2004.

Table 3: State involvement in NIFs (December 2004)

Fund	Number of shares	Stake (%)
Fund I NIF	471,800	3.14
Jupiter NIF	2,972,527	5.71
NIF Progress	591,314	2.49
V NIF Victoria	917,036	6.10
NIF Magna Polonia	1,947,719	6.48
NIF Octava	4, 418,755	18.36
NIF Foksal	3,018,153	14.06
NIF Fortuna	1,071,922	7.13
Zachodni NIF	1,297,141	6.08

Source: Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 52-53.

3.2. The privatisation to strategic investors and restructuring of the companies

Fund management companies carried out restructuring by assigning each 5-6 portfolio companies to a small team of their employees. The team, directed by an investment director or a portfolio manager assisted companies in preparing the strategic plan²⁰. As far as the restructuring activity is concerned the evidence shows that the labour shedding amounted for 10 and 20% between 1996 and 2000. Funds teams pursued significant changes especially in the strategic management, production lines and product designs as well as budgeting, accounting and the compensation system. Approximately 300 companies that joined NIF program were subject of deep organizational and financial restructuring, including debt

²⁰ Hashi 'The Polish National Investment Fund Programme: Mass privatisation with a difference', (para. 24 of 37).

conversion and reorganization, implementation of new accountancy rules and improvement in top management teams.

The NIFs' investments in portfolio companies between 1996-1997 is estimated for PLN 293 million in lead companies and PLN 203 million in minority companies. Additionally, strategic investors invested PLN 173 million. The data as of September 30, 2001 shows that NIFs invested 898.2 million PLN in the restructuring programs in leading companies and 241.8 million PLN in minority companies. Altogether NIFs invested 1,140.3 PLN million what accounts for 62.4% of the gains realized from the companies sale. Meanwhile the sale of company to strategic investors generated ca. 639 million PLN to NIFs, whereas the average income of NIFs from disposal of portfolio companies in 1996-98 is estimated at PLN 143 million.

Portfolio companies, which due to the bad economic situation were directed to the liquidation and bankruptcy processes account for 20% of the overall number. At the end of 2001 16% of these cases were executed. 7 companies were revoked, whereas 13 companies are subject to the liquidation procedure. The decisive strategy of the NIFs towards bankruptcy and liquidation proceedings may be linked to their more favourable position for implementing of these politically unpopular procedures for companies that were evaluated as financially non-viable. The funds were simply better placed as compared to state constrained by political pressures to pursue closing down of unprofitable companies. Until the September 30, 2001 NIFs sold 325 out of 512 companies (63% of their portfolios). More than half of the NIF portfolio companies found strategic investors and in 2/3 of cases these were industrial-related investors. Some companies, mostly in poor financial conditions were sold to insiders whereas at the end of 2001 shares of 26 companies were traded on Warsaw Stock Exchange and 10 on off-exchange market (CTO). As of the end of September 2001 187 companies were still under the management of NIFs. The recent report of the State Treasury (2005) summarized NIF privatization scheme indicating that out of 512 companies covered by the program at the end of 2004:

- in 232 companies (46%) privatization was fully completed;
- 130 companies were liquidated;
- 5 companies were merged in other units;
- 135 is actively controlled by the state.

The table below presents the breakdown of all the NIFs portfolios.

Table 4: Leading companies in NIFs portfolios

NFI	Number of leading companies in portfolio as of 1998	Number of leading companies in portfolio as of Sept 30, 2001	Number of leading companies in portfolio as of Nov 2006
01 NIF	35	10	Closing its activity
02 NIF	34	19	Closing its activity
03 NIF	34	11	0 (fund holds bonds and shares in 4 companies)
04 NIF	35	16	Closing its activity
05 NIF	35	7	Closing its activity
06 NIF	35	10	5
07 NIF	34	28	4
08 NIF	34	8	0 (fund holds in 5 real estate-related companies)
09 NIF	34	11	Closing its activity
10 NIF	33	13	Closing its activity
11 NIF	33	11	0 (merged with 03 NIF)
12 NIF	34	10	New strategy specialising in real estate
13 NIF	34	4	0, fund is closing its activity
14 NIF	34	12	Closing its activity
15 NIF	35	13	New strategy specialising in management of non-food consumer brands

Source: own calculations based on data from NIF annual reports and websites.

