

Ownership, exit and voice after mass privatization

*Evidence from Mongolia*¹

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Abstract

Exit (owners selling their shares) and voice (owners active in corporate activities) are important ingredients in the process by which mass privatization changes managerial behaviour in transition countries. We examine the structure of ownership and the extent of exit and voice in one such country, Mongolia. We document the size of ownership changes since privatization (through mergers, spin-offs, and stock sales) and examine which owners are changing in importance. We scrutinize enterprise governance, examining patterns of violations of company law and deviations from reasonable criteria for effective governance. We show that ownership changes and the quality of governance are correlated.

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1. Introduction

A fundamental objective of post-socialist reforms is the creation of a property régime that induces enterprises to adopt profit-maximizing strategies. Mass privatization aims to set in motion the processes that create such a régime, either by generating active owners (that is, those who will monitor and influence the actions of managers) or by placing ownership in the temporary custody of those who have an incentive to sell to active owners. These are the two processes instituted by privatization that can most immediately create the pressures that induce managers to restructure their enterprises. Thus, the occurrence of exit (original owners selling their shares) and the presence of voice (owners actively participating in enterprise governance) are important indicators of the consequences that mass privatization holds for the restructuring of former state enterprises.²

This paper documents the structure of ownership and the character of exit and voice in one transition country, Mongolia. It aims simply to add to the present stock of information on transition processes in an area where there is a paucity of such information, namely post-privatization developments in the enterprise sectors of countries outside Central and Eastern Europe and Russia.³ The results are descriptive of only one small country, but they should nevertheless have broader pertinence since Mongolia's *de facto* political status as the 'sixteenth republic' ensured that it began reforms with the background conditions typical of ex-Soviet republics. Moreover, given its *de jure* independence from the USSR, Mongolia began reforms earlier than did comparable countries and pursued them vigorously, suggesting that events in this country might lead those in the set of least developed transition countries.⁴ A voucher privatization programme was the centrepiece of these reforms and in terms of speed, comprehensiveness, and clarity of design the programme constitutes an example for the poorer, smaller transition countries.

Previewing the basic findings of the paper, we find that there is little spin-off or merger activity and that there is appreciable stock market trading in one-half of the enterprises. Managers are the only group whose ownership share is growing

2 The crucial role of either exit or voice is a frequent assumption in the transition literature. See for example World Bank (1996, pp. 50–56) and Schankerman (1997, p. 819). Phelps *et al.*, (1993) emphasize the importance of voice in the short- and medium-term in transition economies. For the use of exit and voice by Russian investment funds, see Frydman, Pistor and Rapaczynski (1996).

Coffee (1991, p. 1,288) details the way in which Hirschman's (1970) classic analysis of exit and voice is directly applicable to corporate governance issues. The use of Hirschman's terms in the corporate governance context is a natural extension of his original analysis, where exit occurs when members leave an organization and voice occurs when members express dissatisfaction (1970, p. 4). Of course, it is natural to think of shareholder voice as a continuing phenomenon, rather than something occurring mainly in response to dissatisfaction in the Hirschman analysis.

3 Djankov (1998) remarks that the literature on ownership structure and enterprise restructuring during transition consists primarily of studies from Central European countries.

4 Among comparable countries, the Kyrgyz Republic also pursued reforms with vigour, but Mongolian reforms started earlier, and also had privatization as their centrepiece.

rapidly. The relative importance of insiders and outsiders has changed in 43 per cent of enterprises: in 23 per cent of cases, the insider share is rising and, in 20 per cent, the outsider share is rising. Outsiders are accumulating shares in poorly performing enterprises and insiders are buying in better performing enterprises.

Voice is dominated by insiders. On average, over half of the seats on the boards of representatives are held by the general director and top managers of the enterprise, with a further 13 per cent held by workers. The boards meet frequently and there is rapid turnover in membership, suggesting that they are an active part of enterprise governance. Violations of corporate law and deviations from rudimentary criteria for 'good governance' are frequent and more common in outsider-plurality enterprises than in insider-owned ones. Thus, voice seems to be working least effectively in exactly that set of enterprises where it would be most likely to affect behaviour, namely outsider-owned enterprises.

The presentation begins in Section 2 with a review of pertinent economic and institutional developments. Then, we focus on ownership. Sections 3 and 4 document the current structure of ownership, assessing whether there are core owners in place and examining whether existing owners are those likely to pursue profit maximization. Sections 5 and 6 detail ownership changes since privatization, identifying which types of owners are changing in importance. These sections examine both large-scale changes through mergers and spin-offs and the cumulative results of individual sales on stock markets.

The remainder of the paper examines the functioning of enterprise governance mechanisms. Section 7 reviews pertinent institutional developments, especially those on corporate law. Sections 8–10 document the conduct of shareholders' meetings and the activities of the two enterprise boards. Sections 11 and 12 present crude measures of the quality of corporate governance mechanisms, examining patterns of violations of company law and the ways in which the conduct of governance deviates from some simple criteria for effective governance. The concluding section of the paper examines the correlation between exit and voice across Mongolian enterprises.

The evidence presented here reflects information gathered from a variety of sources. Two enterprise surveys provide statistics on ownership and on enterprise governance. In mid-1996, we surveyed 251 large privatized enterprises in Mongolia, well over half of those enterprises that had passed through the 1991–95 mass privatization programme for large enterprises. This survey included all privatized enterprises in the national capital, Ulaanbaatar, plus those in the regional centres of eight of the remaining twenty-one administrative districts of the country.⁵ Three years earlier we had surveyed all enterprises (106) in Ulaanbaatar that had been privatized by early 1993. We also employ stock trading data taken from the official records of the Mongolian Stock Exchange. These three primary sources of data are supplemented by information from the national news media and by extensive interviews with government and enterprise officials.

⁵ The regional distribution of responses is: Ulaanbaatar (145), Tov (9), Ovorhangai (11), Darhan (26), Erdenet (12), Dornod (19), Hovd (10), Banyan-Olgii (9), Uvs (10).

2. Mongolia and its privatization programme

In early 1990, a political revolution led to Mongolia's first free elections. The old Mongolian People's Revolutionary Party (MPRP) won, but formed a coalition government with the new political parties. The economics portfolio was given to a member of the National Progress Party (NPP), which had been formed by a group of young economists who were convinced that the country needed truly radical reforms. Although many of the reforms that this group advocated were introduced only haltingly, or were slowed considerably, this was not the case for mass privatization, where progress kept remarkably close to a very ambitious timetable.⁶

Economic reform proceeded continuously throughout 1991–96, but not at an even pace. Formal liberalization of the economy was announced early, but actual liberalization proceeded more slowly, with many lingering interventions. Despite the failure of initial early attempts at stabilization, runaway inflation no longer seemed to be a danger by the end of 1993. Since that time successive governments have struggled to maintain fiscal balance and monetary control, inflation remaining above 50 per cent in 1996, the year covered by our data. Growth resumed in mid-1993, after a relatively mild (for transition countries) fall in GDP of 20 per cent. Concurrent with that fall, there was a catastrophic drop in living standards due to the withdrawal of Soviet aid, which during the 1980s had been as high as 30 per cent of Mongolian GDP.

The NPP's economists placed their privatization plan on the national agenda soon after the formation of the first democratic government in September 1990.⁷ Combining ideas gleaned from Soviet and East European sources, this group proposed a far-reaching and innovative scheme, in which citizens' vouchers would be used to privatize a large share of state assets. In January 1991, the government established the Privatization Commission and the Stock Exchange. After the passage of the Privatization Law in May 1991, privatization was separated into three programmes, for large enterprises, for small enterprises, and for collective and state farms. In this paper, we examine the enterprises that passed through the large privatization programme.

