Cooperation patterns between capital owners and managers in the strategic management process: Case Estonia

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Abstract

Purpose – *The purpose of this research is to empirically describe the division of strategic roles between owners and managers and its change when moving from the post-privatisation transition stage of 1995-1999 to the European integration stage of 2000-2004.*

Design/methodology/approach – *The design takes the form of interviews with owners and top managers, questionnaire on managers' risk aversion, discussions in focus groups. A peculiarity of the study was a broad approach to owners-managers interplay in strategy building and strategic decision making.*

Findings – *At least three patterns of role distribution could be observed in the owners' and managers' strategy development cooperation. Corporate governance (CG) culture in enterprises has improved, but the managers' freedom of action in strategy forming, especially in foreign-owned companies, has not increased with the improvement and stabilisation of business environment, contrary to what could be presumed.*

Research limitations/implications – *Any limitations are due to predominantly qualitative nature of the research.*

Practical implications – *The paper enables one to better understand limitations to firms' behaviour caused by CG and to better target respective consulting and training programmes.*

Originality/value – *The paper presents joint treatment of CG and strategy issues. It is one of the first attempts in post-socialist countries to determine dynamics of CG beyond publicly traded companies.*

Keywords *Strategic management, Capital, Corporate governance*

Paper type *Research paper*

Introduction

Strategic management has to deal with changing business concepts in all market economies. In the Central and Eastern European (CEE) countries corporate strategy creation and implementation has however faced more changes during the past 15 years than in established market economies. Changes in the business environment have been especially rapid in the Baltic states, including Estonia, which until 1991 were part of the Soviet command economy and in May 2005 became members of the EU. Micro level studies in Estonian companies have pointed out market-driven changes in strategy, organisational culture, leadership style and the mission of their organisations that can be interpreted as the impact of radical transformation factors in the 1990s (Alas and Sharifi, 2002, pp. 313-31). However, it can be presumed that the effect of these factors has not been uniform during the entire transformation period, but differed within sub-periods.

A key strategic change driver has been a transition from state dominated economy where private ownership of enterprises was ruled out to a vibrant open market economy. The emergence of new start-up enterprises was especially vigorous in the beginning of the 1990s. It was followed by the privatisation process, which peaked in 1993-1995 and resulted

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in many large and medium-sized companies becoming assets of capital originated outside the privatised enterprises, either domestic capital formed in sectors with faster turnover or foreign capital (Terk, 2000, pp. 143-62). The companies' managers faced the challenge of following the strategic will of new owners or being replaced. Somewhat different and no so clear-cut relationship between the roles of managers and owners has emerged in companies privatised through management and employee buyout (Terk and Elenurm, 1996; Elenurm, 1998). Corporate governance (CG) practices afterwards were shaped by the changing institutional framework (the passing of the Commercial Code in 1995 should be emphasised), development of business environment, internationalisation, but also by creative practices of managers and owners.

In the present paper CG is treated as a determinant of strategic management processes. The focus is on the specific challenges that owners and managers have faced when trying to align the strategic management process in the CG framework during two periods: 1995-1999 and 2000-2004. It was attempted to explain how cooperation between owners and managers works in the process of drafting strategies and preparing strategic decisions, what are the general trends and contradictions of the process. The transferring of foreign CG principles and strategic planning systems of international investors and changes into the behaviour of local investors was analysed in the periods 1995-2000 and 2000-2004.

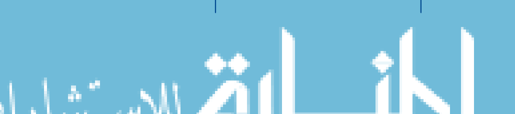
Some conceptual questions on the linking of strategy and CG

Strategic management challenges for owners and managers

The problem of relation between a firm's long-run performance and receiving short-term earnings and the threat that firms tend to value the latter above the former is apparently typical to Western as well as CEE economies. Western publications on CG predominantly blame the managers for pumping up short-term earnings (Kaen, 2003). There are several indications that all positions of the CG theory, developed mainly in the Anglo-American countries, need not hold in case of the transition economies. Differences of situation apparently exist, some of which are related to the dominating capital structure, some to the peculiarities of legislation on CG and some to the prevailing organisational and business cultures. A peculiarity of the CEE countries, as remarked by Berglöf and Pajuste (2003), is the predominance of relatively powerful block-ownership as opposed to dispersed stock ownership. The role of banks is more important than the role of stock exchange As a result, the managers operate as a rule under much closer owner control than according to the Anglo-American CG model.

