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Enterprise Restructuring in Transition Economies and its Determinants: The Case of Bulgaria

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Abstract

This paper is a rough draft of a reflection about the causes of restructuring in transition economies (TEs), resulting from questions arisen after reading the profuse literature related to restructuring. Since the beginning of the 1990s, the number of enterprise restructuring determinants under study has grown to include competition, budget constraints, ownership, human capital and institutions. When most existing studies focus on the impact of one to three different determinants, we will try to know if the simultaneous study of all five determinants could lead to a global and coherent explanation of the restructuring process. For this study, I will refer to the Bulgarian experience with restructuring, and try to evaluate the articulation between its potential causes. Given the variety of problems that hamper quantitative analysis of

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enterprise restructuring in TEs, I chose to refer to qualitative restructuring indicators, following the distinction between “defensive” and “strategic” measures. During the first half of the 1990, competition and harder budget constraint (cut in subsidies) have spurred some defensive adjustment measures, while unconditional bank lending and the bad quality of institutions have hampered more substantial restructuring. More recently, we find that change in ownership and hardened budget constraints do not act necessarily in the same direction, with respect to restructuring, and are, furthermore, dependent on the quality of institutions and on the degree of (foreign) competition.

KEYWORDS: restructuring, transition economies, competition, ownership, institutions, Bulgaria

JEL classification: D23, G34, G32, P31

Introduction

The ultimate objective of economic reform in the transition countries is to achieve sustainable economic growth. Enterprise restructuring is considered essential for this. It encompasses both short-run, or «defensive» actions, and long run, or «strategic», measures (Estrin et al., 1995; Grosfeld & Roland, 1995). The former set, addressed to the immediate survival of the enterprise, comprises, for example, reduction of employment, substitution of cheaper material inputs, disposal of unneeded inventories and equipment, and adjustment of the current product mix to increase sales. The latter set, altering the entire business strategy, comprehends, for instance, a different organizational structure, investment for new production processes and product lines, and stronger quality and marketing².

Since 1990, numerous empirical studies have examined enterprise-level data in order to highlight the forms and determinants of restructuring. This paper seeks to document and synthesize the main determinants of enterprise restructuring³ and to ascertain whether the taking into account of newly found determinants

²*Different indicators are used to assess the results of restructuring (employment, sales, productivity, profitability). It has been argued that in the early phase of «defensive» restructuring, employment and sales are pertinent indicators while profitability indicators are more appropriate during or after «strategic» restructuring (Bornstein, 2000). This present paper does not address problems related to the use of these indicators. On this subject see, for example, Djankov & Murrell (2000), Estrin (1998), and Bevan et al. (1999).*

³*The study focuses on the restructuring of nonagricultural and non-financial firms.*

leads to a better comprehension of the different dimensions of the phenomenon or to the blurring of the already existing findings. In other words, does the addition of new restructuring determinants shed new light on the type of enterprise responses: does it qualify the statements or does it contradict them?

The review of contributions to the field of enterprise restructuring shows five main restructuring determinants: competition, the state of the budget constraints, ownership, human capital and institutions. In order to study the potential complementarities and, or conflicts of the results stemming from the simultaneous use of these five determinants, I will refer more particularly to Bulgaria. The relevant literature on this subject analyzes the impact of isolated variables, mostly competition and budget constraints, at the initial stage of transition, the main reference being different studies of Djankov & Hoekman (1995, 1996, 1997). That precludes taking into consideration the important implications for the enterprise restructuring, of the ownership structure resulting from mass privatization. The use of documents originating from Bulgarian independent economic research centers (e.g., Manev et al., 2000; Pankow et al., 1999), as well as studies co-conducted by the author (Koleva & Vincensini, 2000, 2002) allow the widening of the determinant's variety, on the one hand, and the integration of recent data (up to year 2000) into the present analysis, on the other hand. I will refer to econometric studies as well as to case studies that offer valuable insights concerning qualitative aspects of enterprise adjustment. The contribution of this paper is thus to put together several fragmented studies while discussing the interactions between the factors of restructuring.

The paper is organized as follows. Section II presents the five main determinants of enterprise restructuring in TEs arising separately in the economic literature. Section III investigates their mechanisms of interaction with respect to the case of enterprise adjustment taking place in Bulgaria in the first half of the 1990s. We will show that competition and cut in subsidies both triggered defensive restructuring, while the lack of strategic restructuring could be attributed to several other (institutional) factors whose impact was neglected by mainstream economics. These factors were brought to the fore by the economic crisis of 1996-97. The crisis ended by the introduction of a currency board that abolished independent monetary policy and established fiscal discipline. This period coincided with the end of the first wave of voucher privatization, and with the launch of a new privatization program. Given this, since 1997 it has become possible to study the impact of additional determinants of restructuring in Bulgaria. Section IV focuses more particularly

on the effects of privatization and hard budget constraint, while discussing their relationship with the other determinants.