On the supply side, large privatization was highly centralized. The Privatization Commission staff ordered enterprises to prepare plans, but there was very little discretion applied in the preparation of plans and no discretion applied in the method of privatization – every enterprise would be sold for vouchers on the stock exchange. The prime result of the plans was an accounting of company assets and liabilities, which established the number of shares to be sold on the stock

6 No doubt the size of the exogenous economic shock at the beginning of the reforms was a major factor in causing delay. See Boone (1994) for evidence on this shock and for discussion of stabilization. See Murrell, Dunn and Korsun (1996) for developments on price liberalization.

7 For details on Mongolian privatization beyond those in this paper, see Korsun and Murrell (1995).

exchange, each share corresponding to 100 tugriks of the book value of net worth.⁸ Since the voucher price of shares would be market determined, this valuation had little importance. (Employees were allowed to buy shares at the initial offer price, but, as we explain below, this concession was unimportant.)

On the demand side, privatization was decentralized, with markets determining the allocation of shares between individuals. Every citizen received a set of seven vouchers dedicated for large privatization, which were non-tradeable and hence precluded the accumulation of large blocs of shares during privatization. Enterprises were sold in sequence on the stock exchange for vouchers, with as many as fifteen enterprises being sold concurrently. Buyers channelled their orders through a nationwide network of brokerage houses. These brokerages were the only entities allowed to run investment funds during the privatization process.

Mongolian employees expected concessions during privatization. The reformers responsible for the original privatization programme opposed workers' demands, viewing concessions to insiders as detrimental to equity and harmful to efficiency. Urban workers pressured parliament, but their political power was limited. Parliament gave only a weak preference to employees. The concession was in allowing insiders to use their vouchers to purchase shares at the initial asking price of 100 voucher-tugriks, in a transaction conducted as the enterprise prepared its privatization plan. Alternatively, employees could forgo the concession and use their vouchers in the standard manner, buying shares in any enterprise. Since the average voucher price of shares turned out to be 76, below the initial price of 100, the large majority of workers rejected the concession, waited for their own enterprise to be auctioned, and then proceeded to buy shares in their own enterprise.

Several important changes in the legal and institutional environment occurred as privatization proceeded. We postpone discussion of the developments in company law until Section 7. For the immediately ensuing sections of the paper, the most important development was the passage of the Securities Law in late 1994, after much delay. This Law set the broad framework for securities markets, including the establishment of a Securities Commission, which is charged with regulation and oversight. Secondary trading of shares began in August 1995, after the Securities Commission completed its preparations. These delays meant that ownership had been frozen in place for up to three and a half years, depending on when the enterprise had been privatized. Typical of transition countries, mechanisms of enforcement remain weak.

⁸ The tugrik is the local currency. In early 1991, the (overvalued, official) exchange rate was 5.33 to the dollar. In mid-1996, the date of our later enterprise survey, the free market exchange rate was approximately 500 to the dollar.

3. Ownership: the current picture

The structure of ownership that results from a mass privatization programme is important for several reasons. First, in the early stages of transition, markets will not typically provide the external, competitive pressures on enterprises that could mute the effect of ownership on behaviour (Frydman *et al.*, 1997, p.3). Second, the structure of ownership affects the functioning of governance mechanisms. For example, the extent and nature of the monitoring of managers by shareholders will vary with the mix of owners.

Third, since characteristics of privatization programmes reflect both political pressures and administrative capacities,⁹ post-privatization ownership is a function of both pre-privatization political struggles (Phelps *et al.*, 1993) and inadequacies in design and implementation. These are temporary phenomena, but if ownership structure is path dependent, the immediate post-privatization ownership structure suggests limits on long-run outcomes.

Table 1 reports mean share ownership figures for all enterprises in the 1996 survey sample. The ownership data is for mid-1996, but as we will show in Section 5, these averages primarily reflect the ownership structure that resulted from privatization. The table also reports a geographic breakdown, providing information necessary to understand the effects of our sample's focus on urban areas.

The state owns 20.4 per cent of enterprise shares, outsiders 44.9 per cent, and insiders and their families, 34.8 per cent. Managers own 11.0 per cent of overall shares.¹⁰ Insider ownership did not primarily arise because of preferential rights, since only one-seventh of employees exercised these rights. Rather, when employees used their vouchers on the stock exchange, they bought shares in their own enterprises. The levels of insider ownership represent approximately the maximum amount that employees and their families could buy in their own enterprises given the limits on purchasing power entailed by the non-tradeability of vouchers. (But see Section 5 for some small modifications to this statement, especially in the case of managers.)

Table 2 provides information on the economic importance of the different owners by presenting weighted means of ownership, using a variety of measures of enterprise size as weights.¹¹ During privatization, two different enterprise

9 See Roland (1995) for a discussion of the political economy issues involved in designing privatization programmes.

10 The managerial share is significantly lower than in the CIS countries while the non-managerial employee and outsider shares are higher, based on a comparison with the data presented in Djankov (1998). When comparing with Earle and Estrin's (1997) data on Russia, the outsider share in Mongolia is significantly higher than in Russia and while the state, worker, and the managerial shares are all slightly lower in Mongolia than Russia. Placing enterprise ownership in the hands of outsiders was one of the most important objectives of the designers of the privatization programme.

11 Table 2 omits data on one enterprise, which is very large compared to all other enterprises and which has a very large state ownership share. Inclusion of this enterprise would tend to obscure the general picture presented in that table.

valuations were generated, one based on the book value of net worth and the other reflecting the relative valuations established on the stock market when shares were sold for vouchers. The first and second rows of Table 2 report ownership shares using these measures of enterprise size. The next row provides estimates based on the size of employment at the time of privatization. Several patterns emerge: the state retained shares in enterprises that have greater than average net worth but smaller than average employment. In contrast, insider ownership is greater in smaller enterprises with lower capital-labour ratios. This pattern of insider ownership is due to the characteristics of the voucher programme (non-tradeable vouchers) and the behaviour of employees (uniformly buying shares in their own enterprises.)

The secondary trading of enterprise shares for cash began in 1995. In preparation, a month before trading began, the media published accounting data on the 1994 book values of net worth.¹² Secondary trading itself provided new enterprise valuations based on investor sentiments. The fourth and fifth rows of Table 2 show the importance of the various owners based on these measures of enterprise size. Between the time of privatization and the end of 1994, there are only small changes in ownership shares weighted by the book values of net worth. Relative to book values, market valuations discount enterprises with state ownership and enhance the value of outsider ownership (compare row 2 to row 1 and row 5 to row 4). But the most prominent fact emerging from Table 2 is that there are large changes in investors' valuations between privatization and 1996, especially for state-owned enterprises (compare rows 2 and 5). Without the state selling a single share, the value of the residual state ownership share declines by one-third.

4. Ownership: are there core owners?

It is widely assumed that core owners, or cohesive shareholder blocs, will play a central role in the restructuring process that is crucial during transition (Frydman *et al.*, 1997, p. 3).¹³ When core owners are present, managers will face pressures to make decisions that are in the interests of the owners of capital and without such pressures on managers the inducement to restructure will be less direct and immediate. With the divergent interests of the state, insiders, and outsiders, it is unlikely that coherent coalitions would easily form across these groups. Thus, an important question is whether majority blocs can form within these groups. Table 3

12 For some enterprises, the information in the media reflect 1993 data because those enterprises had not sent recent data to the stock exchange, which organized the media reports. This paper uses the inflation-adjusted 1993 values for these enterprises.