The institutional framework of CG is not the same in the USA and in countries, which have adopted the German model of CG. Estonia belongs to the latter group. The Estonian Commercial Code stipulates that a joint stock company should have the management (executive) board representing company in business transactions and the supervisory board that will elect the management board and has authority to accept or reject strategic decisions proposed by the management board but does not have authority to carry out business transactions on behalf of the company.

A crucial difference from the USA model is that if the managing director (CEO) is chairman of the management board, he/she cannot be member of the supervisory board (the board of directors in the USA context). The Estonian Commercial Code sets the legal ground for the supervisory board as the representative body of owners. In limited liability companies, the two-tier board system is not compulsory and owners can limit their representation to the management board. Although the German-type CG model sets quite clear rules for specifying the role of managers and owners in the strategic management, the actual strategic cooperation process can be organised in sufficiently varied ways. But regardless a country's CG operating the one- or two-tier board system, the real role of the board representing the interests of the owners in strategic management can vary from formal approval (''rubber stamps'') to strong strategic or financial control of management. (Hendry and Kiel, 2004). A general understanding seems to be that capital owners' role in strategic management should at least encompass using their legal power base for timely



identification of strategic problems and introduction of new strategic visions, but it is arguable, however, if this could be interpreted as creating of strategy. While a majority of treatments of management theory link the development of strategy mainly to the role of executive management, then some, e.g. Markides (2000), emphasise strategy development as one of the key tasks of the supervisory board.

Strategy-related ''guru books'' of the recent decade have initiated discourse between the concepts of strong visionary strategic managers that inspire followers (Buckingham and Coffmann, 1999; Welch and Byrne, 2001) versus managers concentrating on creating a superior team, whereas the role of active owners that may redefine the route that follows their strategic ambitions is not the focus of such approaches. The main challenges of the strategic turnaround process are seen in relationships inside the management hierarchy or between teams of company employees, but not as a problem related to CG.

The classical management perspective works on the assumption that CEO can design an explicit ''grand strategy'' for the entire enterprise. Later strategy perspectives question these normative assumptions and depict strategy as a messy, disorderly and disjointed process (Volberda, 2004). Mintzberg (1978) and Quinn (1980) have developed descriptive strategy research and stressed the iterative and incremental nature of business decisions. Strategy is seen as schemes or frames of reference that allow the organisation and its environment to be understood by organisational stakeholders (Bettis and Prahalad, 1995; Volberda, 2004).

Managers risk aversion and myopia – legend or reality?

In the context of microeconomic literature, one of the rather much-discussed questions of the owners-managers relations (the agency problem) is the issue of the managers' alleged risk aversion resulting in the preference of short-term results to long-term ones. The background to this hypothesis is the premise that the capital owner, due to his immediate interest, is characterised by a complex and strategic view of the business. It would be difficult to hand over this position and motivation when delegating the rights to a manager. The usual explanation here is the difference in the level of hedging in case of an owner and a manager. The owner's risk is dispersed, at least theoretically, between various investment objects, while the risk of the manager is non-dispersed and firm-specific. The manager invests (in the sense of effort) in the development of a firm-specific capacity and the fruits of this ''investment'' would be largely lost in case of losing the job (Fama and Jensen, 1983, p. 306). Orientation on lower-risk and short-term results would help to reduce the risk of job loss. In case of orientation on long-term results, the profits from risk taken would come only at a later date and possibly at the time the manager would no longer work with the enterprise. Moreover, the profit from such a risk paying off would presumably be greater for the owner than for the manager.

