

A. Kostyuk, S. Kozmenko, Ukrainian Academy of Banking of NBU;
R. Apreda, University of Cema, Argentina;
H. Kostyuk, Ukrainian Academy of Banking of NBU

EMPLOYEE SHAREHOLDING: THE CASE OF UKRAINE

Previous investigations of corporate ownership in Ukraine, undertaken by researchers, just analyzed the corporate governance mechanisms in Ukraine and did not try to find out, what the type of owner is the most efficient in Ukraine, i.e. employees, executives, foreign institutional shareholders, Ukrainian financial-industrial groups. Moreover, nobody researched the reasons, why corporate governance mechanisms, that are so popular worldwide, are not still applied in Ukraine effectively.

From this perspective, it is very important to know *the role of employee ownership in corporate governance*, i.e. why employees own shares and what corporate governance mechanisms they use.

To find out how “industrial” privatization influences the role of employee shareholdings in corporate governance in Ukraine, we have undertaken investigation of the structure of corporate ownership of 270 Ukrainian companies, whose shares are in the different levels of listings at PFTS (OTC market). We prefer to use a PFTS companies database to those, represented by stock exchanges (there are eight stock exchanges in Ukraine), because the largest companies prefer to list the shares exactly at PFTS. The period under research was from December 1998 to December 2003.

The most important finding, related to the ownership structure, concerns an increase of the share of institutional shareholders and management in the corporate ownership structure in Ukraine during 1998-2003. An increase in the share of institutional shareholders in the structure of corporate ownership in Ukraine is explained by activity of institutional investors at the market for corporate control, and aspiration of executives of Ukrainian companies to concentrate corporate control in their hands through buying shares at employees (see fig. 1).

Development of the process of concentration of corporate ownership in Ukraine is controlled by two groups of investors. These are management (executives) of the companies and institutional investors.

During 2001-2003, management of Ukrainian companies started to use one more mechanism to grasp corporate control – proxies voting. It is not difficult for management to force employees give proxies to management. We have accounted more than 60 cases how such mechanism works. As a rule, management come to the General Meeting of a works council, that happens before the Annual shareholder meeting, and order employees, who are shareholders, to give proxies to management. Doing in such way, management obtain corporate control with no costs. This is a management dictate.

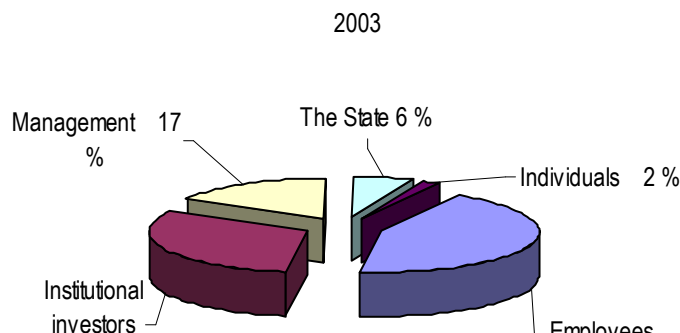


Fig. 1. Distribution of corporate ownership in Ukraine

In Ukraine, employee shareholders still prefer to consider their own interests over the interests of a company. Thus, pay-out ratio for companies, controlled by employees, is the highest in comparison to companies, owned by other groups of shareholders. As a rule, employee do their utmost to use the net income gained to pay cash dividends. Investment projects are not developed enough. This is a proof of a short-term behavior of employee shareholders in Ukraine.

Table 1

Pay-out ratios at the companies under control of various groups of shareholders

Groups of stakeholders	Pay-out ratios, %			
	2000	2001	2002	2003
Executives	24	22	26	28
Commercial banks	32	35	38	32
Ukrainian investment companies and funds	36	41	39	36
Foreign institutional investors	27	28	24	27
Ukrainian financial-industrial groups	48	57	54	52
Employees	47	48	51	57

One of the most effective indicators of efforts of the companies in the way of innovation is the level of research and development expenses and the proportion of these expenses in the total operating expenses.

With reference to table 2, it may be concluded that there is a strong dependence of innovation efforts on ownership type of the companies.

Table 2

Structure of operating expenses in Ukraine

Groups of controllers	Structure of operating expenses, %			
	R&D	Sales & Marketing	General & Administrative	Total
Executives	21	54	25	100
Employees	23	56	21	100
Foreign investors	39	47	14	100
Ukrainian financial-industrial groups	27	51	22	100

Ukrainian commercial banks	29	53	18	100
----------------------------	----	----	----	-----

In comparison to employee shareholders and executives, foreign institutional investors, as controlling owners, are much more inclined to bear research and development expenses than those companies, controlled by Ukrainian financial-industrial groups or executives. The share of research and development expenses in operating expenses in the companies under control of foreign institutional investors is 39 per cent, in comparison to 23 per cent at the companies under control of employees.

Foreign owners try to manage the companies in the way to be one step ahead to competitors. Almost always foreign owners begin with development of concept to manage innovation.

At the same time at the companies, controlled by employees the share of general and administrative expenses is very high (21 per cent). This is almost equal to the share of research and development expenses (23 per cent). Companies are inclined to increase rather sales and marketing expenses than research and development expenses.

Therefore, it is reasonable to conclude that in Ukraine employee shareholders perform much worse than other groups of shareholders, say, foreign institutional shareholders and Ukrainian financial-industrial groups. This is because of very low degree of knowledge of shareholders how to govern companies, their low welfare and weak legal protection of employee shareholders rights.

Low welfare makes employee shareholders make “anti-investment” decisions when distributing net income gained by the companies they own. As a rule, employee shareholders prefer to use net income gained to pay dividends in cash, in contrast to foreign institutional shareholders who use net income to invest in perspective projects.

Weak legal protection of employee shareholders rights gives executives a chance to destroy activism of employee shareholders. As a rule, executives use two methods. The first is administrative pressure on employee shareholders to make them sell their shares to executives at very low prices. The second is a proxy voting, that is a result of administrative pressure too.

Under such circumstances, employee shareholders lose a motivation to own shares and participate in corporate governance, and stay a part of the fight for corporate control in Ukraine.