13 Frydman *et al.*, (1997, p. 3) suggest that ownership is 'extremely concentrated' in most Central and East European firms, which suggests the presence of core owners. Djankov's (1998) data on the Czech republic also suggest a fairly high degree of ownership concentration.

provides pertinent information, examining whether one set of owners dominates within each enterprise. Although almost all possible combinations of the three types of owners are found in the sample, in 90 per cent of enterprises, one ownership type possesses more than 50 per cent of the shares. Of course, these data say nothing about the ability of these owners to overcome collective action problems and form coherent blocs, but the data do provide assurance that current ownership shares do not immediately preclude such a possibility.

Paradoxically, given that the surveyed enterprises have all gone through the privatization process, the state owns a core bloc of shares in 40 per cent of enterprises, although this is hardly the type of core ownership sought during privatization. Of enterprises with state ownership, 45 per cent report that local government oversees their operations and an additional 29.9 per cent identify line ministries as their primary state overseer, with 70 per cent reporting meetings between top management and oversight agencies at least once a month. Approximately 9 per cent of enterprises with state ownership report no oversight agency and no meetings with government representatives ever. Evidently, for the most part, the state is not an absentee owner, as is often presumed to be the case in transition countries.

It is generally assumed that worker ownership will not bring a coherent focus to restructuring efforts, whereas managerial ownership might.¹⁴ Therefore, one indicator of the presence of core owners is whether there is significant managerial ownership. In the original voucher privatization, the size of any individual's ownership was limited and, therefore, initial managerial holdings were small. Even so, by mid-1996, after ten months of secondary trading, managers had a significant amount of ownership. In 18.5 per cent of enterprises, managers own over 40 per cent of shares and, in 15 per cent of enterprises, managers are majority owners. However, as is clear from Tables 1 and 2, managerial ownership is concentrated in smaller enterprises.

Other possible core owners are wealthy nationals, foreign owners, other enterprises, and investment funds. (Insurance companies, pension funds, and banks have not yet made significant entry into ownership in Mongolia.) One-fifth of enterprises are partially owned by other enterprises but these holdings are small, with only 4 per cent of enterprises having majority ownership by other enterprises. There are foreign owners in only two enterprises in our sample and in only one of these cases is the ownership share significant.¹⁵ The role of investment funds is small. The only investment funds are state-controlled and were given little publicity. No important economic or political actors encouraged citizens to use investment funds. Thus, few investors took advantage of this option and investment funds purchased only 2 per cent of shares during privatization.

14 See Shleifer and Vasiliev (1996) on the role of managerial ownership in the Russian privatization process.

15 This is not unusual for transition countries: Djankov and Pohl (1998) find an absence of foreign owners in Slovakia. Djankov (1998) finds that foreigners own a minor share of the stock of privatized enterprises in a sample of CIS countries.

To gain a broader overview of the role of outsider core owners, the survey asked whether there were representatives of large shareholders on enterprise boards.¹⁶ Such representatives are present in 14 per cent of enterprises, a surprisingly large number given the small role of institutional investors in the economy. This suggests that wealthy individuals are beginning to take significant ownership stakes.

An overall picture can be formed by combining the above information. Let us define, rather inclusively, an enterprise as having core shareholders if one or more of the following criteria are satisfied: managers own over 40 per cent of the enterprise, other enterprises or foreigners own over 40 per cent of the enterprise, or there are representatives of large non-insider non-governmental shareholders on the boards. Then, fully 30 per cent of enterprises satisfy this criterion. If one excludes the enterprises with state majority ownership (in which non-state core ownership is difficult), then the figure rises to 42 per cent. Despite the difficulties of establishing ownership in this poor and sparsely populated country in which the institutions of capitalism were unknown before 1991, a significant proportion of the enterprises possess core owners who are likely to have an incentive to pursue the interests of capital.¹⁷

5. Ownership changes: acquisitions, mergers, spin-offs

Immediately after privatization those in control of the enterprise had some latitude to determine the future pattern of ownership by placing ownership restrictions in the corporate charter. According to survey results, 8 per cent of Mongolian enterprises have enacted such clauses, restricting the ownership share of individual shareowners and thus protecting themselves against takeovers. These enterprises tend to be larger ones, with a higher outsider ownership share, and better than average economic performance.

Of the enterprises in the sample, 6.5 per cent have been involved in merger or takeover activity. However, of these 16 cases, 11 were instances of the reversal of spin-offs undertaken in the course of privatization, leading to the reconstitution of the original enterprise. In two of the five remaining cases, one enterprise gained a

¹⁶ See later sections of the paper for more information on boards.

¹⁷ Further judgements on the 42 per cent figure seem inappropriate. The separation of ownership and control, akin to the absence of core owners, is much debated in the literature on market economies, and it is possible that similar data for those economies would lead to numbers for core ownership that are roughly the same as those for Mongolia. But we are unaware of data that would be comparable to ours. There is also the question of whether that comparison would be appropriate, since ownership structures have been generated by a process of selection in long-lasting market economies, subject to the constant pressures of competition in goods, labour, and financial markets. Moreover, the need for changes in enterprise behaviour are vastly greater in the transition economies and we would assume that core owners are a lot more important in inducing change than in managing continuity. See Frydman *et al.*, (1997) for an extended discussion of these points.

controlling share in another enterprise suggesting that an incipient takeover market could be emerging. As insignificant as this merger activity is, it is greater than spin-off activity. Many spin-offs occurred during privatization, but only two enterprises have spun-off separate entities after privatization.

The enterprises themselves do not actively engage in stock trading. Only 32 enterprises (12.9 per cent) have bought shares since the beginning of secondary trading, two-thirds of whom did so purely in themselves. Twelve enterprises did purchase shares in other enterprises, with supplying enterprises the most common target. The enterprises that have re-purchased their own shares tend to be bigger, more profitable, and have larger managerial and outsider ownership. These patterns suggest that managers might be using enterprise profits to ward off possible threats to their control.

6. Ownership changes resulting from stock market trading

In Mongolia, sales of shares must be conducted through the stock exchange, which has maintained a database of stock trading activity.¹⁸ Thus, we are able to present data that reflect a complete record of share ownership changes, which is unusual, if not unique, for transition countries. The secondary trading of shares for cash began on August 28, 1995. Table 4 provides data on share turnover up to the end of 1995 (approximately 4 months of trading activity) and up to the end of June 1996, approximately 10 months after the onset of cash trading (and also the time at which our survey data were collected).¹⁹

Only a minority of enterprises (less than 17 per cent) experienced any significant trading activity (more than 10 per cent of available shares) in the opening four month period. Even after ten months, almost 64 per cent of enterprises had less than 10 per cent of their shares traded and 10 per cent of enterprises listed on the exchange had no shares traded. Fifteen per cent of enterprises had trading that corresponded to more than 50 per cent of shares. However, it is possible that these statistics could overstate the significance of this trading for changes in ownership structure, since there is evidence of considerable churning of shares, especially in search of temporary ownership to secure dividends.

Survey data provide information on how share trading has affected patterns of ownership, between insiders and outsiders and between managers and workers. (State ownership changes only in an insignificant number of cases.) In 52 per cent

18 This rule has been changed, with the stock exchange now no longer holding a trading monopoly. However, the change occurred after the period covered by our data.