However, the hypothesis of managers' risk aversion/myopia is rather simplified as to its concept. Several authors (Nagarajan *et al.*, 1994; Donaldson, 1990; Zhao, 2006) have attempted to enter supplementary factors in the situation model in recent years. For example, it has been presumed that the manager's attitude towards risk and future-oriented efforts probably depends on his age (logically, a manager nearing retirement age would be less interested in future results, since these would become apparent only after his retirement); his opportunities to find employment outside the particular firm, which in turn could depend on a number of factors; on the manager's labour contract, which increases his likelihood of continuing working in the enterprise in case of changing situation (e.g. takeover of the firm by other owners or in case of temporary financial problems); the system of motivation or ownership of the firm's shares. The inclusion of these additions in the situation description apparently increases the realism of the model of treatment, yet these additions could in principle be encompassed within the limits of the managers' risk aversion/myopia hypothesis. At least partially they could be interpreted as the creation of compensation mechanisms enabling the owners to counter the aforementioned managers' risk aversion/myopia. For example, they could offer the manager shares of the firm, develop special motivation systems or conclude long-term labour contracts, which would be complicated to terminate and grant the manager assurance of their long-time labour relation

with the firm. The latter case could bring along the threat of entrenchment effect, i.e. it would be difficult to get rid of the manager even in case he should act in a clearly irrational or unethical manner. Some authors have even expressed a clear disagreement with the managers' risk aversion/myopia hypothesis. Nagarajan *et al.* (1994) point out that managers tend to make large prestigious investments, which need not be validated by business. Unfortunately, the positions denying the mainstream (i.e. myopia) hypothesis have not yet been developed in sufficient detail.

The issue could also be addressed from a somewhat different viewpoint, i.e. the aspect of trust and cooperation. As is pointed out by Davis *et al.* (1997) and Donaldson (1990), the issue of trust in agency relations is still underestimated. In a number of occasions the social ''putty'' in the society could be sufficient for the managers to act in good faith in the best interests of the owners and the theoretical causes of conflicts, specified within the realm of microeconomics need not be realised or at least obtain critical importance. In such cases one can presume that the level of the top managers' risk-taking and strategic action would actually depend on the extent they would be motivated for this by communication between the owners and the managers and the model of cooperation, including their acceptance by the owners as full-scale partners, and moral recognition.

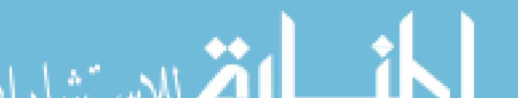
Several reasons allow presuming that the risk-aversion hypothesis need not dominate in Estonia or at least be the sole significant one. Different surveys show that the Estonian managers, just like the general public, as viewed against the international background, cannot be considered risk-averse. In order to clarify the situation, a special study was carried out in the Estonian Business School (supervisor Jan Andresoo, conducted by Meelis Härms and Eve Karo), where enterprises were divided according to whether the level of risk delegated by the owner was either higher or lower than that desired by the manager. It showed that in a significant part of the studied cases (40%) the manager desired a higher level of risk than delegated by the owner. The risk aversion of top managers could be observed in case of the youngest and the oldest age groups and less in case of middle-aged managers. The manager's length of service in the given enterprise had a positive correlation to risk aversion. Risk aversion was not typical of middle-aged male managers, who had not worked for a very long time in the enterprise. Managers working in foreign capital-owned enterprises showed in general greater willingness to take risks above than permitted to them than those in domestic-owned firms, according to the results of the above study.

The above study did not directly concentrate on the risk behaviour in corporate strategy; it measured desire for independence regarding only larger-volume purchase decisions, but its results presumably enable to better understand the psychological climate, which influences strategy-building in general.

Entrepreneurial element in the activities of the owner and the manager

While studying this problem it is essential to ask how the entrepreneurial activity and the entrepreneur's role should be broken down between the owners of the enterprise and the managers (agents). In some cases, the role of entrepreneur is connected with that of the capital owner, in other cases with the role of the manager, while sometimes it is attributed to both of the above.