However, the strategy of NIFs with the respect to their role differs significantly. Some of the NIFs actively searched for strategic investors and carried the reorganization, whereas some others perceived themselves as purely financial investment funds focusing more on trading shares and other securities on domestic and foreign markets. As evidence shows many funds decided to pursue very easy strategy – instead of actively restructure portfolio companies they sold the most attractive assets to other investors and purchased bonds or other financial instruments. The quick liquidation assets strategy belong to the biggest disappointed pf the NIF scheme.

3.3. Increase in firm value, improvement in productivity, investment, and sales

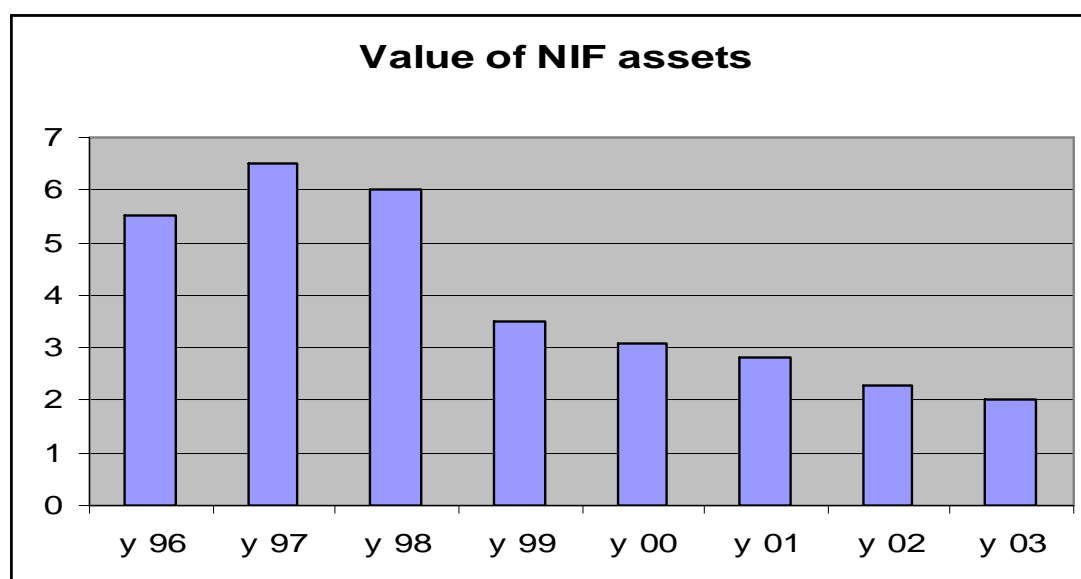
Approximately, 30% of portfolio companies were recording losses at the time of joining the program. Most of them represented troublesome sectors as meat sector, clothing, coal mining and steel. Despite significant restructuring efforts, improvements in profitability (or reductions in losses) and labour, the productivity of portfolio companies showed the significant long-turn market underperformance²¹. Other researches deliver however evidence

²¹ Aussenegg, 'Going public in Poland: Case-by-case privatisation, mass privatisation and private sector initial public offerings', para. 25 of 44).

that firms included in the mass privatisation program showed rapid improvements in the profitability before these companies were virtually privatised²². The proportion of the leading companies recording losses increased in 1996 before dropping to 29% in 1998. 71% in 1999 and 48% in 2000 of the leading companies generated net profits.

Despite important restructuring efforts carried out by the NIFs, their performance has been rather disappointing. The dividend paid by the funds was very small if any. The net assets value of most NIFs has not kept up with the inflation²³. As compared to 1997 the net assets value plummeted significantly what is perceived as a disappointing results totally opposite to the goals of the program and government laws (figure 4).

Figure 4: Value of NIF assets (bln PLN)



Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 16.

The breakdown of the assets value of individual NIFs is presented in table 5.

Table 5: Net assets value of NIFs (million, PLN)

NIF	End 1996	1 st quarter 1997)	End 2000	End 2001	End 2003
I NIF S.A.	440	412	190	184	155
II NIF S.A.	470	459	155	146	140
IV NIF S.A Progress	390	405	230	190	175
V NIF S.A Victoria	340	299	150	135	120
VI NIF S.A Magna	350	328	240	200	180

²² Commander, Dutz, Stern, 'Restructuring in transition economies: Ownership, competition and regulation' (para. 31-32 of 43).