19 The four month period corresponds to the period from August 28, 1995 through December 31, 1995, and the ten month period carries the data through to June 30, 1996. The four month period was chosen to reflect all trading in 1995, while the ten month period was chosen to match the timing of our survey in the summer of 1996 and to minimize any impact of the June 30, 1996 parliamentary elections.

of enterprises, there is no net change in the proportions of shares held by managers and held by workers. In one-quarter of the 48 per cent of cases where insiders are trading, managers and workers are on opposite sides of the market and, when this occurs, managers are the buyers. In 30.5 per cent of enterprises, managers are raising their stake and in 9 per cent of enterprises workers are raising theirs. The relative importance of insiders and outsiders is changing in 43 per cent of enterprises: in 23 per cent of cases, the insider share is rising and in 20 per cent the outsider share is rising.²⁰

For a small subset of 81 enterprises in Ulaanbaatar that were surveyed in both 1993 (before any reselling of shares was permissible) and 1996 (ten months after the reselling of shares became possible), we have numerical estimates of the changes in the composition of share ownership.²¹ The mean managerial share rose from 3.5 per cent to 14.1 per cent and the worker share fell from 35.7 per cent to 29.8 per cent, meaning that insiders are increasing their aggregate ownership stake.²² The managerial share is increasing in 70 per cent of this smaller sample of enterprises, while the worker share is increasing in 38 per cent. There is, therefore, mixed evidence on the hypothesis of Aghion and Blanchard (1996) that insiders will be more reluctant to sell than outsiders. In our data, worker insiders seem as likely to sell as outsiders, but managers are active buyers.

Table 5 examines the associations between enterprise characteristics and type of ownership changes. Insiders have slightly more tendency than do outsiders to buy enterprises with significant state ownership. However, the most marked tendency on this score is that the balance between insiders and outsiders is more likely to remain stable in those enterprises with state ownership. The third column of the table shows that trading is more active in enterprises in the capital city, where there is easier access to the stock market. The fourth and fifth columns indicate that outsiders are increasing their stake in the larger enterprises and insiders are increasing their stake in smaller ones.

The different forms of ownership change are associated with distinct patterns in enterprise share prices. (Each share corresponds to the same value of enterprise net worth at the time of privatization and therefore comparisons between share prices are meaningful.) Outsiders are buying those enterprises with lower share prices, that is, the enterprises which have extracted less value from the capital stock than would have been expected given the book values emanating from socialism. Insiders are increasing their stake in enterprises with higher share valuations. Consistently, insiders tend to buy shares in enterprises whose production and

20 These percentage figures are estimates based on a combination of our 1996 data and on data collected in the smaller 1993 survey, in cases where the 1996 information is incomplete. The element of estimation is trivial and therefore the margin of error is small.

21 These enterprises are all in Ulaanbaatar, which contains one-quarter of the population and all significant institutions, including the stock exchange. Therefore, the degree of ownership change in these enterprises is likely to be larger than in the country as a whole, as we show later in Table 5.

22 These patterns of change are very similar to those identified by Djankov (1998, p. 9) in six CIS countries: managerial ownership increasing significantly and worker ownership declining, but to a lesser degree.

profits have not declined since 1992 (when the transitional recession was reaching its height.) Outsiders are buying into enterprises with worse performance.

There is a plethora of reasons that could be postulated for these patterns, some quite prosaic. For example, a more profitable insider-controlled enterprise would have higher paid managers and workers, who might have more spare cash to buy shares. This process has considerable import. As we will show later in this paper, insiders are in effective control in a large majority of enterprises. In those enterprises in which such control has been a relative success, insider ownership is increasing. Where there is relative failure, insider ownership is decreasing, with the possibility that new outsider owners could be aiming to construct a controlling block of shares. Thus, the data might indicate the presence of a benign evolutionary process in which poor enterprise performance tightens the budget constraints of insiders and causes them to reduce their ownership.

An additional way in which insider ownership can change is if enterprises are laying off share-owning workers and thus altering the outsider-insider element of ownership structure without any change in the identity of the owners. This could be a significant factor in view of the fact that 85 per cent of the enterprises have had a net decline in their workforce between privatization and the end of 1995. However, there is only a weak correlation between the size of workforce decline and the degree of change in insider ownership. This raises the possibility that worker lay-offs are being determined by share ownership, where workers who own shares are less likely to be laid off.

7. Corporate governance in Mongolia

We now turn from exit to voice, examining the ways in which shareholders directly participate and affect enterprise governance in Mongolia.²³ Shareholder activism takes on special significance in transition economies for at least two reasons. First, there is the dire need for restructuring. Second, there is the relative ineffectiveness of substitute mechanisms that might steer corporate behaviour in the interests of capital owners. Product market competition can be weak, managerial labour markets underdeveloped, and capital markets thin. Information sources are underdeveloped, so that the exit of owners is unlikely to serve as an effective signalling device for managerial incentives. In sum, when privatization is seen as the key to enterprise restructuring during the near to medium-term, there might be no reasonable substitute for direct shareholder mechanisms (Phelps *et al.*, 1993).

Before turning to the evidence, we review pertinent institutional developments. The Economic Entities Law (or company law) of July 1, 1991 brought modern corporate forms and limited liability to Mongolia for the first time. It was written

²³ Black, Kraakman and Hay (1996) discuss the place of corporate law in Russia and other transition economies. Pistor (1995 pp. 33–36) examines the problems transition economies face when attempting to implement corporate governance mechanisms that provide voice for company shareholders.

when contacts with developed countries were only beginning and when foreign aid, which might have helped in drafting a better statute, was minimal. The law adapted textbook examples of European laws, using the drafters' knowledge of Hungarian experience. The law is best described as one of Central European parentage, nurtured in an environment permeated with perceptions derived from socialism.²⁴

The designers of the privatization process paid little attention to governance before privatization. The laws and decrees on privatization were silent on the process of corporatization and on pre-privatization governance. By default, the Economic Entities Law became the governing statute. A clause in the Law dictated that in newly formed companies a 'constituents assembly' of shareholders should meet to adopt a corporate charter and elect the company's first administration.²⁵ These meetings were held at the time of corporatization, and attended by workers, management, and a staff member of the privatization commission, ostensibly representing the interests of the yet-to-exist outside shareholders. The constituents assembly elected a 'Control Council', which was the body specified in the original Economic Entities Law that would play the role closest to that of a board of directors.²⁶ With path dependence likely in the membership of such bodies, one can expect this early history to be reflected in the present.

July 1993 saw amendments to the Economic Entities Law, most notably the addition of a requirement to form an Anglo-American-style board of directors, called a Board of Representatives. After those amendments, the control councils and the boards of representatives operated in tandem. In May 1995, the Partnership and Company Law replaced the original Economic Entities Law. The new law was more complete in terms of definitions of responsibilities and power, but it did not attempt to alter the balance of power between the various actors on the corporate stage, for example between insiders and outsiders.

The Partnership and Company Law mandates and defines several governance mechanisms. These mechanisms include the shareholders' meeting and a dual board structure that splits authority between a Board of Representatives and a Board of Auditors, which is intended to provide financial, legal, and operational oversight of company activities. For many enterprises that have followed the model provided by the laws, the Board of Representatives came into existence significantly after privatization. Before this board was created, the enterprises operated under the oversight of the control council only. Given the statutory

24 For example, Article 4 Section 1 specifies that state financial organs should monitor the financial activities of all economic entities. When the corporate governance statute was revamped in 1995, this section of the old law was not retained. The role of the State in company affairs was made much more conventional, at least on the statute books.