Five determinants of enterprise restructuring

In the last ten years a bulk of analyses of economic transformation in Central and Eastern Europe has investigated the responses of enterprises to the changes in their environment. The review of these contributions allows us to draw out five main determinants of restructuring (without pretension of exhaustivity): competition, budget constraints, ownership, manager turnover and «institutions».

Competition

In the first years of transition, the economists were strongly interested in testing the importance of product market competition on the subsequent performance of enterprises. The neoclassical economic view has suggested that the competitive environment will affect mainly the efficacy of organizational change: greater competition increases pressure to maximize efficiency. It was predicted that the generalized introduction of market forces through price and trade liberalization would help to break the path dependence and result in beneficial changes made by rational actors (Lipton & Sachs, 1990). At the center of this consensus was a confidence in the ability of economic technocrats to design feasible, if painful, solutions. Organizational reforms departing most decisively from practices of the past, such as industrial sectors' demonopolization through splitting of conglomerates and spin-offs of individual production units, and the entry of new private firms would increase pressure to restructure.

The opposite assumption was formulated by evolutionary economists, who argued that enterprise behavior is a product of both present incentives and historical continuity. According to Murrell (1992, p.38), « the productivity of an organization depends to no small degree on the ability of that organization to continue its operations within some small neighborhood of its past behavior ». Evolutionary economists were therefore concerned that the reforms in transition economies were too preoccupied with removing institutional legacies for the sake of freeing the competitive forces of markets along Western models. They considered the process of destruction of large organizations to be harmful, due to inherent externalities arising from the non-market elements of coordination intrinsic in organizations (routines). Core organizational properties, such as goals, forms of authority, and marketing strategy only change gradually. The

slowness of the process makes it possible to learn through experience and to benefit from existing information on the characteristics of the new system. Consequently, to provide for individual and social learning processes in a context of high volatility, evolutionists advocated a gradual lowering in barriers to entry in order to permit firms in the temporarily protected sector to become more competitive by the new, market-based rules of the game, before facing global competition. More generally, in the beginning of the 1990s evolutionists like Murrell put forward the need to implement stabilization programs with caution and consider short-run decentralization and marketization of the state sector as less important than policies favoring the growth of the private sector.

Budget constraints

The second important factor that was expected to foster restructuring of the existing firms, arising from the literature on transition, is the hardening of the budget constraints. The concept of « soft budget constraint » was first used by Kornai (1980) to depict ex-post bailouts of loss-making enterprises by the paternalistic state. The key routes by which budget constraints are softened in TEs are twofold. The first is via tax nonpayment, a mechanism that enables firms in financial difficulties to obtain what is in fact an additional government financing. The second is via soft credits extended via the banking system. It is generally assumed that the effect of state budget subsidies on soft budget constraints in transition economies is not as strong as under the centrally planned economy. Budget subsidies consist essentially in price subsidies for a small number of goods and services in the public transport, agricultural and electric power generation sectors, a phenomenon well known in many developed market economies (Schaffer, 1997). As for inter-enterprise arrears, their role in softening budget constraints is still a matter of debate. While Kornai (1993) considers that very large stocks of trade credit and overdue trade credit present in transition economies are an example of weak financial discipline, Schaffer (1997) argue that the fears surrounding this apparent payment indiscipline have been exaggerated because competition and the hardening of budget constraints had encouraged enterprises to introduce cash management techniques expected of a market economy.

Ownership

In the early debates on transition policy, the importance of hard budget constraints as a prerequisite of enterprise restructuring, has been emphasized by the supporters of a gradual reform (Roland, 1994). On the opposite, the

advocates of a big bang reform (Lipton & Sachs, 1991) argued that only private ownership would put in place proper incentives for enterprises to restructure. Privatization was then put forth as another mechanism hypothesized to have a positive impact on firm adjustment and performance. It was expected to do so via two causal channels. On the one hand, the introducing of a financial stake for new owners should increase the monitoring of enterprise performance: poor performance endangering the financial investment of the new owners. On the other hand, passing cash flow and control rights from the state to private owners would dissolve the 'umbilical cord' linking the two, thus hardening budget constraints and reducing managerial discretion to pursue nonprofit maximizing goals. The underlying assumption was that any form of privatization would necessarily be much better than state ownership and that market mechanisms would lead gradually to a more efficient distribution of assets among private owners. However, real development in TEs has led to qualify this assumption, putting forward two important issues. First, an increasing number of researchers currently argues that what matters most is not privatization as such but the type of owner it gives control to. The method of privatization chosen by each TE determines the new controllers of the enterprises but the likelihood of extensive restructuring depends on their desire, knowledge and resources for transformation (Frydman *et al.*, 1999; Bevan *et al.*, 1999). Second, studies revealing that only foreign investors perform well could be misleading if they do not address the bias that may be induced by the nature of the privatization process. Firms having already recorded a good pre-reform performance are more likely to attract foreign owners; therefore the causality could run from performance to restructuring and not the other way around.