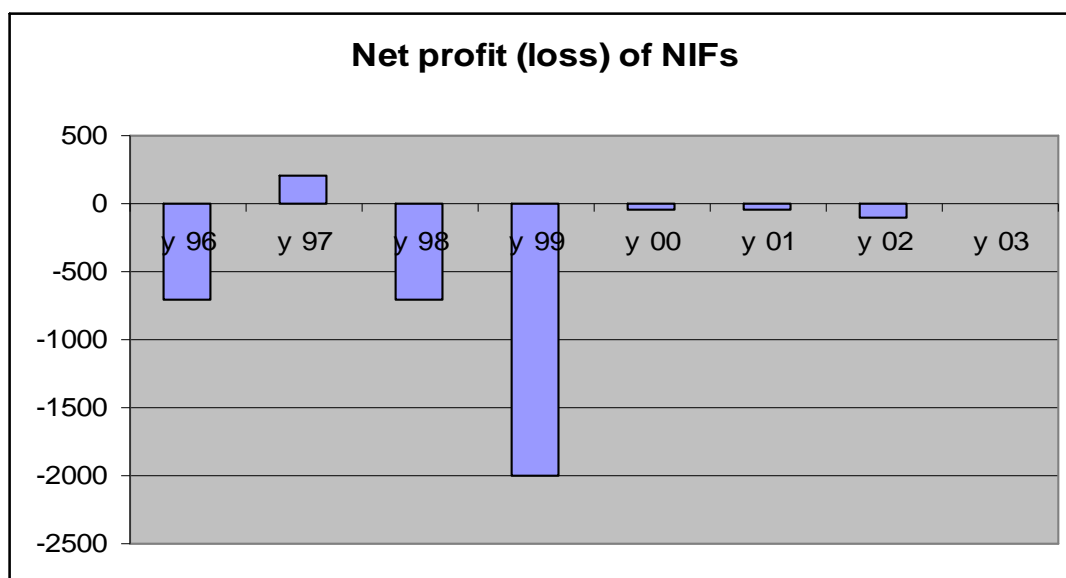
²³ Hashi, 'The Polish National Investment Fund Programme: Mass privatisation with a difference', (para. 34 of 37).

Polonia					
VII NIF S.A im. Kazimierza Wielkiego	390	378	100	107	98
VIII NIF S.A Octava	380	347	340	331	250
IX NIF S.A im. E. Kwiatkowskiego	390	370	350	318	280
X NIF S.A Foksal	500	464	170	146	100
XII NIF S.A Piast	410	382	130	101	45
XIII NIF S.A Fortuna	500	378	200	185	160
XIV NIF S.A Zachodni	380	374	220	211	170
XV NIF S.A Hetman	410	401	270	131	70
NIF Jupiter (II NIF and XI NIF merged)	760	746	500	414	230

Source: based on Szczepkowska, 'Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych', p. 12-13; Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 17.

The loss of the investment activity tends to be the major weakness of NIFs. Despite the intensive sale of shares majority of capital is allocated in risk-averse bonds and debt securities which are unable to cover losses in portfolio companies. The loss on investment activity reached 16.42 million PLN at the end of 2001. The total profit of NIFs in 2001 was negative as well and accounted for 51.2 million PLN²⁴, which stands for 37% of the previous year loss²⁵. Figure 5 presents net profit generated by NIFs during the period 1996-2003.

Figure 5: Net profit (loss) generated in NIFs, 1996-2003, mln PLN



Source: Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 21.

²⁴ Hashi, 'The Polish National Investment Fund Programme: Mass privatisation with a difference', (para. 26 of 37).

²⁵ Nevertheless ca. half of the NIFs generated positive profits at the end of 2001.

3.4. The pace and scope of privatisation

The mass privatisation program definitely contributed to the acceleration and increasing the scope of privatisation process although it covered merely 512 companies what by standards of other CEE countries appears to be marginal. For instance the MPP covered ca. 1,800 companies in the Czech Republic and ca. 15,000 companies in Russia. On the other hand however the long period of the scheme implementation raises questions if the pace of the privatisation would be slower/ faster in the case of the alternative methods.