25 Actually, the law specified that these events must take place within 30 days of the last-sale date for shares. This last-sale date was interpreted as being when the Privatization Commission created the shares, holding them on behalf of their future owners. This curious interpretation was probably technically inconsistent with the law and certainly inconsistent with its spirit.

26 There was nothing in the Law that precluded the creation of a board of directors, but the Economic Entities Law was viewed as a model that only the most innovative enterprises would have rejected.

history, the Board of Auditors is the more direct descendant of the old control councils and its place in present law is probably as much a result of history as of the imperatives of the design of governance mechanisms.

The institutional capacity for enforcement of the laws is extremely weak. The Partnership and Company Law (Article 59) indicates that shareholders can file a claim in court if company officers are in violation of the law. But the court systems are overburdened and the judges are inexperienced in aspects of law related to corporate governance. The Law makes it even more difficult for the courts by suggesting that the court convene a shareholders meeting to address shareholder complaints. The courts simply do not have the institutional capacity and the resources to accomplish this. In addition, the Securities Commission does not have a clear mandate to police whether publicly traded companies are in compliance with the Partnership and Company Law and does not have the staff to implement such a mandate if they should decide to do so.

To analyse voice, we examine the functioning of the shareholders' meeting, the Board of Representatives, and the Board of Auditors. These are three mechanisms that activist shareholders could use to influence company decisions and that present an opportunity for study using survey data. In Sections 8–10, we provide a picture of the operations of these three mechanisms. In Sections 11–12 we attempt a tentative measurement of the quality of governance, examining the extent to which there are evident violations of the law by these three bodies and the degree to which their operations deviate from criteria of good governance.

8. The shareholders' meeting

According to Article 42 of the Partnership and Company Law, the general meeting of shareholders, to be held at least once a year, is the 'company's supreme authority'.²⁷ The Law reserves a number of decisions exclusively for the general meeting, including changes to the corporate charter, company reorganizations (presumably mergers, divestitures, and share acquisitions), changes in the share capital (including the issuing of new shares), and direction of the members of the boards of representatives and auditors, specifically their appointment, removal, and remuneration.

Ordinary, yearly, general meetings are called by the Board of Representatives, but extraordinary meetings may be called by shareholders representing at least ten per cent of outstanding voting shares. Thus, the occurrence of extraordinary meetings may be considered a weak indicator of shareholder activism and perhaps of the presence of shareholder blocs. The law further requires that the agenda (draft resolutions) for the general meeting be distributed 30 days in advance and that deviations from the agenda 'may only be transacted upon the consent of all the

²⁷ The Partnership and Company Law of Mongolia, May 11, 1995, Article 42, Clause 1. Translation provided by the Asian Development Bank.

members [shareholders] present ...'. The law stipulates a quorum of more than 50 per cent of all outstanding voting shares, including those shares represented by proxy. If the 50 per cent requirement is not met, the meeting is postponed and the subsequent meeting has a quorum level that is either specified specifically in the corporate charter or equal to the default 50 per cent.

The vast majority of enterprises (89 per cent) have held at least one ordinary shareholders' meeting since their original corporatization, although 18 per cent of the enterprises held no meetings between January 1, 1995 and mid-1996. Nearly 30 per cent of enterprises in the sample held two meetings over this period, with at least one 'extraordinary' meeting in 79 per cent of these cases. Only 15 per cent of these second meetings were called by shareholders. Nevertheless, this implies that at least ten enterprises have active shareholder blocs able to exceed the 10 per cent threshold required for calling extraordinary meetings.

Our survey allows us to make inferences about how a typical shareholder meeting is conducted. Nearly three-quarters of shareholder meetings are held in the enterprise, probably making it more difficult for outsiders to attend and skewing attendance toward insiders. The meetings are generally small (the median attendance was 105) and appear to be dominated by insiders (approximately 67 per cent of employees attend, on average). Given the employment data provided by the enterprises, we estimate that, on average, insiders make up about 78 per cent of those present. Although proxies are used fairly extensively, the majority of outstanding shares are represented in person: those shareholders attending in person represent an average of 71 per cent of outstanding shares. In about 20 per cent of the meetings, new agenda items were introduced by a vote of those present.

One issue that has arisen frequently over the years during interviews with general directors concerns the difficulty of organizing shareholder meetings because of logistical problems, the extremely dispersed outsider ownership, and inefficiencies in the share registry system. About 16 per cent of enterprises had to postpone their most recent annual meeting because of insufficient attendance, with a median delay of 24 days and with some enterprises delaying a full year.

9. The Board of Representatives

Articles 45 through 48 of the Partnership and Company Law govern the creation, authorities, responsibilities, and procedures of the Board of Representatives. The Board of Representatives is the acting authority of the company between shareholders' meetings. The board must have at least three members and the majority of members must be shareholders or their representatives. No other conditions or proscriptions on board membership are in the law except that an enterprise's executive (or general) director cannot serve as chair.²⁸ Members are

28 The 1995 law adopted the terminology *executive director* in place of the old *general director*.

appointed or dismissed during shareholders' meetings, but the relevant procedures for nominations or for changing board composition are not spelled out in the Law. A number of the functions of the board are listed in the Law, including responsibility for drawing up the business plan, determining the company's administrative structure, appointing and supervizing the executive director, negotiating the director's terms of employment, and defining limitations on the executive director's ability to dispose of company assets.

Virtually all enterprises in the sample (97 per cent) have boards of representatives in place, ranging in size from 3 to 15 members, with over three-quarters of the enterprises having boards with either five (53 per cent) or seven (26 per cent) members. The number of board meetings held per year ranges from 0 to 20, with a mean of 0.74 per month and a median of 0.42.

Given their fairly recent genesis (usually after the 1993 amendments to the Economic Entities Law), a surprisingly high percentage of boards has experienced membership change (71 per cent) with a mean turnover across all enterprises of 38 per cent of members. In 8 per cent of the cases where membership changes occurred, all members were replaced and in 35 per cent of cases a majority of members was replaced.

Although only shareholder meetings can officially replace board members, the instigators of changes in membership can vary. Shareholders were the largest single source responsible for originating board membership changes, accounting for 42 per cent of the changes in board composition. Other important instigators were the boards themselves (13.8 per cent), general directors (9.8 per cent), boards and shareholders in concert (8.1 per cent), and the government (8.1 per cent).

Table 6 presents data on the distribution of types of board members. On average, over half of the seats on the boards of representatives are held by the general director and top managers of the enterprise, with a further 13 per cent held by workers. As is clear from such data, outsiders do not play as large a role on the boards as they do in ownership.²⁹ Table 7 depicts this point by examining the relationship between ownership plurality and board plurality. (We treat outsiders, insiders, and the state as three separate groups and ascertain which of the three holds the plurality.) The link between ownership and board membership is weak. Finally, the company law explicitly forbids general directors from serving as chair of the Board of Representatives. Yet 16.9 per cent of general directors report serving in such a capacity.

²⁹ Blasi and Shleifer (1996) present similar information on the composition of boards in Russia.

10. The Board of Auditors

The Law describes the duties of the Board of Auditors as focusing on oversight of company operations, particularly ensuring that the enterprise is run in accordance with governance and accounting laws. The law is silent on the size of this body, although it explicitly countenances the possibility of a single auditor. It brands several classes of individuals as ineligible to act as auditors, including individuals working for the company or its affiliates.