While these three determinants of enterprise restructuring in TEs have arisen separately in the economic literature during the first half of the 1990s, in recent years some empirical analyses have tried to investigate their relationships. A study by Frydman *et al.* (2000) demonstrates the complementarity between hard budget constraint and privatization. State enterprises appear less likely to pay back their debt. The creditors' difficulty in imposing financial discipline is related to the property rights structure. According to the study, creditors continue to finance firms' losses in the hope of partially recovering, at a later stage, the cost of their initial investment. This expectation is strongly linked to the prospect of privatization of these firms and to the anticipated improvement in their performance. Other studies attest the complementarity between competitive pressure and privatization. Thus, Grosfeld & Tressel (2001) use Polish quoted firms' data and find that in privatized firms, competitive pressure tends to reinforce the disciplinary power of the new owners, thus constraining

managers to launch restructuring measures. On the contrary, competition does not have any significant impact on the performance of enterprises characterized by weak corporate governance device: competitive pressure cannot be a substitute for inefficient shareholders' control over managers.

The main conclusion of these studies is that there is no dominant determinant of firm adjustment - competitive pressure, hard budget constraints and ownership act rather, as complementary factors. Another direction of research since 1996 has consisted in stressing the role of new potential determinants of restructuring in TEs, such as manager turnover and «institutions».

The role of managers

Manager turnover, or more broadly, new human capital incorporation, is considered to be important for improvement in enterprise performance not only in private but also in state-owned firms. In a survey of Russian shops in the period following privatization, Barberis et al. (1996) show that privatization, and the introduction of high-powered incentives for managers, are not enough to cause shops to undertake major restructuring measures (such as engaging in capital renovation, keeping longer hours, changing suppliers). The replacement of management has more effect than incentives. These findings are confirmed by Claessens & Djankov (1999) in a study of privatized Czech firms. In addition, a large EBRD-World Bank survey (EBRD, 1999) shows that the probability of replacement of the top manager increases when the enterprise faces harder budget constraints and higher product-market competition.

Institutions

Although the beginning of the economic transition coincided with the publication of North's (1990) important book, its central message, about the crucial role of institutions in market economies and the difficult process of their building was not largely discussed by policy makers in TEs. Liberalization, stabilization and privatization were given the priority. Roland (2000, p.3) summarizes the dominant slogan in the early nineties in the following terms: « when the emphasis was on 'getting the state out of the economy', it should be a surprise to nobody that 'fixing the law' was a very low priority task and that many legal loopholes were left widely unattended ». However, the first disappointments over privatization (asset-stripping practices, continuation of soft budget constraints, lack of restructuring in firms privatized to insiders) led economists to give further thought to the problems of the sequencing and the

complementarity of reforms. In the second half of the 1990s, an increasing number of economists started to focus on this subject, stressing the economic influence of corporate governance, corruption, trust and networks. However, what these studies (including the World bank's publication) call « formal institutions », is corporate governance laws, securities laws, elements of civil and criminal law and their respective enforcement. Property rights themselves are not always analyzed as a separate institution and privatization not necessarily perceived as an institutional reform. Therefore, in what follows, I will use the term «formal institution», in quotation marks, to designate this relatively qualified vision, which differs from the original institutionalist view (that of Commons in particular), considering the activity of acquiring and disposing of property rights as the basic institutional unit of analysis.

As far as TEs are concerned, two opposite hypotheses were formulated with respect to institutions. On the one hand, it has been argued that enterprise restructuring in TEs will remain poor, because of the low quality of «formal institutions » (Murrell, 2000). On the other hand, some analysts consider that enterprise performance, with no corporate governance and low securities, can improve, because informal institutions (networks or trust) can operate as a substitute (Moers, 2000). In addition, some analysts have argued that in the absence of institutions, in TEs, organized crime can provide a locus of authority for contract enforcement (Feige, 1997; Hendley *et al.*, 2000). There are two channels by which criminal groupings may affect businesses: first, by running protection rackets and stealing good and cash, thus *directly* reducing restructuring resources; second, by inducing violence and insecurity in society, which in turn lower *incentives* for enterprise restructuring.