The classical definition of the entrepreneur describes one as ''someone who organizes and assumes the risk of business in return for the profits'' (Casson, 2002). The risk of business depends above all of course from the state of the markets, purchase and sales prices, but, as is proven by J. Schumpeter, also from innovation, i.e. the capability of new products and technologies to be realised and accepted. Kirzner (1973) in his theory of entrepreneurship concluded that the entrepreneur is a driving force of the market due to his role in discovering unused opportunities at the marketplace and his competitive behaviour is operational for storing the equilibrium of the market. The nature of risk of the innovative entrepreneur in the context described by Schumpeter is more related to introducing creative business ideas that may change the nature of markets whereas the entrepreneur described by Kirzner is more an opportunity seeker whose risks are linked to the capability to perceive market gaps and



mistakes of other entrepreneurs in the situation of incomplete information supply. Presumably, at the early stage of transition to market economy the opportunity-seeking approach to risk was dominating and in the course of time the importance of the Shumpeterian interpretation of risk will rise. Zaratiegui and Rabade (2005) have convincingly proven how an ''entrepreneurial deficit'' or a ''hunger for entrepreneurs'' emerged. On the one hand it could even be interpreted as nostalgia for the era of the industrial revolution, where the capital owner played the central role in business activity. On the other hand, it is clear that a passive ''superintendent-type of manager'', would not be sufficient for successful business. Using the CG terminology, ''good stewardship'' is not enough and besides acting in the interests of the owners, the top manager must also possess leadership skill and charisma.

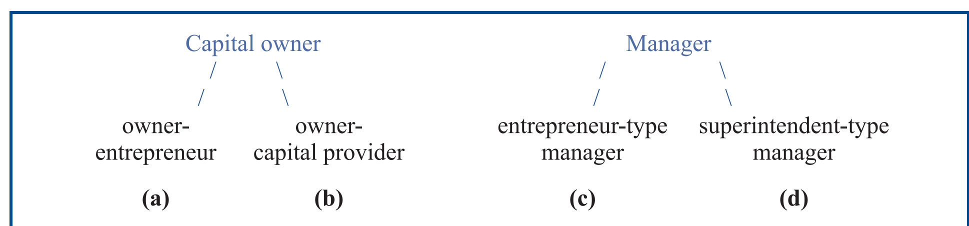
A recent trend, especially in Anglo-American countries, is the increasing significance of small shareholders and thus decline of the owner-entrepreneur combination in case of large corporations. This should logically lead to an increasing demand for entrepreneur-type top managers. Yet this variant, which is the most promoted in theory, cannot be unequivocally viewed as universal, since corporate ownership structure is different in different countries. Therefore the performance of the entrepreneur's role by the owner may be quite widespread practice in some countries.

To sum up the above, we can therefore in principle discuss both in case of capital owners and managers, entrepreneurial and non-entrepreneurial variants (see Figure 1).

The different variants ''a + d'', ''b + c'' etc. can be possible in the breakdown of the roles of the owner and the manager. In this paper we are the most interested, considering the dynamics of ownership relations characteristics of CG in Estonia, the quite complicated ''a + c'' variant, i.e. the situation, where both the block owner and the top manager have ambitions for operating like entrepreneur.

Although ownership structures, which emerged in CEE in the 1990s, developed somewhat differently due to historic background as well as privatisation schemes used in different countries, some basic features can be pointed out. Firstly, in the period immediately following mass privatisation, the ownership structure was as a rule dispersed, characterised by a relatively large part of passive share-owners. Estonia is largely an exception in CEE, since its privatisation scheme was oriented at producing core owners as quickly as possible (Terk, 2000, pp. 7-18), but one can certainly refer to the initial dispersal and later concentration process of capital in Estonia's case as well. Secondly, the gradual entry of foreign capital in the post-socialist countries as their economies became more stable and the rules of game became more precise. In a number of cases this meant the takeover of enterprises hitherto owned by domestic capital. Thirdly, due to the high profit margins of the initial stage of emerging market economy, the generally high entrepreneurial activity in the first half of the 1990s. As a result of concentration of enterprises, which coincided with a decline of profit margins, the number of actors has decreased. Part of the entrepreneurs raised capital, diversified their spheres of activity and began to act as capital owners. Another part, having sold/lost their share, was relegated to the role of managers.

Figure 1 The roles of the owners and the managers from entrepreneurial viewpoint



The stock market as a rule is of peripheral importance in the post-socialist countries. Thus it can be stated that the mixture of roles of owner, manager and entrepreneur is, firstly, quite peculiar in the post-socialist countries, and, second, transforming rather rapidly.