Auditing boards have been established in 98 per cent of companies. They are much smaller than the boards of representatives, with 95 per cent of auditing boards having three or fewer members. A significant number of 'boards' (29 per cent) are, in reality, single auditors. As would be expected, given the legal prohibition on employees serving on auditing boards, the two types of boards differ significantly in their composition, as evidenced by Table 6. That table reveals two remarkable features of the composition of the auditing boards. First, despite the prohibition in the Law, company employees are found on the auditing boards in significant numbers. Second, state representatives are still numerically quite important. There are two possible reasons for the presence of state officials, one historical and the other a matter of human resources. The auditing boards are the institutional successor to the control councils, which initially had many state representatives because they were usually formed before the existence of any non-state outsider shareholders. Even though most enterprises have changed the composition of these boards over time, there is likely to be some inertia in membership. The lack of human resources arises because an independent accounting profession is only slowly developing and a large proportion of qualified accountants still work for the government. Nevertheless, these factors will diminish over time, as is suggested by the fact that the numerically important 'others' on the Board of Auditors are primarily professional accountants.

11. Measures of governance quality: violations of the law

An important, but difficult, task is to estimate the underlying quality of governance mechanisms and to ascertain whether the governance bodies are serving owners well. Our surveys do provide some pertinent information. We consider two distinct approaches to measuring quality. A first set of measures, presented in this section, reflects the occurrence of overt violations of the company law.³⁰ On the assumption

³⁰ The survey questions do not ask for respondents to admit to violations of the law that are identified as such in the question itself. Rather the existence of violations is inferred by comparing the dictates of the statute with behaviour reported in responses to questions that were phrased in terms of eliciting interesting information about the company's operations. The questions that allowed inferences about the existence of violations were disguised to some extent, by innocuous phrasing and by sandwiching them within questions that had no relationship to violations of the law. But we were reliant on the firms

that the Partnership and Company Law aims to enhance the power of shareholders, violations of this law indicate ineffective governance mechanisms. The second set of measures examines deviations from those governance practices that could reasonably be judged to be important elements of effective governance. In the ensuing section, we describe these governance practices and present data on the extent to which enterprises deviate from them.

The 1996 survey elicits information that reflects on six potential violations of company law. On the shareholders meeting, we can ascertain whether the required annual meeting was held, whether there was a quorum in attendance, whether resolutions were distributed thirty days prior to the meeting, and whether voting was on a per share basis. On the boards, the survey reports whether the general director is the chair of the Board of Representatives, which is expressly forbidden by the law, and whether there are insiders on the auditing board, which is also forbidden.³¹

Table 8 presents data on the frequency of violations of each of these six aspects of the law. The most frequent violation of the company law uncovered by the survey is employees serving on auditing boards (33 per cent), followed by the general director serving as chair of the Board of Representatives (19 per cent), and then by the non-occurrence of the mandated ordinary shareholders' meeting (18 per cent). All three types of violations are more likely to occur in enterprises where outsiders hold an ownership plurality.

Table 9 presents a frequency count of the number of total violations perpetrated by individual enterprises. Over 60 per cent of enterprises are in violation of some aspect of the law, with approximately one fourth having two or more violations. The data suggest that repeat offenders are much more likely to have an outsider-ownership plurality, with nearly 60 per cent of the enterprises with multiple violations exhibiting that kind of ownership.

Tables 8 and 9 strongly suggest that voice is not working in outsider-owned enterprises. For example, if we assume that following the law is a necessary condition for effective shareholder voice, then 72 per cent of outsider-plurality enterprises do not satisfy this very weak condition. There are two obvious explanations for these facts, one prosaic and one sinister. First, with outsider owners dispersed across huge distances, it must be difficult for shareholders in outsider-plurality enterprises to attend shareholder meetings. This suggests that

themselves (since no other systematic source of information was available) and, therefore, self-reported information is the only feasible way to generate these data. We do not know of any way of getting accurate information from a respondent who knows the law, violates it, wants to cover up that fact, and is savvy enough to see through the surveyor's attempts to disguise the true nature of the question. Thus, there could be under-reporting of violations if respondents know the company law and want to hide violations.

31 Article 49 states '... The executive director shall not be entitled to act as the chairman of the representative governing board'. Article 53 states 'The following persons shall be prohibited to act as an auditor ... 4) a person who is working for this company, or an affiliated or subsidiary company'.

In classifying an enterprise as a violator or non-violator, we assume an occurrence of the fifth violation when the Board of Representatives does not exist and an occurrence of the sixth when the auditing board does not exist.

the present law inadequately takes into account the dispersed ownership that follows a privatization programme implemented with non-tradeable vouchers. Second, the greater frequency of violations in outsider plurality enterprises might also arise from insiders flouting the law, when obeisance would threaten their entrenched power.³² There is some support for this second explanation in that the fifth violation is much more frequent in outsider plurality enterprises and yet this violation, having the general director as chair of the board, has no simple relationship to the presence of dispersed ownership.

12. Measures of governance quality; deviations from good practice

We now present measures of governance quality that are not explicitly based on the law. The creation of such measures is highly constrained by the nature of the evidence that can be collected from surveys. For example, we would really like to know whether the shareholders' meeting is a *pro forma* affair or involves serious discussion of real issues. But this information is difficult to collect on surveys. Therefore we must use rather crude characterizations of the conduct of the shareholders' meeting.

To construct indicators of governance quality, we formulate eight different criteria of 'good governance'. A first criterion notes whether shareholder meetings are held within the enterprise's facilities, on the assumption that, when this happens, it is more difficult for non-insiders to attend, thus increasing insider dominance. Holding the meeting on a neutral site provides better access for all and could lessen the possibility of intimidation.

A second criterion focuses on whether shareholder meetings provide a forum for the representation of all ownership types, assessing whether insiders dominate the attendance of shareholder meetings. We identify a deviation from good governance as a situation where the proportion of meeting attendees that are insiders is more than five times the proportion of shares owned by insiders.³³ A third measure notes whether changes in the agenda occurred during a shareholder meeting. This practice suggests potential for abuse, since such changes require the unanimous consent of all those at the meeting. Such consensus is hardly likely to

32 Akamatsu (1995, pp. 162–63) discusses examples of methods Russian enterprises have used to attempt to 'obstruct the participation of outside shareholders', including requiring 'shareholders' representatives to have authorized certificates to participate in the [shareholders'] meetings as an excuse to exclude sham shareholders, and to have those certificates validated by notaries'; and voting at meetings 'counted on the basis of 'one person one vote' rather than 'one share one vote''. In addition, 'over 10,000 enterprises issuing shares planned to have annual shareholders' meetings at about the same time, making it impossible for multiple shareholders such as [voucher investment funds] to attend most of the meetings'.

33 Where the formulation of a criterion requires the choice of a numerical parameter, such as the value 5 in this second criterion, we have chosen a value that makes the criterion a weak one, so that we do not exaggerate the number of deviations from good practice.

emanate from a challenge to the incumbents' power, since the incumbents undoubtedly own shares. Rather this consensus is probably a sign of incumbents using their dominance of a meeting to disenfranchise those not attending.

Our fourth criterion uses survey data on the degree of influence exerted by shareholders on enterprise decisions. Survey respondents were asked to rate the degree of influence of various bodies on a variety of enterprise decisions. They were asked to choose between the following options: very important influence, significant influence, a small amount of influence, and no influence. We assume that active shareholders will influence the allocation of profits, between retained earnings and dividends, for example. Therefore, we classify an enterprise as deviating from good governance practices in this respect if shareholders exercise only a small amount of influence or no influence over the allocation of profits.