After this brief presentation of potential determinants of restructuring, the point is now to try and understand if their simultaneous use contributes, or not, to give a coherent picture of the kind of restructuring that occurred or did not occur in a given TE, in this case Bulgaria. The two following sections raise empirical evidence of enterprise restructuring in Bulgaria for two different periods: from 1990 to 1996 (year of the most severe economic and political crisis since the beginning of transition) and from 1997 to 2000.

Patterns of enterprise restructuring in Bulgaria in the first half of the 1990

Competition and cut in subsidies as factors of defensive restructuring

The largest numbers of empirical studies on this period investigate the relationship between competition and restructuring. This is not surprising given that measures aiming at changing the highly concentrated market structure inherited from the command economy were implemented in Bulgaria relatively early on. Thus, the objectives of the demonopolization and the decentralization policies announced in 1990 consisted in the liquidation of artificially created administrative links in the economy, the elimination of the system of income redistributions among economic units in the firm structures, the creation of independent economic agents with simplified structures and the preparation of all existing state enterprises for future privatization. Moreover, in 1991, a program of macroeconomic stabilization provided for the removal of the allow-and-ban regime of foreign trade transactions and quantitative import restrictions. Various studies by Djankov & Hoekman (1995, 1996, 1997) show that defensive restructuring measures (cost-reductions) were launched by state-owned firms, exporting a substantial share of their production. These studies tend to support the prediction of neoclassical economic reasoning concerning the beneficial effect of competitive markets on enterprise performance. However, these analyses seem unsatisfactory for two reasons. First, they give the impression that in the absence of large-scale privatization and inward foreign direct investment, the world market competition was the only existing factor of pressure to restructure imposed on firms. Second, it gives no clear expectation on why domestic market competition had no significant disciplinary effect upon producers and why investment (one of the components of strategic restructuring) by firms in the manufacturing sector is generally very low, and not strongly correlated with profits. Hence, there is a need to raise other determinants to better explain the level of restructuring that occurred in Bulgaria during this period.

Indeed, it is important to recall that starting early 1990 Bulgarian enterprises were facing a harder budget constraint related to the cut in state subsidies due to the enormous external debt burden (Dimitrov, 1999). Although there are poor data on subsidies to firms in TEs, thus offering a poor basis for cross-country comparisons, there is some evidence that the phasing out of state subsidies was more dramatic in Bulgaria than in the other TEs. This could also contribute to explain the larger employment losses that occurred in Bulgaria in comparison to the other countries in transition. Moreover, suppliers proved to be cautious in

extending, let alone increasing, trade credit to buyers because of the low liquidity of most firms and the insufficient protection of lenders by Commercial Code⁴. It is interesting to note that defensive restructuring measures were largely instigated by the existing managers (with or without formal agreements with trade unions), which goes to show that the conservation of old economic elites is not necessarily a barrier to restructuring, as long as they strive for the survival of their firm (Shapira & Paskaleva, 2000).

Barriers to strategic restructuring

The lack of deeper restructuring, until 1996, could be explained by several factors. One of them is that budget constraints were not hardened altogether as extensive bank lending continued. Series of unconditional bailout operations performed in the period 1991-1996 nourished the expectations of delay in enterprise restructuring and hope that firms could rely on an «all forgiving» policy on behalf of the state. In a study on the actual impact of the debt workout programs on the performance of the 670 enterprises affected, Dobrinsky et al. (1997) found that this impact was highly differentiated. On the one hand, they identified a relatively small group of SOEs for which the financial relief was really beneficial and who managed to improve their performance indicators and, in general, their viability. On the other hand, for the large majority of the enterprises covered by the programs, no notable performance improvement was observed two years after the debt workout. Moreover, on payment of dues became gradually contagious, affecting even the financially sound state or private companies, thus contributing to the financial crisis of 1996-1997.

The second complementary explanation for the lack of strategic restructuring lies in the fact that the expected competition from the newly created private firms did not materialize: instead, a particular kind of «joint ventures» emerged between private and state enterprises, the profits of the latter being siphoned by the former. Furthermore, neither was demonopolization able to stimulate competition: carried out only formally in some branches, some informal cartels remained (Berov, 1993).