3.5. Lower costs of the ownership change

It is extremely difficult to judge if the mass privatisation program led to reducing the costs of the ownership transformation. During the period of transition Poland relied mostly on the case-by-case privatisation, which on the other hand in case of direct sale to investors allowed to generate revenues needed for reforms. The mass privatisation program was not costly since it was to a large extent financed by the World Bank. The sale of stakes in only 115 companies generated over 745 million PLN (ca. \$195 million) to the state which remains pretty moderate number as for privatisation revenues. Table 6 compares privatisation by three main methods.

Table 6: Comparison of privatisation by indirect, direct and NIF method

Element	Indirect privatisation (1990-2003)	NIF program (1995-2003)	Direct privatisation (1990-2003)
Investment (mln PLN)	69, 655	6, 014	4, 955
Investment in environment protection (mln PLN)	4, 662	674.5	225
Employment	217, 097	63, 631	87, 747
Average salary (PLN)	2, 929	2, 270	2,130

Source: Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 39.

3.6. Distribution of the 'national' wealth and boosting the public interest in the stock market

The mass privatisation program played a marginal role in Polish transformation²⁶. The NIF scheme did not manage to encourage interest in the stock market. The public interest in the

²⁶ Michał Federowicz, 'Corporate governance and industrial relations in Poland', Centre for the Study of Economic and Social Change in Europe, School of Slavonic and East European Studies, Working Paper, no. 28, 2003, [accessed on 8 May 2005] (para. 17 of 22).

program peaked during the certificates distribution and conversion and dropped afterwards. An average Pole did not feel any significant impact of the distribution of the wealth accumulated during socialism since the value of the certificate was very low. Majority citizens decided to sell either the certificates even before they were converted into the 15 NIF shares or the NIF shares in some of the very first weeks of their trading and therefore the interest in the stock market as such was significantly limited.

3.7. Development of corporate governance mechanisms

Avoiding the control vacuum

The NIF structure characterized by the dominant position of one leading fund, the incentive compensation for the fund management companies, the participation of the reputational foreign investors and the regulatory framework of the scheme provided monitoring mechanisms and allowed to avoid the control vacuum (no dispersed ownership structure). The available data on the mass privatisation program deliver evidence that the NIF structure did not suffer from the control vacuum so characteristic in the Czech Republic, Slovakia or Russia. Just the opposite: it created complicated and multi-level structure that caused the overlapping of competence of various agents and might in effect lead to higher transaction costs.

Designing structure of sound governance mechanisms

The NIF structure may appear to be relatively successful with respect to active role of funds, monitoring and incentive structure and restructuring results, yet some researchers claim that more attention should have been given to managerial incentives and supervision²⁷. The MPP scheme that from the definition adds one surface of intermediary institutions in the Polish case produced a complicated, multi-level structure that is associated with the problems of ‘who monitors the monitors’²⁸.

Additionally the trend towards increasing the NIF ownership concentration is accompanied by the extensive buy back programs introduced by many funds. Therefore authors claim we observe the phenomena of ‘disappearing’ of NIFs. Data shows that investors involved in the NIFs structure tend to merge or buy back its shares and dissemble funds. On average the NIFs

²⁷ Grosfeld, Tressel, ‘Competition and corporate governance: Substitutes or complements? Evidence from the Warsaw Stock Exchange’ (para. 15 of 41).

²⁸ Estrin, ‘Competition and corporate governance in transition’, (para. 12 of 42).

bought back more than 10% of their shares²⁹. Investors (mostly foreign, powerful financial groups) that dominate in the NIFs ownership tend to be involved in other Polish companies but outside the NIFs structure.

Evolution of active institutional investors

The current NIFs involvement in Polish new companies is marginal and in the non-MPP companies appears to be relatively modest. Funds are de facto in legal and organizational terms diversified conglomerates acting as closed investment funds³⁰.

