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The Ethical Challenge of Management Buy-Outs as a Form of Privatisation in Central and Eastern Europe

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ABSTRACT. There has been a growing debate about the ethics of management buy-outs (MBOs). One possible criticism of the MBO is that it serves the interests of incumbent management at the expense of shareholders. In this paper we develop the general arguments concerning the ethical aspects of the MBO to include other forms of buy-out beyond "going privates" and apply the analysis to MBOs as a mode of privatisation in Central and Eastern Europe (CEE). MBOs are justified in this context post *perestroika* as a means of incentivising economic activity by giving managers an ownership stake in former state enterprises. The actual mode of privatisation, though, raises issues of social justice and the criticism that MBOs are at the expense of the broader social good. The ethical problem for the CEE is to balance the economic gains of a move to markets with the ethical risks to the agents of these markets.

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I. Introduction

In the newly emerged democracies of Central and Eastern Europe, considerable interest has developed in the use of privatization as a means of transition from central planning to market economy. Confronted by the enormity of privatizing so many companies so quickly, in countries with no capital markets and with minimal levels of saving, governments are divided as to the most appropriate means to achieve such a change. Voucher privatization schemes, such as in Czechoslovakia, aim to distribute State assets widely across the population in a short period of time and may be argued to have strong ethical advantages as each adult generally receives an equal amount of vouchers.

The voucher approach is regarded with some scepticism in Slovenia, Estonia, Poland and especially in Hungary, because large-scale privatization through vouchers schemes poses problems in resolving the basic issue of the "divorce" or ownership and control in firms with diffuse shareholdings. As a result increasing stress is being placed in these countries on management and employee buy-outs as the key means of privatization. The supporters of "collective ownership" argue that buy-outs may have an important role to play because they introduce active owners and appropriate incentives into the State-owned sector of economy. The need for populist governments in and Buy-Outs in Central and Eastern Europe to secure the support of workers unions who have often built up powerful positions within enterprises adds weight to this argument. Even in Russia and Slovenia where voucher schemes are being introduced, vouchers can be used by managers and employees to purchase significant ownership stakes in the enterprises in which they are employed.[1]

As is well-recognised in the West, buy-outs raise

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serious ethical issues. Much attention has been addressed to the ethical problems when managers of quoted companies attempt to take them private (e.g. Schadler and Kahns, 1990; Jones and Hunt, 1991; Bruner and Paine, 1988; Houston and Howe, 1987). But the potential problems go well beyond these cases, reflecting the diversity of the buy-out market as it has developed internationally. Ethical problems may also rise in respect of buy-outs of divisions or privatisations, where in large complex hierarchies managers may attempt to manipulate the terms of a transaction to their own advantage, something which is difficult to monitor by head office staff, let alone shareholders.

In this paper we address the ethical issues relating to buy-outs of firms in CEE (Central and Eastern Europe) in the light of Western private and public sector experience. Such ethical issues represent not simply an extension of those experienced in the West but rather add new dimensions. In particular, the vastness of the transformation process in CEE means that ethical problems are raised at a societal level and are complicated by the widespread absence of appropriate legal frameworks, lack of clarity as to who is the principal of a firm, the legacy of previous over-exploitation of the population by the state, and a huge deficit of entrepreneurship in a situation where such expertise is required to effect essential efficiency gains. Section II summarises the debate concerning the ethics of buy-outs in the West and suggests how this may be related to CEE. Section III outlines the theoretical rationale for buy-outs in CEE. Section IV analyses the ethics of buy-outs in CEE. Section V discusses mechanisms for dealing with ethical issues. Section VI draws some conclusions.