The methodology of the study

CG and strategic management are both sensitive business knowledge fields, where respondents are often hesitant to disclose their failures and conflicts with business partners and other stakeholders. The need to build trust between researchers and sources of sensitive information can be satisfied through the qualitative research design, where researchers are able to act as sparring partners and sources of meaningful feedback for managers and owners they are interviewing or involving to discussion groups.

Qualitative methods have strengths in descriptive and explorative research or where the context and the respondent's frame of reference are important (Marshall and Rossman, 1995), enabling one to get close to the object of the study, to identify important variables, patterns and meaning structures for participants in order to investigate little understood phenomena (Remenyi *et al.*, 1998, pp. 107-13).

A combination of interviews lasting 2-3 hours (the semi-structured questionnaire contained 60 sub-topics) and focus group discussions as qualitative research tools was used. The questions did not aim at determining the precise situation in the enterprise represented by the interviewee, but rather at describing the part of Estonia's organisational practice the interviewee claimed to know either based on the enterprise they were currently working in or on other experience. Accordingly the selected interviewees were predominantly individuals, who had worked at different positions and in various enterprises during the past ten years. Considering the delicacy of the issue, an attempt was made to arrange the interviews so that the interviewee would know the interviewer from previous contacts, which would help to achieve greater openness.

In nearly all questions two aspects were addressed: difference between the period 1995-1999 and 2000-2004 and also differences between the enterprises based on foreign and domestic capital. The studied questions concerned the level of the functioning of capital (business groupings, diversification in the placement of capital, intertwining of industrial and banking capital), the company-level CG (main topic of the study) as well as the owners' and the managers' relations with various stakeholders.

General conclusions of interviews were discussed with in small groups of interested managers and owners during two workshops. Some elements of focus group techniques were applied by using summaries of interview results as group work drivers and facilitating groups in order to get them to reflect, challenge and/or explain conclusions derived from interviews.

Changing roles of owners and managers in the strategic management process

Can the conflicting interests of the owners and the managers obstruct cooperation on strategy-making?

In case of some representatives of agency theory one can proceed from the basic premise that the interests of the owners and the managers are, due to their positions, so different that it requires very strict and precise terms of contract and performance criteria to ensure control over the managers. This approach actually limits the opportunities for trusting the manager in the creative strategy-making process, where formal and inflexible rules and restrictions often do not work. In order to find out, whether this approach works in practice, a list of 11 potential conflicts was compiled for assessment by the interviewees, both owners and managers, for choosing the most typical and commenting on them. A generalisation of the results can be found in Table I.

One can conclude from the table that conflicts related to economic interests do not predominate as one could presume according to the ''economic man'' pattern of thought, but largely the kind of conflicts based on opposition related to self-realisation and communication practice.

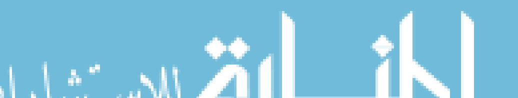


Table I The frequency of conflicts between the owners and managers of Estonian enterprises (based on interview results)

Possible cause of conflict	*How widespread*
Conflict of interests and goals between owners and managers	Moderately frequent
Different ideas of achieving goals	Widespread
Confusion about rules and roles	Moderately frequent
Ratio of manager's performance and compensation	Not frequent
Lack of communication and information	Quite widespread
Conflicts between owners	Not frequent
Incompatibility of personalities or styles	Not frequent
Lack of ethics and trust	Not frequent
Difference of organisational cultures	Not frequent

Who should have the initiative and control of forming the strategy?

The answers to the question in the heading could be divided into three principal positions:

1. *Position.* The preparing of the draft strategy, as well as the firm's annual budget, must certainly be a task for the CEO's team. Further, the draft strategy would be debated with the owners, detailed and the adjusted version approved by representatives of the owners. This position by itself need not mean that the strategy would be viewed as that of the managers rather than of the owners or that the owners' role would be viewed as that of a ''rubber stamp'' or merely accepting a ''take-or-leave'' type of choice. All those commenting on this issue claimed that they were talking about domination of managerial input only in preparation of initial material for strategy or strategic solutions. At the same time: interpretations of the ability of the supervisory board representing the owners to change that input could differ. Two examples from the interviews:
   - ''I would not be worth my salary if I could not, knowing the situation and opportunities, explain the owner (within a strategy-related debate) that I am right''; and
   - ''The top manager must be a reliable partner to the manager in a strategy discussion, while acknowledging that only the owner can be the dominating partner in the discussion''.