3.8. NIF scheme versus other privatisation methods applied in Poland

The privatisation privatisations is indisputable positive for the companies³¹. There is however no agreement towards the scheme and the pace of the process³². Comparative studies of privatisation schemes in Poland show that the identity of the owner matters significantly. Outsider-owned privatised firms noted significantly higher annual revenue growth than either state or insider-owned firms. Firms privatised to outsider, particularly to foreigners, tended to perform best in the terms of labour productivity and investment³³. Privatisation to investment funds is 5 times more productive as privatisation to insiders, whereas privatisation to foreigners and blockholders is 3 times more productive as privatisation to insiders. The concentrated ownership is beneficial³⁴ however as shown by Grosfeld and Tressel³⁵ the controlling shareholder in Poland has a negative effect, when CEO, a bank or NIF controls the

²⁹ Hetman NIF bought 50% of its shares, Kwiatowski NIF bought 25% of its share, NIF Progress – 20%, NIF Octavia – 19%, Drugi NIF and NIF Jupiter 9-13%. Apparently, the tendency toward increasing ownership concentration results also from the ending time of the program and associated payoff from the State Treasury and thus the ownership block enjoys higher premia. Some observers claim that the new, more concentrated structures evolving currently show higher efficiency since they eliminate one layer of agents in the corporate governance structure as noted by Maciej Samcik ‘Wokół parkietu: NFI Hetman może zniknąć’, 2002, Gazeta Wyborcza – online resources, <http://www2.gazeta.info/elementy/druk.jsp?xx=1121702&plik=/htm/1121/a1121702.html>; Maciej Samcik ‘Czy Prokom zainwestuje w fundusze NFI należące do PZU?’ 2002; Gazeta Wyborcza – online resources, <http://www2.gazeta.info/elementy/druk.jsp?xx=1131064&plik=/htm/1131/a1131064.html>

³⁰ Szczepkowska, ‘Funkcjonowanie przedsiębiorstw w ramach grup kapitałowych na przykładzie Narodowych Funduszy Inwestycyjnych’, p. 11-12.

³¹ Estrin, ‘Competition and corporate governance in transition’, (para. 24 of 42)

³² Svejnar, ‘Transition economies: Performance and Challenges’ (para. 8 of 45); Gerald Mc-Dermott, ‘Network restructuring and firm creation in East-Central Europe: A public-private venture’, William Davidson Institute Working Paper, no. 361, 2000, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd361.pdf> [accessed on 10 April 2002] (para. 7-8 of 56).

³³ Commander, Dutz, Stern, ‘Restructuring in transition economies: Ownership, competition and regulation’ (para. 15-16 of 43); Roman Frydman, Cheryl W., Gray, Marek Hessel, Andrzej Rapaczynski, ‘The limits of discipline’, Economics of Transition, 8, 2000, pp. 579.

³⁴ Estrin, ‘Competition and corporate governance in transition’, (para. 25 of 42).

³⁵ Grosfeld, Tressel, ‘Competition and corporate governance: Substitutes or complements? Evidence from the Warsaw Stock Exchange’ (para. 20-21 of 41).

company³⁶. Relative to MEBOs, mass privatisation and direct sales more than double the productivity change recorded over the subsequent two years, with the effect slightly stronger for direct sales. Insider privatisation has been mostly associated with low investment, limited managerial change and product innovation³⁷. Table 7 presents performance of companies privatised by NIF scheme as compared companies privatised by other methods.

Table 7: Performance of privatised companies in 2003

Method	No	Loss making (net)	Cost ratio	Operating ration	Net operating ratio	Liquidity ratio
Total	2,434	34.7	93.5	5.9	4.4	24.4
Sole State Treasury companies	337	39.5	87.3	10.9	9.8	28.8
NIF	367	43.3	98.4	1.9	0.6	13.2
Indirect privatisation	275	32.4	94.0	6.0	3.9	30.3
Controlled by the state	174	35.6	102.7	-2.7	-4.0	14.7
Debt swaps	12	58.3	106	-5.7	-5.8	16.9
EBO	1092	25.7	96.9	3.1	1.9	32.6
In process of direct privatisation	18	83.3	90.2	9.6	17.0	1.0

Source: Source: Ministry of State Treasury, 'Report of NIF programme 1997-2003', p. 35.

As shown in table performance of companies privatised by NIF scheme remains disappointing.

3.9. Polish NIFs versus the MPP in other CEE countries

³⁶ In the Czech Republic ownership concentration is associated with better performance as long as strategic investor other than investment fund is the author of this concentration as noted by Andrew Weiss, Georgiy Nikitin, 'Performance of Czech companies by ownership structure', *William Davidson Institute Working Paper*, no. 186, 1998, <http://wdi.umich.edu/files/Publications/WorkingPapers/wd186.pdf> [accessed on 3 April 2002], (para. 3 of 45).