II. Ethics and management buy-outs

The ways in which, in principle, management buy-outs may contribute to improving the efficiency of enterprises are well-known (Jensen, 1989). The scope for buy-outs to achieve such possibilities is also extended through a whole range of flexible financing instruments and governance structures and processes beyond those proposed by Jensen (Wright *et al.*, 1993). But, although there is extensive evidence to show that buy-outs lead to increases in shareholder wealth (see Palepu, 1990 for a review) they have nevertheless been criticised on ethical grounds. Jones and Hunt (1991) draw particular attention to leveraged management buy-out transactions which transform publicly traded companies into firms which are privately owned by existing management groups and financed by debt primarily on the grounds of their impact on non-stockholder constituents of the firm. In this regard they disagree with Houston and Howe (1987) and Bruner and Paine (1988) who argue that management buy-outs can be ethical if the division of the "spoils" between managers and other stakeholders, primarily shareholders, is equitable. Jones and Hunt focus on unethical practices that favour managers in this division: through managers using their privileged knowledge about the true value of the firm, especially where managers do not reveal that the firm is worth substantially more than the bid price (Stein, 1985; Schadler and Karns, 1990); through the manipulation of an apparently "high risk" situation in their favour, for example in withholding information about added values which they then use to reduce the debt risk to themselves of the buy-out; and through pursuing their own self-interest ("ethical egoism") at the expense of other stakeholders; and through acting in ways that positively disadvantage the interests of other stakeholders such as bondholders whose holdings are diluted by the downgrading of a firm's bond rating after a buy-out. There are also the ethical issues of employees who lose their jobs in the inevitable restructuring that follows buy-out or who may not share in the gains from buy-out which result from equity ownership. A generally negative effect on social mores due to the speculative behaviour which surrounds buy-outs has also been suggested. The latter is epitomised in the description of corporate raiders as individuals who know the price of everything and the value of nothing!

Jones and Hunt (1991) show that buy-outs can be criticised from a number of ethical perspectives. They dismiss the utilitarian defence of buy-outs, arguing that such transactions may maximise neither the net utility of all stakeholders affected nor of society as a whole. Standards of Rawlsian justice may also be violated if managers do not fulfill their fiduciary duty to stockholders nor their responsibility to those they manage. Kant's "reversibility" principle ("do as you would be done to"; "Act only

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according to a maxim by which you can at the same time will it should become a general law" (Russell, 1961: 683) is also violated. Managers exploit other stakeholders and, from a moral development perspective, management motivation in buy-outs is suspect. Ethical behaviour is predicated upon the "development of an independent sense of self in which personally owned morality is fully integrated" (Harris and Brown, 1990: 855) and is seen as crucially dependent upon the formation of a sense of self which incorporates a moral sense independent of externally imposed rules. Management pursuit of self-interest in buy-outs may be interpreted as testimony to a fixation at the early ethical stage of "dualism" in which people accept rules instrumentally to avoid punishment or out of self-interest. Those operating at the limits of the law typically use legality as the ultimate criterion as they strive to keep one step ahead of regulation. According to the development perspective they have not reached the ethical level of "relativism" in which "people acknowledge the validity of multiple ethical systems, but have not yet achieved the sense of self which embraces commitment to a personal morality that shows concern for the good of society" (Harris and Brown, 1990: 859).

These arguments have generally been developed in the context of buy-outs of publicly traded firms where opportunistic behaviour by managers undertaking a buy-out in the absence of a hostile takeover bid are most severe. The analysis may also be extended to divestment buy-outs (Wright *et al.*, 1991) and buy-outs from the public sector (Thompson *et al.*, 1990). In both cases managers may be in a position to conduct a buy-out unethically. Arguably, the ethical problems are greater in respect of public sector sales given the trust placed in public servants by society and the likely extent of underpricing as indicated by the speed and size of gains realised in such buy-outs.[2]

While, theoretically, the above ethical problems might arise in buy-outs there is both some debate as to the extent to which they actually do occur in practice and, moreover, that they may not be so clear cut. De Angelo (1986), Kaplan (1989) and Lee (1992), for example, cast doubt on the manipulation and insider trading arguments in respect of, primarily, U.S. going private transactions. One has also to reconcile the returns accruing to buy-outs and the risks managers assume in their pursuit. Managers may be aware that the company's activities could be reorganised profitably, but they may be reluctant to do so where they would bear the effort-costs but reap few rewards. The question is thus raised as to whether it is ethical on the part of stakeholders to expect managers to act in such a manner in the absence of adequate incentives and just reward. It is also not clear in law whether the behaviour of managers in buy-outs breaches their fiduciary duties (Sterling and Wright, 1990: 130–138). This issue is compounded by the fact that in general the entrepreneurs are the employees of the firm and not the stockholders.