The last factor to be mentioned is the influence of political and economic networks. The collapse of the communist regime in Bulgaria did lead to a

⁴The level of total credit in Bulgaria (14% in 1995, 22% in 1996) remained close to the levels of trade credit in other transition economies and the developed market economies (Dimitrov, 1999). This tends to support the assertion of Shaffer (1997) concerning the main channels softening the budget constraints in TEs, rather than that of Kornai (1993).

normative dissociation of the economic power from the political power but in fact the members of the former communist nomenklatura actively traded political for economic capital. As a result, during the period under study, informal networks remained an important component of the business environment of every Bulgarian company, and consequently one of the most important sources of its competitive advantage. In a context of high uncertainty, managers used direct contacts with government officials and politicians, and with managers from other companies to gather information about technical matters, potential new customers and source of resources (Elenkov, 1997). However, while networks seemed to be an efficient short-run response of existing enterprises to the threat of disappearance, networks were not able to promote deep restructuring of enterprises, in their constituent elements, or to attract outside investment (Shapira & Paskaleva, 2000).

Thus, the degree of enterprise restructuring was strongly affected by the development of various informal connections blurring the boundaries between public and private, and between economic and political organizations. The role of informal factors appeared also at the level of the mechanisms of enforcement of existing laws. In this early transition period, the weakness of the Bulgarian government in securing property and creditors' rights - its resignation from the monopoly on coercion in this field - opened a gap in the public order that was filled by private organizations (the so called «grupirovki»). The first area of activity of these companies was protection of property and personal security. However, very soon this term received a broader interpretation to include services (though not explained in these terms) such as: “motivating” parties to accept contractual terms imposed by an initiating party, “monitoring” the loyalty of fellow-circles, “persuading” people to meet the terms of a contract (Yonkova et al., 2000). In 1994, after a series of murders and scandals, the government canceled the licenses of several firms but soon thereafter, they reregistered as insurance companies or advertised themselves as investment companies. The implications of the proliferation of these criminal groups, for enterprise restructuring, were two fold. On the one hand, it directly reduced available resources for restructuring. A 1996 survey on private sector transaction costs found that 35% of private firms in major Bulgarian cities had an informal protection contract. These direct costs have probably influenced enterprise restructuring projects in Bulgaria more than in Central Europe but less than in Russia and Ukraine (table 1). On the other hand, violence and insecurity in the society, instilled by «groupirovki», lowered the incentives to invest, revealing the absence of legal ways to secure property rights.

Table 1. *Percentage of private firms saying they pay for «protection»*

Bulgaria	Poland	Slovak Republic	Ukraine	Russia
35	8	14,9	88,8	92,9

Note: Data refer to 1996 for Bulgaria, and to 1997 for the other countries.

Source: Bulgaria: Yonkova et al. (2000, p.5); other countries: Johnson et al. (1999, p.7).

In conclusion, by putting together various determinants that are documented separately, we can find that there were two factors of (defensive) restructuring in Bulgaria during the first half of the 1990s, namely competition and a certain hardening of the budget constraint (cut in direct subsidies) while the manager turnover was not a prerequisite. In contrast, the lack of deep restructuring measures shows the existence of other factors that can slow down restructuring. Thus, the simultaneous use of different determinants makes it possible to draw a more exhaustive picture of enterprise restructuring and helps to explain the kind of restructuring which took place in TEs.

Enterprise restructuring in a new environment: the Bulgarian experience since 1996-97

Since 1996-1997, as the privatization process in Bulgaria progressed⁵ and as unconditional bank lending ceased, after the introduction of a currency board agreement, it has become possible to study the influence of change in ownership and of hardened budget constraints on restructuring, both generally hypothesized to have a positive impact.

The effects of privatization and hardened budget constraints

The nature of the privatization mechanism employed in Bulgaria - combining auction, tenders, direct negotiations with potential buyers, sales to insiders without tender or auction, centralized voucher auctions and, lately, public offerings on the Stock Exchange - has meant that ownership forms have not been limited to the private and state ownership, which have often been the focus of Western literature. Instead a variety of ownership forms have emerged,

⁵Although sparse and unregulated privatization occurred in the immediate aftermath of the fall of the communist regime, the first regulated privatization program of Bulgaria dates back to 1993. However, the process did not pick up speed until late 1997. Between 1993 and 1996, only 7% of the total industrial assets were privatized, while between 1997 and 2000, privatization was extended to another 44% of the assets.

which were characterized notably by concentrated insider power⁶ and the emergence of privatization funds as important shareholders.