Submitting of ''input'' by owners was as a rule acknowledged by all respondents. A debated issue was how many and which financial indicators should be provided as such ''input''. In a number of cases the managers feared that the set financial indicators (if they are too numerous or the short-run financial indicators are too high) would excessively restrict the leeway in developing the strategy, effectively turning the drafting of strategy into a fiction and replacing it by a mere plan of realisation of fixed financial targets.

- *Position.* Strategy is viewed from the beginning as the owners' strategy (''The manager may have a strategy, but the owner must have one''). The importance of the owner's vision, main directions and profit seeking is emphasised in the framework of this position. The role of hired managers is seen as the involving the detailing of that strategy, ''calculating the details''.
- *Position.* The drafting of a formal strategy (as a formal document) is not viewed as important or practical. It is considered natural in this case that the actual strategy would be developed piece-by-piece in the owner-manager dialogue. If the manager is ''on the same frequency'' with the owner as to ideas and proposed solutions, approval and investments would follow[1]. It should be pointed out here that the latter position presumes close (informal) relations between the owner and the manager. These conditions need not be a significant limitation in case of an enterprise with an (single) owner, who has enough opportunities and time to deal with it, but would not suit a situation, where a foreign-based parent firm owns subsidiaries in a dozen countries.

A clear majority of the interviewed managers supported the first position. The central problems causing stress among the managers were, first, the issue of managers being left

out of strategic decision-making by owners, and, secondly, the owners' excessive interference in operations, which would obstruct the manager's opportunities to operate according to an established strategic plan. According to managers, the owners are remote and less informed, but often do not acknowledge it and start interfering. Approximately half of the interviewed managers considered more long-term, clearer and complex strategies necessary. The owners were described as immediately addressing numbers in the strategy discussions instead of conceptual debates and quickly descending to the level of next year's business plan. In their opinion, this approach could not lead to good results. The other half would be happy with the dominating practice characterised by usually short-term perspective, budget-based (instead of strategy-based) management and strategy changes in the course of operation. They only expected to be discussed regarding important matters and not to be forced to face fait accompli. This effectively equalled the aforementioned 3rd position.

The owners' opinions regarding the optimum allocation of roles in the drafting of strategy were somewhat more varied and conditional. As compared to the managers they emphasised more the importance of the owners' vision, the initiative coming from the owners, but in most cases admitted that the allocation of roles may differ dependent on the owner, the manager, the stage of operation, the situation etc. They emphasised the clear difference between strategic investors and financial investors. They cited as an example a situation, where in the initial stage of operation with a high degree of uncertainty the owners determined the strategy, while the management began to draft the strategy later when the uncertainty declined. The more recent the case and the latest the owners, the more active they are in the shaping of strategies.

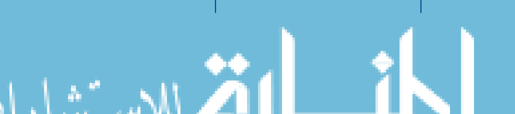
The idea of the situational nature of the strategy-related allocation of roles was further reinforced during the discussions held in the focus groups. The owners set apart the businesses, with which they were actively connected, either as authors of the business idea or sometimes because of personal interest, and where they view the manager's role primarily as the executive. They displayed a different attitude towards the enterprises, which have achieved stability and whose owner/founder has turned his attention to other business projects. In these cases the CEO was expected to show initiative, which would help to retain or restore the growth trend. Managers were in this situation seeking for a greater strategic decision-making role in enterprises with multiple owners, whose expectations regarding its development need not coincide and some of whom had, in the CEO's opinion, become owners ''undeservedly'', e.g. having acquired an interest in the enterprise at favoured terms during privatisation or otherwise being in the right place at the right moment.