The Rawlsian justice perspective may also be problematic in respect of the treatment of employees, particularly where buy-outs occur of firms which face severe trading difficulties.[3] It cannot be assumed that in the absence of a buy-out the *status quo* would have remained viable. Without major job losses the firm as a whole may fail. Alternatively, in the absence of a buy-out, takeover by an outside firm may result in more severe job losses than would have occurred anyway under a buy-out. Indeed, a buy-out may be a means of ensuring greater job levels in the long term than would otherwise have occurred and in a number of public sector privatisations in the UK such transactions have been preferred for this reason (Wright *et al.*, 1990).

These difficulties raise the notion of a trade-off between ethical issues and those relating to wider efficiency benefits which result from buy-outs. To a considerable extent mechanisms may be used to compensate those who might lose from a buy-out transaction whilst still leaving sufficient incentive for managers to undertake such transactions, which invariably involve some degree of risk, in order to generate wider social benefits. Whilst there may be a requirement for managers to act ethically towards all stakeholders there must also be some ethical limit in respect of what other stakeholders can expect of managers. If wider gains can only be achieved through a buy-out, then introducing mechanisms to take some of these gains away from management reduces their willingness to undertake such transactions with the consequence that the benefits will be lost. The issue of trade-offs is crucial, then, in considering the ethics of buy-outs. How is one to balance the relative efficiency gains with the accru-

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ing problems of moral hazard. Theorizing this balancing act is made more difficult by large distance between theories of moral and economic behaviour.

> A theory of value, grounded in all the dimensions of human experience that are normative-affective *and* logical-empirical, is the missing link between the economist's world of self-interested, rational individuals and [the] collective world of moral duty. . . . the challenge for business ethicists is to *empirically discover* humane values within the context of ecological and cultural imperatives (Swanson, 1992: 551–552).

In CEE the ecological and cultural context is one of society and economy in crisis due to the bankruptcy (moral and economic) of the old regime. The notion of a trade-off between ethics and praxis may be especially important in this context because of the problems in generating efficiency gains in ways other than buy-outs.

III. The theoretical rationale for buy-outs in CEE

After the collapse of communist regimes in CEE, the intellectual vacuum which followed the abandonment of Marxist ideology was replaced by neoclassical economic theory. This approach, which found many supporters in academic and political circles in former socialist countries, provides the theoretical basis for the process of economic reforms. The ideas of rationality, optimisation behaviour, and economic efficiency associated with mainstream economic theory have begun to play a dominant role in the process of transformation, while the problems of social justice, welfare economics, and social protection have been largely ignored.

The privatisation of public sector enterprises is a basic means to achieve increases in the efficiency of the state-owned plants and enterprises. Economic reform is aimed at encouraging: a stimulation of competition and demonopolization of the economy; stabilization of the monetary system by taking the "hot money" of the population away from circulation; provision of budgetary relief from the financial burden of subsidizing the unprofitable enterprises as well as an increase in revenue part of the state budget by sells of state-owned assets. Finally, privatisation is seen as a way of achieving such political targets as growth in the numbers of the "middle class of property owners" and free enterprise groups in general which are supposed to be the most reliable basis for the long-term viability of the reform process.

Unlike the Western experience, buy-outs in CEE are developing in a legal and regulatory vacuum, as legislative development and the formation of regulatory procedures lag behind the development of spontaneous economic processes. The general effects of the disintegration of the former system of centralized management has been to shift responsibility for the administration of state-owned enterprises to managers and employees' collectives. As a result, managers of state-owned firms have received all the rights of private entrepreneurs without many of their responsibilities, including the absence of any significant possibility of failure. Given the general passivity of the population in CEE with respect to privatization, it is clear that managers will play a leading role in the process of "denationalization" of the enterprises, probably in coalition with representatives of the old "nomenklatura", the old *status quo* of party *apparatchiks*. "Nomenklatura" buy-outs involve various forms of alliance between existing management and the old political *status quo*.

From an efficiency point of view, "nomenklatura buy-outs" seem to be the most viable solution to privatisation problems as nomenclature representatives are proving to be most prepared to organize business activities during the transition period. Their power of control over decisions in State enterprises was significantly strengthened by successive decentralization reforms after 1985 which meant that they had become more or less independently minded entrepreneurs, with a good knowledge of how the system functioned. The best part of the former economic bureaucracy, which rightly saw the reforms as a threat to its existence, tried to join this fast developing social group. They know that privatization is coming and the more ambitious want to keep ahead of the game. (This form of buyout does, though, raise the spectre of social unrest, especially in those enterprises where populists have built up powerful positions, using such slogans as "social justice" and "defence of workers interests".)