Three recent studies (Manev et al., 2000; Pankow *et al.*, 1999; Koleva & Vincensini, 2000) focus on the effects of ownership on enterprise restructuring in Bulgaria⁷. It appears that defensive restructuring measures were implemented by all type of new owners. In the case of the privatization funds transformed into holding companies, these measures included sales of unused equipment and other long term-assets, and the creation of several consortiums that unite portfolio firms by branch. As for the companies bought by management-and-employee teams (MEBO), empirical evidence, summarized in table 2, suggests that they have launched more restructuring measures than predicted by some theorists (for example, Blanchard et al., 1991) arguing that insider-dominated firms tend to follow decisions aimed at maximizing individual income (distribute excessive wages, maintain above-optimal employment, and underinvest). Despite assumed commitments of maintaining employment, Bulgarian MEBO firms have also initiated employment reduction measures,

⁶In 1994 the Privatisation Law introduced a special regime for management-employee buyouts (MEBO) of cash privatization deals. In particular, a preferential payment system allowed management-employee buyer companies to provide a down payment amounting to 10% of the price offered, whilst scheduling the remaining 90% through installments over a period of ten years. Thanks to these and other advantages, MEBOs were in many cases able to put forward the winning bid. Available estimates indicate that between 1993 and 1998, 44.3% of the total sales went to management-employee-buyer companies. Figures isolating such percentage for 1998 only, however, indicate a considerably higher percentage of 74.4%. This could be related to the coming into office of a new (center-right) government in 1997, which was followed by the appointment of loyal managers of state-owned enterprises. They have largely used their position to launch MEBO operations taking advantage of the numerous preferential provisions introduced by the said government but have rapidly experienced series of problems with respect to restructuring (see further). Thus, while management turnover has accelerated in recent years, it did not generate the same positive outcomes with respect to restructuring as that emphasized in the study of Russian firms made by Barberis et al. (1996).

⁷These studies should be considered as complementary to the extent that each of them offers insights into the impact of one or several categories of owners, but none provides a comprehensive data on all type of owners simultaneously. Indeed, the first two aforementioned studies could be viewed as complementary to the extent that the former focuses on the effects of ownership structure of large enterprises only while the latter includes small, medium and large enterprises. On the other hand, the former sample contains only one company having participated in voucher privatization while 50% of the latter sample consist in such companies. Last, the relatively restricted time scope of the latter study - it covers privatization transactions concluded up to 1996 - does not permit to fully assess the role of insider owners in restructuring. As for the study of Koleva & Vincensini (2000) on restructuring strategies of voucher funds, it seems a useful complement to the investigation of Pankow et al. (1999) who reason about the general category of outside owners instead of establishing the specific features of voucher funds' restructuring behavior.

although they tend to lay off less than local and foreign owners. Moreover, firms dominated by insiders have undertaken appropriate changes in the product range, following the example of other privatized companies. Nonetheless, concerning deeper restructuring measures, it appears that MEBOs companies were less active in completing technological modernization and in undertaking a new approach to marketing, comparatively to companies with a majority stake owned by foreign investors. In addition, contrary to the other companies, and especially foreign-owned ones, which have completed changes in their organizational structures, insider-owned firms seem to have clearly avoided these changes.

Table 2. Post-privatization restructuring activities of Bulgarian enterprises*

	Completed				Ongoing			
	MEBO	Local	Foreign	Dispersed	MEBO	Local	Foreign	Dispersed
Sale of equipment	-	+	-	+	n.a.	n.a.	n.a.	n.a.
	-	+	-	n.a.	+	+	+	n.a.
Reduction of employment	+	++	-	++	-	++	-	+
	+	++	++	n.a.	+	+	+	n.a.
Extension of the range of products	++	+	+++	+++	+++	++	++	++
	+	-	+	n.a.	++	+++	+++	n.a.
New organization structure	-	++	+++	+++	++	++	+++	+
	-	+	++	++	+	++	+	n.a.
Development of marketing strategy	++	+	+++	+++	++	+++	+	++
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Undertaking new investment projects	++	+	++	++	+++	++	+++	+++
	-	-	+	n.a.	++	++	++++	n.a.
Attracting new sources of funding (mostly foreign)	n.a.	n.a.	n.a.	n.a.	+	-	n.a.	+
	-	-	+	n.a.	+	+	+	n.a.

* *Note: I use “+” or “-” instead of the percentages in the original studies. The first row of each cell corresponds to the results of Pankow et al. (1999), while the second one refers to the results of Manev et al. (2000).*

“-” means that 0% to 9% of the firms of each category have implemented corresponding restructuring activity, “+” means 10% to 24%, “++” means 25% to 49%, “+++” means 50% to 74%, “++++” means more than 74%.