³⁷ Commander, Dutz, Stern, 'Restructuring in transition economies: Ownership, competition and regulation' (para. 15-16 of 43).

Research shows that 19 out of 25 transition countries used some forms of mass privatisation as either a primary or secondary method³⁸, although the applied schemes varied significantly in the terms of structure, pace and governance mechanisms that eventually evolved. In most of the CEEC mass privatisation programs were implemented earlier and faster than in Poland. 512 Polish companies privatised via 15 investment funds account for a marginal share of all companies as opposed to many of CEECs: some 600 funds were created for 2,352 privatised companies in the Czech scheme³⁹ whereas the Russian MPP covered 14,000 medium and large enterprises what stands for two third of the industrial labour in the terms of employment. Russia and Ukraine implemented rapid mass privatisation and relied mostly on management-employee buyouts, whereas the Czech Republic, Lithuania and to a lesser extend Slovakia based the program upon equal-access voucher distributing the shares among the society⁴⁰ and privatising the companies via investment funds⁴¹. The rapid mass privatisation could be crucial from the perspective that it used the window of opportunity and eliminated the threat of reform regression. On the other hand the equal-access voucher privatisation allowed for speedy and relatively fair distribution of the nation's wealth. These methods however neither contributed to the emergence of new investment funds nor generated resources for government. Moreover both led to the poor corporate governance structure⁴². The rapid mass privatisation failed to provide the existing management with incentives or tools for the efficiency improvement. The equal-access voucher privatisation resulted in the dispersed ownership since the program usually involved the whole population of a country. Researchers argue that the failure of the voucher mass privatisation to provide effective governance structure is rooted in the structure of long agency chains since the citizen who receives a privatisation voucher cannot provide appropriate incentives for corporate control⁴³. From that perspective the voucher investment funds provided a 'vehicle for high abuse'⁴⁴. The dispersed ownership resulted in the control vacuum what in turn led to the tunnelling carried out by

³⁸ Estrin, 'Competition and corporate governance in transition', (para. 12 of 42).

³⁹ Coffee, 'Privatisation and corporate governance: The lessons from securities market failure', (para. 22 of 71).

⁴⁰ Svejnar, 'Transition economies: Performance and Challenges' (para. 31 of 45).

⁴¹ Coffee, 'Inventing a corporate monitor for transitional economics: The uncertain lessons from the Czech and Polish experiences', p. 122.

⁴² Estrin, 'Competition and corporate governance in transition', (para 12-14 of 42); Coffee, 'Privatisation and corporate governance: The lessons from securities market failure', (para 24 of 71).

⁴³ Joseph Stiglitz, 'Whiter reform?', ABCDE Conferencem Washinton D.C., World Bank 1999; Joseph Stiglitz, 'Quis custodiet ipsos custodes? Corporate governance failures in the transition', ABCDE Conference, Paris, World Bank, 1999 as quoted in Estrin, 'Competition and corporate governance in transition', (para. 14 of 42).

⁴⁴ Joseph Stiglitz, 'The role of government in economic development', in Michael Bruno, Borin Pleskovic (eds.) Annual World Bank Conference on Development Economics, Washinton D.C., World Bank, pp. 11-23 as quoted in Estrin, 'Competition and corporate governance in transition', (para. 14 of 42).

managers or majority shareholders at the expense of minority shareholders⁴⁵. Moreover, the Czech case shows that the investment privatisation funds acted more like agents not owners since they were receiving a management fee but did not benefit from the increase in the equity value. Additionally since the stock market was thin, the institutional investors were locked in without the choice between exit or voice⁴⁶. However, in principle it was possible for financial intermediaries to concentrate voucher holdings and carry out the effective monitoring as it happened in Poland, Slovenia and Slovakia and to some extent in the Czech Republic, although 'who monitors whom' structure was not always clear⁴⁷.