Discussing interview summaries in focus groups raised in an intriguing manner the issues of the managers' and owners' ambiguous identities and CG arenas. Many Estonian owners' core identity is to be an entrepreneur. They are not satisfied with the role of passive capital owner who should distance himself from the hands-on development of products, services and technologies. They tend to see themselves as strategic visionaries. There is however a growing number of above type of owners that start to think more in terms of managing a portfolio of investment projects and companies rather than focusing only one exiting business. For managers they are not easy partners. ''It is easier to agree on the rules with a passive type of professional capital owner but more interesting and challenging to work with the entrepreneurial-type owner'', as a manager remarked in a focus group. This statement assumes that strategy emerges as synergy between an entrepreneurial owner and a manager.

On the other hand: CG is not limited to the situation where capital owners are looking for managers as their agents. Agents might simultaneously search and choose capital owners that are ready to be partners in implementing their own strategic ideas.

Controversies and challenges in CG during the latest (2000-2004) period

When discussing the changes in the firms' practice of strategies development in the latest period of development, one can notice changes caused by two factors. These are, first, the



change of the markets, especially their stabilisation; secondly, the role of foreign ownership, which is extending and at least partially modifying its initial principles of operation.

Many domestic founders of enterprises, who previously combined the roles of managers and owners, are trying to leave active management. They exchange the role of management board chairman for that of supervisory board chairman. According to the idea this should mean concentration on the management of the capital portfolio and distancing from operative management of their enterprise or enterprises. But this model does not always work in reality: in many cases the role of the erstwhile founder/entrepreneur remains fluctuating between those of a capital owner and a ''super-manager'', which could obstruct the CEOs of his firms in acknowledging themselves as bearing responsibility for the firms, including their strategic development.

At the early stage of market economy, management jobs were sometimes distributed to reward founders' commitment and following the need to fill in gaps in the management team. During the period 2000-2004 new strategic challenges of growing companies and more fierce business competition have revealed mismatch between being one of important owners and at the same time a bad performer compared to other members of the management team.

Certain problems related to the CG scheme also exist in foreign capital-based firms in Estonia. Large foreign-owned corporations have brought in more systematic strategic planning and budgeting cycles. Many entrepreneurial Estonian managers however compare these practices to some features of the Soviet-style central planning system, where the room for local initiative and creativity was very limited. They perceive contradictions between themselves as entrepreneurial actors in the business environment, where strategic opportunism and rapid strategic moves are a key to business success versus ''bureaucrats'' in corporate headquarters. In particular, corporate headquarters representatives in Sweden are often blamed for being too conservative, arrogant and slow in making both strategic and operative decisions whereas it seems that informal communication with headquarters in Finland enables better strategic communication. Several Estonian respondents, who have the experience of managing rapidly growing companies in 1995-1999, either as owner/entrepreneurs, co-owners or just managers enjoying rather extensive freedom of action, admit their inability to match their experience of entrepreneurial management of a growing company with the competence needed to influence strategy making in larger organisations, where owners are represented by agents that have to comply with the classical strategic planning and budgeting procedures. The increasing role of overseas ownership is seen as a factor that may diminish the motivation of local managers even if they formally remain management board members of the Estonian subsidiary. That situation have potentially damaging impact also on the interests of foreign owners as they might lose momentum and strategic initiative of their agents that is essential for competitiveness in the rapidly changing business environment.

At the same time interviewed experts admitted that Estonian owners tend to interfere in the operational management level more actively than international owners. They are often confusing institutional, strategic, business unit and operational management arenas in their initiatives. They can be compared to ''dive-bombers'' as they are for some days away from the company site doing institutional lobbying work but upon return they are eager to check and improve operational details and sometimes by-pass top managers in the chain of command.

Integration with the economic space of the EU and globalisation of many business sectors has raised a topical question for many local owners: ''When is the right time to sell my company to international investors?'' There are several alternative strategic responses to this question. A reactive response is to take the position ''let's wait what will happen and cash in so long as possible''. It might mean low profile of owners in accepting investment plans and other strategic moves that do not guarantee immediate cash flow. An opposite strategy could focus on developing distinctive core competences in order to increase competitiveness of the company and make it less vulnerable to international competitors.

The third strategic options could be strategic alliances with Estonian or international companies to establish the company as a partner in a larger value chain. The nature of the strategic co-operation between present owners and managers will be shaped by the choice made between these alternatives.