While superficial restructuring measures were easier to undertake using internal financial sources, expectations for future possibilities to use such resources shrank. Therefore, an increasing number of companies owned by former privatization funds or insiders began looking for external funding. But they were faced with both the change in banks’ behavior triggered by the collapse of the banking sector during the crisis in 1997 and the strengthened bank supervision accompanying the introduction of a currency board regime. During the last four years, Bulgarian banks maintained a very high total capital

adequacy ratio (over 35%) exceeding considerably the required minimum of 12%. Banks now prefer directing financial resources in low-risk investments (claims on the government, fully secured claims against government securities, and deposits abroad) rather than grant credits to firms. Consequently, enterprises started to experience serious problems because of the rationing of bank credits, the extremely high collateral requirements, and the predominantly short-term bank lending, which inhibits long-term investment and restructuring.

Long-term restructuring paths: investment or exit?

It is largely accepted that receiving appropriate access to credit is of fundamental importance in enabling enterprises to engage in (long-term) restructuring activity (Bevan et al., 1999). Given the excessive hardness of the budget constraint imposed by banks and the lack of liquidity of Bulgarian stock markets, there are only two possibilities for privatized firms to finance their restructuring. The first one is the formation of large business groups in order to pool financial resources and benefit from the possibilities of cross subsidization offered by such groups. This strategy has been used in Russia where the lack of available finance significantly constrained investment activity in firms, except in those belonging to financial-industrial groups (Perotti and Gelfer, 1998). However, this solution raises the question of the origins of the finance, some of the most powerful Russian and Bulgarian groups being created during the initial, chaotic phase of the transition have accumulated their capital in an illegal way. Since 1997, Bulgarian «gray» organizations have been confronted with increasing pressures for legitimation and transformation. Although recently the leader of the biggest transformed group publicly advocated tolerance in the business and apologized for his own aggressive behavior until then, it still remains to be seen whether this is just rhetoric against the backdrop of a new political scene or a commitment to a new business ethic.

The second possibility for firms to finance long-term restructuring measures is to have access to foreign funds. Although, by doing so, they may have to give up control rights to foreign investors. The secondary restructuring of Bulgarian industry seems to have already begun. Several MEBO companies are undergoing processes of redistribution of ownership rights that will contribute to the ownership structure concentration and the emergence of strategic investor⁸. It is noteworthy that in some cases strategic partnerships between managers and foreign investors have been concluded before the privatization

⁸See, for example, the article «MEBO units are a failure, admitted the economic ministry», *The Banker*, 03.17.2001.

transaction. The former offered to the latter the possibility to buy the company cheaper than if the investor had competed with a MEBO-unit in a bid. In turn managers should have had the insurance of keeping their job⁹. Hence, the resources saved by the investor in the privatization deal could be pumped into the company's restructuring. A similar process of redistribution is under way within the sector of the former privatization funds, which are selling shares of non-strategic companies in their portfolio in order to obtain liquidities and eventually concentrate on the restructuring of companies in which they have direct interests. It now turns out that in fact MEBO-units and privatization funds act as «mini-privatization agencies», that is, as intermediaries between the state and the eventual strategic investors. Finally, if it looks like the competition induced recently by the presence of foreign investors in Bulgaria, could have a positive impact on enterprise restructuring it can only be in conjunction with hardened budget constraint. Indeed, competition from foreign companies, taken separately, not only did not generate the expected positive spillovers to domestic firms but discouraged enterprise restructuring as the initial technological and efficiency gaps between foreign and Bulgarian firms operating in the same markets were too important to be filled by domestic owners (Estrin et al., 2001). On the other hand, the increasing presence of foreign firms in Bulgaria since 1998 made it easier for domestic privatized enterprises facing a very hard budget constraint to find access to fresh capitals for their restructuring (notably by subcontracting, joint ventures, etc.). Therefore, in the second half of the 1990s, privatization, hard budget constraint and (foreign) competition appear as complementary determinants of restructuring.

While the formation of large business groups and the resale of firms to foreigners could be seen as two processes favoring restructuring through investment, it is noteworthy that there is another way of restructuring, a more perverse one, which consists in the disinvestment via forms of asset-stripping and capital evasion, and which comes down to a restructuring by exit. This strategy - already observed in the Czech Republic after the end of mass privatization - has been characteristic of some privatization funds using their controlling position in portfolio firms to engage in asset-stripping, under the forms of special contracts and non-transparent side deals with firms related to holding managers (Koleva & Vincensini, 2002). This is favored by the highly

⁹A similar collusive behavior was observed in the context of voucher privatization. Faced with the threat to lose their job in the privatization process, enterprise managers approached privatization fund managers with offers to collect vouchers from their employees in return for later support from the privatization fund.

dispersed ownership of holding companies that prevents minority shareholders from efficiently monitoring the holdings' managing bodies, as well as by information disclosure problems. In Bulgaria, suspicions of asset stripping have been sustained by the widespread holdings' strategy to withdraw many small privatized firms from the stock exchange under the pretext of reducing costs (Atanasov, 2001).