Next we turn to the boards of representatives, which are supposed to represent the interests of shareholders. With three disparate sets of owners, insiders, the state, and outside shareholders, one way in which owners' interests could be reflected is for each group to be represented on a board in rough proportion to its ownership. To capture whether this proportionality occurs at all, we examine which group, insiders, outsiders, or the state, has board membership plurality. The fifth criterion is satisfied if board plurality is the same as ownership plurality. (This measure reflects the data of Table 7.)

The more often boards meet, the more opportunities there are for members to exercise their voice as owners. For our sixth criterion, we have presumed that at least one meeting of the board per calendar quarter is a necessary feature of good governance.

According to Article 46 of the company law, the Board of Representatives is charged with appointing and setting the contractual terms for the executive director. Therefore, this body undertakes a crucial aspect of its duties if it exerts considerable influence over managerial compensation. Our seventh measure uses the survey responses on influence, described above, and deems an enterprise in violation of this good-governance condition if the Board of Representatives exercises only a small influence or no influence over the executive director's compensation.

Finally, we focus on the boards of auditors, which have a broad mandate to examine the activities of enterprise management and to ensure compliance with laws and the company charter. Given this mandate, it would be surprising if this body were effective and survey respondents ascribed to it absolutely no influence over company decisions. Thus, we assume that the quality of the governance exercised by this body is low if respondents rate it as having no influence at all over the nine company decisions that were posed in the survey.

Tables 10 and 11 summarize the data on the extent to which enterprises deviate from these good-governance conditions.³⁴ The results are consistent with those in

³⁴ In identifying whether there is a deviation from the good governance criteria, we assume deviations from criteria 5, 6, and 7 when the Board of Representatives does not exist and a deviation from criterion 8 when the auditing board does not exist.

the two previous tables. In general, outsider plurality enterprises are the ones in which governance is of the lowest quality. Fully 57 per cent of enterprises have three or more deviations from what we have defined as good-governance practice, a rather large proportion in view of the minimal standards adopted in the criteria. For outsider-plurality enterprises, 68 per cent have three or more deviations. This suggests a reinforcement of the conclusion of the previous section: it would be hard to make a case that voice is a powerful force in Mongolian outsider-owned enterprises.

One fact that is not contained in the tables, but which the reader might guess, is that there is a correlation between the propensity of an enterprise to violate the law and the propensity to deviate from the good governance practices. Of the enterprises not violating the law or violating it only once, 26 per cent have 4 or more deviations from good governance criteria. In contrast, for the group of enterprises that violate the law twice or thrice, 41 per cent have 4 or more deviations from the good governance criteria.

13. Conclusions

Whether the data presented above lead to optimism or pessimism will depend largely on one's preconceptions concerning the possibilities for swift changes in ownership and control immediately after an initial move away from complete state ownership. Thus, the central message of our paper is contained in the details of the data presented above, rather than in any synthetic summary that we can provide. Nevertheless, we will hazard some judgements in these concluding paragraphs.

It is our view that the data contain a note of optimism, especially when viewed in the perspective of a country that entered the area of modern capitalism only 52 years before the collection of the data. Core owners are in place in a significant number of enterprises. Some ownership changes are occurring and the move away from insider ownership is greatest where insider control seems to have been a relative failure. Many enterprises do follow the company law and do not deviate from elementary criteria of good governance, even though mechanisms for the enforcement of the law are virtually non-existent. The most consistently troubling items of information are the indications of the poor quality of governance mechanisms in outsider plurality enterprises, suggesting that exit of small shareholders is necessary before voice can gain hold in these enterprises.

Do exit and voice overlap? Or, are these mechanisms functioning in different enterprises so that exit and voice together influence a large swathe of the privatized sector? Table 12 examines these questions, looking at the relationship between the incidence of ownership-change and measures of governance quality. Governance quality is measured by the number of violations of the law and by the number of deviations from good governance practices (that is, the data appearing in Tables 9 and 11). Two different summary measures of ownership changes are

used. The first is the number of shares traded in the first ten months of secondary trading as a percentage of the total number of shares. The second is a binary variable, identifying whether there have been shifts in ownership, either between managers and workers or between insiders and outsiders.

Table 12 clearly shows that exit and voice are associated. Those enterprises with higher quality governance (no violations or fewer deviations from good practices) have a higher volume of shares traded and are more likely to have seen their ownership change. This suggests that exit and voice are working in only part of the privatized sector and that a significant share of the enterprise sector is unaffected by either of these two mechanisms. For example, over 10 per cent of the enterprises have 2 or 3 violations of company law and simultaneously exhibit no ownership changes.

A final question, one for future research, is whether there are causal mechanisms that can explain the patterns in Table 12. For example, if ownership changes lead to ownership concentration, the new owners might be able to force better governance practices on enterprises. However, given the brief time in which ownership changes have been possible, this path of causation seems unlikely.³⁵ Alternatively, those enterprises that are conducting their affairs within the spirit of the new corporate régime might make more attractive targets for new owners. Building a reputation for sound corporate governance practices might be a rational policy for an enterprise that is likely to seek funds from outside investors in the future. Then the existing shares of such enterprises will already be attractive to investors. Lastly, perhaps management in enterprises with large insider ownership can follow the spirit of the new corporate régime without any challenge to their power, thus leaving outsider owners nowhere to go but the exit.

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³⁵ Several of the measures of governance quality reflect events that occur in the year in which secondary trading began, making it virtually impossible for causation to run from the existence of new owners to better governance.

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Tables

Table 1. Distribution of share ownership by major ownership class and by geography. Results for 249 Mongolian enterprises

Class	N	Average percentage of enterprise shares owned by:				
		State	Outsiders	Insiders	Management	Workers
All enterprises	249	20.4	44.9	34.8	11.0	23.8
UB enterprises	143	15.8	48.0	36.1	11.0	25.1
Non-UB enterprises	106	26.4	40.6	32.9	11.0	21.9
Urban enterprises	181	16.8	48.4	34.7	11.3	23.4
Rural enterprises	68	29.7	35.4	34.9	10.3	24.6

Notes: UB = Ulaanbaatar; Urban refers to Ulaanbaatar, Darhan, and Erdenet, while Rural refers to all other localities.

Table 2. Distribution of ownership by major ownership class, using various measures of enterprise size. Results for 248 Mongolian enterprises

Weight used in calculating size of ownership	Weighted average percentage of enterprise shares owned by:				
	State	Outsiders	Insiders	Management	Workers
Book value of enterprise at time of privatization	32.3	47.8	19.9	6.0	13.9
Stock market valuation of enterprise in the voucher denominated auctions	29.4	53.9	16.7	4.3	12.4
Employment at the time of privatization	15.1	53.2	31.7	8.7	23.0
Book value of enterprise in 1994	29.9	49.2	20.9	5.7	15.1
Stock market valuation, using average price in the first ten months of secondary trading	19.4	60.1	20.5	6.2	14.3

Table 3. Distribution of enterprises by ownership category and size of holding

Employee: State:	Outsider ownership									Row total
	None			>0 and #50%			>50%			
	None	>0 #50%	>50%	None	>0 #50%	>50%	None	>0 #50%	>50%	
None	*	*	2	*	2	53	0	83	*	140
>0 & #50%	*	0	0	0	12	9	0	10	*	31
>50%	*	7	*	0	71	*	*	*	*	78
Column total	*	7	2	0	85	62	0	93	*	249

Note: * denotes an impossible ownership combination.