Conclusion and discussion

The predominant practice of CG in Estonia is different from the Anglo-American-based stock market-centred mainstream model with its central position of block owners and the resulting somewhat stronger control over management. The roles of the owner and the top manager are only gradually moving apart and obtaining more definite outlines.

The CG culture of enterprises in domestic ownership has significantly improved in the past ten years, while, e.g. in foreign-owned enterprises the list of financial indicators presented to the management is much more developed and the CG procedures are more detailed. While in the sharing of power between the owners and the top managers the domestic enterprises have problems with somewhat hectic operation, where the periods of the manager's independent acting may be interspersed with unexpected interventions of the owner, in the foreign-owned enterprises the level of independent action is stipulated, while the limits are narrower.

Strategy-related conflicts between owners and managers are often caused not by contradicting interests or principal differences regarding chosen strategies, but ill-arranged communicative process, the top managers being somewhat ignored, the owners having made vital decisions without consulting him, having excluded him from crucial information, the top manager feeling that his strategic playground is too restricted and he cannot present his ideas on strategy or its implementation.

Quite different variants are possible on the division of roles between the capital owners/their representatives and executives in the development of company strategy. The executives predominantly prefer the development of strategy or strategic decision draft by the manager's team. The owners' ideas of strategy building process deemed desirable vary more widely. A minority of the interviewed owners even stated that the strategy is first of all set by the owners and the hired managers' task is to ''crunch the numbers'' and detail the owners' strategic positions rather than to submit strategic ideas of their own. Compared to top managers, the situation's peculiarity was more emphasised – in the owners' view the optimum division of roles depends on the type of owner, development stage of the enterprise, owner-manager relations etc.

Estonia's experience shows that the stabilisation of business environment and reduction of the related risks need not lead to the owners granting grater strategic freedom of action to top managers. An opposite tendency can be observed in foreign-owned enterprises, restriction of the subsidiaries' managers' freedom of independent action, increased regulation by the advisory board representing the parent firm. Among domestically-owned enterprises the owners' trend towards greater diversification can be observed, which drives the strategic decision-making level more to the individual enterprise level. The management's role in managing this more complicated construction increases, but this need not reduce the capital owners', (usually with entrepreneurial background) desire to initiate themselves the decisions on strategic placement of capital and to maintain quite strong ''hands on'' management.

An intriguing question worth further study is continued sustainability of either established predominant model of CG, based on foreign and domestic capital. One could develop a hypothesis that in the first case the more costly economic environment will require increased emphasis in the (subsidiary) firms on innovation instead of simple production process, which should presume granting greater strategic freedom of action to local managers. In the other (domestic capital case) the established model of CG can be forced to change by the need to expand to other countries, which presumes the use of country specific strategy building potential and/or in the longer run the replacement of the first wave owners by the following generation.

A topical issue is the expansion of training and consulting practice in CG, including the aspect related to strategy building. Different versions can be singled out:

- Special training and consulting of members of supervisory. Its goal could be helping the supervisory boards to assume the optimum role in the CG process, including defining the ''strategic playground'' for managers and in assessing their ideas concerning strategy.
- In-house training and consulting, in which owners and managers could develop their common understanding of the firm's development strategies. In the changing competitive environment understanding the dynamic capabilities of owners could be the key to linking the external threats and opportunities to the company's present and future competences.

Training could also serve as a tool for the compensation of the largely inevitable distancing of the capital owners and top managers of international corporations as their primary agents from the managements of local subsidiaries in the course of the internationalisation and concentration of economy. Trainings, attended by international corporations' top managers and representatives of capital owners, could make the factors shaping the operating logic of parent companies more comprehensible to the local managers, while helping to move upward the strategic interpretations and initiatives emerging locally.

Note

1. This position was quite clearly presented only in a couple of interviews, but its signs (the emphasising of informal relations) could be observed in a number of interviews classified by the researchers as representing the first or second positions.

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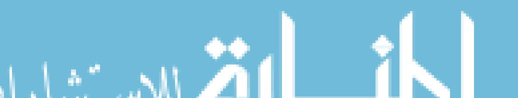

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