Such behaviors put to the fore the question of the role of « formal institutions » and their enforcement in restructuring of Bulgarian enterprises. After the banking crisis of 1996-97, the negative impact on restructuring exerted by agents of private enforcement decreased as most «insurance companies» engaged in racket were closed down. However, other problems remained. A recent report of the World Bank (2000) stresses that the objectives of an institutional infrastructure propping equitable treatment of shareholders is not yet entirely met. This discourages productive investment and could explain the practice of asset stripping. In recent empirical studies on restructuring, institutional factors are grasped through managers' assessment of laws and the level of corruption. These can be considered as different indicators of the quality of the rule of law (Moers, 2000). When asked about the impact of laws on restructuring policies of their company, over 44% of Bulgarian managers declared it was negative. Nonetheless, this percentage is not as high as that registered in Russia where 76% of local managers stress the bad quality of formal institutions (table 3). As regards the level of corruption perceived by managers (Center for the Study of Democracy, 2001) - as measured by the percentage of managers who think firms make extralegal payments for government services - it is higher in Bulgaria – where the majority of managers believe firms make unofficial payments for licenses (79,5%), for government contracts (82,7%) or for privatization tenders (85,2%) - than in Central Europe (20% on average for Poland and 38% for the Slovak Republic), and is very close to the figures for Russia (91,7%) and Ukraine (87,5%) (Johnson et al., 1999).

Table 3. *The impact of laws on company restructuring policies (% of response), 1999*

	Bulgaria	Russia
Negative	43,8	76,1
Positive	16,9	10,1
No influence	33,7	13,8
Unanswered	5,6	-
Total	100	100

Source: *Bulgaria: Manev et al. (2000, p.71), Russia: Moers (2000, p.17).*

The focus on economic processes in Bulgaria since 1997 has brought forth the role of privatization as an additional factor in the study of restructuring. However, its effect depends on the type of new owners it gives control to. Moreover, according to the preceding findings, when considered simultaneously, privatization and hard budget constraints (in particular bank lending) do not act necessarily in the same direction, with respect to restructuring: the lack of bank credits preventing the new owners from engaging in strategic restructuring measures. This in turn raises the question of the extent to which the hard budget constraint could be considered as a positive factor and a barrier to restructuring. While the latter assertion seems to prevail in the short run, it does not stand the long run observation, as the need to attract external funding leads to a redistribution of property rights in favor of structures more favorable to investment. However, the scope and the speed of emergence of this virtuous relationship are furthermore dependent on the quality of rules and on the degree of (foreign) competition, which can give access to additional funding through the presence of foreign companies. As for human capital, it now appears that what is most important, with respect to restructuring, is not the manager turnover as such but the managers' ability to attract external funding and to deal with informal institutions.

Conclusion

The study of the paths of restructuring of Bulgarian enterprises since the beginning of the 1990s and of their potential causes leads to the conclusion that the mobilization of several determining factors incontestably contributes to broaden the vision of the mechanisms in play in the restructuring process. No factor taken separately is sufficient to explain restructuring. Thus, it is the combination of competition and the cut in direct subsidies that gives an account of defensive restructuring in Bulgarian industry in the first half of the nineties. This acknowledgement converges with the suggestions made by the theoretical

literature that stresses the complementarity of reforms in transition economies. However, the addition of new determinants can also generate conflicts between certain explanatory factors, which can make total comprehension more difficult. For example, the sudden hardening of budget constraints altogether (as it was the case in Bulgaria after the 1996-97 crisis) constitutes a barrier to restructuring in a context of insider or voucher fund ownership, and of embryonic stock markets. It is in this context that a dynamic approach of the articulation of determinants reveals itself particularly useful, offering insights on the way these conflicts can be solved in the long run. Through the example of Bulgaria, three solutions have been put to the fore: the formation of large business groups, the attracting of foreign funds and restructuring «by exit».

The mechanisms leading to restructuring are complex and imply interactions of several factors. They go beyond the simple solutions of the mainstream economics based on the slogan «getting the state out of the economy». Privatization surprises and heterogeneity observed in enterprise behavior could be explained by the negligence of determinants by this kind of theorists, but which have been pointed out by evolutionists and institutionalists. Indeed, taking into account the influence of political and economic networks and of institutional «scaffolding» (North, 2000) helps to understand the kind of adjustment that occurred in Bulgarian firms in the last ten years.

It would now be interesting to test the influences of these various determinants using quantitative information, given that it has become possible to study privatization in Bulgaria, and to compare the results with those of other transition economies.

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