Management buy-outs in CEE raise similar ethical issues to those that are being discussed in the

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West. In particular, there is the question of whether both efficiency (the reinvigoration of the economy) and ethical and equity criteria can be met. Policy-makers in CEE face a dilemma. According to the conventional theory of economic transformation, managers and employees of state-owned enterprise will initiate the process of buy-out with the subsequent rationalization of its performance if and only if this process will result in an increase of their wealth through ownership or/and will be followed by the income re-distribution in their favour as a result of ownership transformation. But conventional theory does not specify whether the gains of managers and employees may be substantially larger than the losses of the general public as a result of the buy-outs. It is to analysis of these issues which we now turn.

IV. The ethical problem of management buy-outs in CEE

(a) *Valuation of the firm*

Sales involving incumbent managers and others with connections with the former regime carry the threat of illicit transfers at nominal prices, based on inside information and bolstered by various forms of corruption. Usually, managers have a substantial advantage over other potential buyers regarding the appropriate value of the state-owned assets, as well as the situation with current and potential markets for the enterprise's products. They are, consequently, tempted to reduce the selling price of an enterprise, thus maximising their gains from buy-out transaction. These two factors may contribute to substantial "undervaluation" of state-owned assets (beyond the effects of uncertainty). Investments in new capital equipment in CEE were usually made from centralized funds as part of national investment programmes. Typically for all countries in CEE, savings of individuals, tax deductions and foreign trade revenues have been collected by the single Monobank, which also was responsible for the financing of the enterprises' investment projects. To a certain extent the industrial potential of CEE has been created by the super-exploitation of the population by the state, and as a result the conflict of interests between managers running state-owned enterprises and the general public is inevitable in buy-outs.

It is clear that under-valuation of assets in buy-outs is far more likely than with conventional corporate flotations and divestments because, in most cases, the activities to be sold have been part of a cost centre within a State operation, providing goods and services either free or at heavily subsidised prices. This means that although "objective" valuation techniques are available, such as net asset value calculations as price/earnings ratios (Valentiny *et al.*, 1992) any bidder must make very subjective assessments of the earning power of the assets to be privatised. The problem is exacerbated by accounting conventions and systems which do not provide information to the same depth and quality as in the West. These problems together with inside information provide managers with an incentive and the ability to exploit their position. For example, managers can encourage the State to "strip out" the most profitable assets for privatisation, they may be more aware of the re-development value of land following a change of use,[4] and they can take advantage of the idiosyncrasies of asset depreciation policies in State activities (Filatotchev *et al.*, 1992).

(b) *The special case of enterprises in the Military-Industrial Complex (MIC)*

The problem of exploitation of insider information is especially severe in the MIC, which typically accounts for a significant proportion of the national economy in many former communist states. MICs involve both vertical monopolized production structures and integrated managerial hierarchies based on a vertical system of information flows. As a result, a vast amount of economic information and industrial data flow between defence ministries and the enterprises. Neither the general public nor the different structures of the Soviet command system had access to these information flows, and this gives the military a clear advantage over the non-defence sector in the competition for scarce resources and technologies.

Reductions in the centralized control of defence enterprises following the reforms increased substantially the role of managers in this sector. In Russia and the Ukraine it was managers who started the

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process of the "commercialization" of military enterprises through the foundation of independent joint-stock companies, affiliated commercial banks and participation in different commodity exchanges. The administrative model of "conversion from above" proved to be completely inefficient: the simple switching of the defence factories to civil work has been accompanied by a dramatic increase in costs and a fall in the competitiveness of products because of poor quality.