Table 4. Intensity of enterprise share trading in the first four and the first ten months after the opening of Mongolian secondary markets

Number of shares turned over as a percentage of total shares (X)	Percentage of the universe of privatized enterprises		Percentage of the sample of 249 privatized enterprises	
	First 4 months	First 10 months	First 4 months	First 10 months
No shares traded	34.0	13.5	21.9	6.8
Up to 5 per cent	44.1	38.6	44.6	30.3
More than 5 per cent, up to 10 per cent	8.9	11.6	12.7	11.6
10 per cent < X # 15 per cent	4.9	4.9	6.8	5.6
15 per cent < X # 20 per cent	2.1	4.0	3.2	4.8
20 per cent < X # 30 per cent	3.0	8.0	4.8	10.0
30 per cent < X # 40 per cent	1.1	4.4	2.0	6.4
40 per cent < X # 50 per cent	0.8	3.4	1.6	5.2
50 per cent < X # 75 per cent	1.1	6.8	2.0	10.8
75 per cent < X	0.2	4.9	0.4	8.8

Table 5. Characteristics of Mongolian enterprises undergoing ownership changes

	N	% State	% in UB	Emp	Book value	IPO Price	1995–96 Price	Prod \$0	Profits \$0
Total	249	20.3	57.6	303.0	44.4	86.2	115.3	54.6	54.3
Insiders Outsiders	46	13.1	65.2	347.3	33.9	65.7	82.3	37.0	50.0
No net change	130	25.4	50.4	328.2	55.3	88.5	81.1	52.3	55.8
Insiders Outsiders	52	15.8	75.0	235.6	31.3	109.1	213.1	71.2	56.9
Managers	77	14.8	67.5	261.2	30.6	98.0	192.0	68.8	59.2

Notes: | denotes ownership share decreasing; | denotes ownership share increasing. Net ownership change between insiders and outsiders is indeterminate in 21 enterprises. In a large proportion of these enterprises, the managerial ownership share is increasing. N, number of enterprises; % State, mean percentage state ownership of enterprises; % UB, percentage of enterprises in Ulaanbaatar; Emp, mean employment at the time of privatization; Book value, mean book value of net worth at time of privatization, millions of tugriks; IPO price, mean enterprise share price in the privatization auctions, voucher tugriks; 1995–96 price, mean across enterprises of the average enterprise share price during August 1995 to June 1996, tugriks; Prod ≥ 0 , percentage of enterprises with production not declining since 1992; Profits ≥ 0 , percentage of enterprises with profits not declining since 1992.

Table 6. Composition of representative and auditing boards. Percentage membership of different groups

	Board of Representatives	Board of Auditors
Non-management employees of the enterprise	12.6	1.5
Managers of the enterprise	53.1	7.2
Members of the local government acting in their official capacity	8.6	16.8
Members of the central government, the parliament, or the executive branch acting in their official capacity	4.6	11.3
Members of the central or local government, the parliament, or the executive branch not acting in their official capacity	1.7	6.6
Representatives of mutual funds or large individual shareholders	4.4	2.8
Shareholders of this enterprise not included in the above categories	10.8	19.3
Others:	4.2	21.2

Table 7. Ownership plurality and Board of Representative plurality. Percentages of the sample of 249 of Mongolian enterprises

Board of Representatives plurality	Ownership plurality			Row total
	Insiders	State	Outsiders	
Insiders	25.8	24.4	30.0	80.2
State	0.0	5.1	1.0	6.1
Outsiders	4.0	1.4	8.8	14.2
Column total	29.8	30.9	39.8	100.0

Table 8. Percentage of enterprises violating six features of the Mongolian Partnership and Company Law, by ownership plurality

Violations of the company law	Percentage of enterprises that are in violation of specific features of the company law			
	% of all enterprises	By ownership plurality		
		% of insider plurality enterprises	% of state plurality enterprises	% of outsider plurality enterprises
Mandated shareholders' meeting not held	18.1	5.7	14.1	31.1
Meeting held with less than required quorum	9.4	3.0	15.2	10.0
Resolutions not distributed prior to shareholder meeting	4.7	4.3	5.8	3.9
Resolutions passed by attendance vote rather than proxy vote	10.2	11.6	8.7	10.4
General director serving as chair of Board of Representatives	18.8	16.9	10.3	27.1
Company employees serving on Board of Auditors	32.7	32.4	28.2	36.5

Table 9. Distribution of numbers of violations of the company law in Mongolian enterprises, by ownership plurality

Number of violations of the company law	Percentage of enterprises with each specific number of violations of the company law			
	% of all enterprises	By ownership plurality		
		% of insider plurality enterprises	% of state plurality enterprises	% of outsider plurality enterprises
0	38.8	46.5	44.9	28.1
1	37.6	36.6	37.2	38.5
2	18.8	14.1	12.8	27.1
3	4.9	2.8	5.1	6.3

Table 10. Enterprises that deviate from elementary criteria of good practice in the implementation of corporate governance institutions, by ownership plurality

Deviations from good practices	Percentage of enterprises that deviate from good practice in the implementation of corporate governance institutions			
	% of all enterprises	By ownership plurality		
		% of insider plurality enterprises	% of state plurality enterprises	% of outsider plurality enterprises
Shareholder meeting held at enterprise	74.0	78.3	79.7	64.9
Insiders over-represented at shareholder meeting relative to their ownership	29.6	0.0	39.3	46.8
Changes in shareholder agenda occurring during shareholder meeting	20.0	23.2	17.4	19.5
Small or no influence of shareholders in the decision to allocate profits	22.1	15.5	26.0	24.0
Board of Representative plurality not the same as shareholder plurality	61.2	13.2	85.3	79.1
Board of Representatives meets less than once per quarter	31.1	25.0	33.8	33.3
Small or no influence of the Board of Representatives in setting managerial compensation	21.0	20.3	23.1	19.8
The Board of Auditors has no influence over enterprise decisions	27.3	28.2	23.1	30.2

Table 11. Distribution of numbers of deviations from elementary criteria of good practice in the implementation of corporate governance in Mongolian enterprises, by ownership plurality

Number of deviations from good governance practices	Percentage of enterprises that have each number of deviations from 'good practice' in the implementation of corporate governance institutions			
	% of all enterprises	By ownership plurality		
		% of insider plurality enterprises	% of state plurality enterprises	% of outsider plurality enterprises
0	1.6	5.6	0.0	0.0
1	14.7	31.0	5.1	10.4
2	26.5	29.6	29.5	21.9
3	27.3	21.1	28.2	31.3
4	20.0	7.0	24.4	26.0
5	5.3	2.8	6.4	6.3
6	3.7	2.8	3.8	4.2
7	0.8	0.0	2.6	0.0

Table 12. The relationship between exit and voice across Mongolian enterprises

Measure of ownership change	Sample of enterprises			
	All enterprises	Enterprises with the following numbers of violations of corporate law		
		0	1	2 or 3
Percentage of shares traded	26.2	32.6	22.6	21.5
Percentage of enterprises with ownership changes	48.6	53.7	47.3	42.4
Measure of ownership change	All enterprises	Enterprises with the following numbers of deviations from good governance practice		
		0 or 1	2 or 3	4 or more
	Percentage of shares traded	26.2	25.9	25.7
Percentage of enterprises with ownership changes	48.6	62.5	53.7	31.5