Further research indicates the crucial role of the regulatory and institutional regime that created frames for privatisation⁴⁸. In the Czech case regulations allowed for the trading the shares of companies subject to the privatisation outside the stock exchange and trading on the Prague Stock Exchange did not require contemporaneous price reporting what contributed to the systematic looting of the Czech companies by their controlling shareholders (IPFs) and the expropriation of the remaining minority shareholders⁴⁹. As result of these problems between 1995 and 1999 the number of companies listed at the PSE fell by more than 80% (from 1,716 to 301). Therefore, the quality of the regulation appears to be the crucial element of the privatisation program and the efficiency of the new ownership structure.

Conclusions

The results of the Polish MPP are highly controversial and relatively blurred. Despite a lot of criticism one shall conclude the main goals were achieved. The restructuring was carried out in most of the portfolio companies. Many of the NIF companies were sold to outside, mostly strategic and industrial-related investors. The financial results although still highly disappointing got improved. Comparative analyses show that the Polish MPP as opposed to the Czech, Slovak or Russian schemes provided relatively adequate control structure. There is however hard to say to what extend looting was reduced. The structure characterized one additional level of agents turned to be complicated and costly and the investors involved in the NIF scheme will be present on the Polish market but outside the NIF structure. The NIF

⁴⁵ Coffee, 'Privatisation and corporate governance: The lessons from securities market failure', (para 23 of 71); Svejnar, 'Transition economies: Performance and Challenges', (para. 12 of 42).

⁴⁶ Coffee, 'Inventing a corporate monitor for transitional economics: The uncertain lessons from the Czech and Polish experiences', p. 125.

⁴⁷ Estrin, 'Competition and corporate governance in transition', (para 12 of 42).

⁴⁸ Edward Glaesser, Simon Johnson, Andrei Shleifer, 'Coase versus Coasians', *Quarterly Journal of Economics*, 116, 2001, 3, p. 894.

⁴⁹ Coffee, 'Privatisation and corporate governance: The lessons from securities market failure', (para. 31-32 of 71).

structure is not that efficient as the one tailored by market institutions. It is however highly disputable whether the MPP contributed to the development of governance mechanisms in Poland. NIFs are hardly involved in the ownership of Polish companies, they definitely evolve towards pure investment activity and ownership concentration appeared to be the most significant control mechanisms used by the funds. NIFs' stake accounts for 10 to 16% ranging from average 21% of some privatised to 6% of new set companies⁵⁰. Besides foreign and domestic companies and to a lesser extend banks it is questionable whether other institutional investors will be willing to engage in the active governance in Polish companies. On the other hand however the change in the ownership and governance structure of both portfolio companies and the NIF indicate that the ownership concentration is very important in transition economies. Additionally, the change portrays the development and importance of capital networks and shareholdings tend to play crucial role in the Polish governance system. Comparative analysis describe the Polish scheme as 'the least mass' amongst MPPs in transition economies. As a matter of fact Poland was the only country that so far administratively structured its investment funds. Many experts indicate deficiencies and negative aspects of mass privatization programs across CEE what may lead to the conclusion that the scheme is wrong from the definition⁵¹. From this perspective the Polish model although did not lead to efficient restructuring or emergence of corporate governance, was able however to minimise yet not fully eliminate the most problematic aspects of mass privatisation.

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⁵⁰ Grosfeld, Tressel, 'Competition and corporate governance: Substitutes or complements? Evidence from the Warsaw Stock Exchange' (para. 18-19 of 41).

⁵¹ For instance the evaluation of Russian privatization program shifted from optimistic to concerned and doubtful in 1995 as 'the second 'cash' phase of privatization was not proceeding in a rapid or honest manner, then to alarm, in late 1995-early 1996, over the 'loans-for-shares' program in which some very high potential, natural resources-based finds were transferred in a matter neither competitive not transparent nor lucrative to the selling state, to a group of financial 'oligarchs' connected to the presidency. And there were few signs of substantial restructuring, much less production growth, in the firms privatized by vouchers' as noted by John Nellis, 'Privatization in transition economies: What happened? What comes next?', 2001, pppue.undp.org/indexAction.cfm?module=Library&action+GetFile&DocumentID=53. Addressing the poor performance of Russian economy of the period 1995-1998 and the inequitable distribution of wealth the Nobel laureate Kenneth Arrow described Russian privatization as "a predicable economic disaster" and former advocate of rapid privatization and adviser to CEE governments Jeffrey Sachs called for re-nationalization of the mis-privatized companies in order to re-privatize them second correctly.

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