Consequently, the overall production of the defence industries has been reduced dramatically, and, more importantly, a large portion of fixed assets has become obsolete and has been taken out of production. This equipment, however, is technologically advanced, and was simply misused because of organisational and managerial mistakes. Managers in defence enterprises and their colleagues in the military bureaucracy have unique access to economic and technological information in the defence sector and have started to transfer valuable state assets to companies run by themselves or family members. Paying below these assets' value, on this basis, a mutually-beneficial symbiosis of state enterprises and private firms arises. Private firms have access to cheap resources through their "parent" state-owned enterprises, while state enterprises are able to redistribute their profits before taxes and other deductions through private "commercial" structures, owned by the state firms' managers, their friends and relatives. The state implicitly subsidizes the development of the private sector in activities closely related to the defence industries. This symbiosis of state and private firms is a rapidly expanding sector which is threatening to strip assets and monopolize the best parts of the MIC industries leaving the large "value subtractors" and inconvertible enterprises to collapse, with little chance of reconstruction.

(c) *Agency problem*

As noted earlier, there is an extensive literature which shows that the divorce of ownership and management inevitably creates a "principal-agent" problem, conflict between owners (shareholders) and executives over the use of corporate resources. These arguments are especially relevant to privatization proposals in CEE. Before the act of privatisation state enterprises remain in the ownership of a specialized State Property Fund (SPF). The relationship between the Fund's Directors and managers can be represented as one of agency, since managers (the agent) are acting on behalf of the legal owner (the principle). Appointed directly by the government, Directors of SPFs exert little direct control over management. Though they could in principle monitor managers and replace them, significant externalities and asymmetries of information will prevent them from doing so. Bearing in mind the scales of privatisation programmes in former centrally planned economies and the time constraints involved, it is difficult to imagine that the SPF will be able to impose efficient control on managers to prevent the kind of abuses of insider information mentioned above.

Indeed, SPFs which receive their assets without payment might not have an incentive to control management at all. Given also that the main objective of the SPF is to privatise assets in the shortest period of time SPF directors may well turn a blind eye to opportunistic behaviour by managers, or will give them first refusal during the state property sell-off. Such regulatory capture is a well-known problem of any process of regulation. Moreover, regulators themselves are in turn agents of government or the public rather than principals, which may exacerbate the situation.

(d) *Managers versus other workers*

It may be argued that employee participation in share ownership in newly-privatized enterprises will have strong positive effects on efficiency and innovation. Employees will participate in decision-making, imposing a strong collective monitoring on management's activities. Employees and management will be closely united, stimulating efficiency and innovation. Unfortunately, privatization experience in CEE shows that this kind of unification of employees and management has not happened yet. The workers are usually passive "players" in the process of buy-out who follow the managers as leaders. This passivity can be explained by peculiar social-psychological stereotypes, which developed during decades of

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Stalinism. Very often these stereotypes are not consistent with the very idea of private property.

Notions of private property differ dramatically between those advocating buy-out schemes and the average citizen. Buy-outs of enterprises for most of the workers are first and foremost a means to receive higher salaries, participation in equity ownership being considered just a "whim" of bosses. Post-buyout, workers often try to get rid of their shares because in the current situation the opportunity costs of holding financial assets are higher than that of selling shares for cash. Since the internal share market in the newly-privatised enterprise is normally closed, the concentration of shares in managers' hands seems to be an inevitable consequence of the buy-out life-cycle development. Case study evidence from buy-outs in Russia suggests that managers aim to increase their relative stake in the capital of the newly-private firm. They can achieve this target through buying out the shares of other workers (normally at their face value or even at substantial discount) and through the emission of new shares distributed among the members of management team. Such a re-distribution of ownership, and, as a result, re-distribution of dividend streams and capital gains favours managers at the expense of workers.

As in the West, buy-outs are typically followed by a process of profound restructuring and re-organization of the newly private enterprise with significant job losses occurring. In addition, there is a serious danger that redundant workers will suffer a substantial income loss directly related to the problem of under-valuation of company's assets. By undervaluing the assets of the enterprise, managers are reducing the absolute face value of workers financial assets. Whilst a worker is still employed by the newly privatised company, the under-valuation does not matter to him, because his share in distributed profits depends on his relative stake in the capital. But if this worker loses his job, he will be under pressure to sell his shares to other employees or managers, and in the absence of a market mechanism of valuation of shares in a closed joint-stock company there is no guarantee that he will be able to obtain a price higher than the face value of the shares.

(e) *Buy-outs and voucher schemes*

The future of buy-outs in Eastern Europe and especially in Russia is directly linked to the development of voucher schemes. Vouchers may be seen as offering a means of distributing wealth in CEE as an approximation to ethical principles of egalitarian treatment. However, voucher schemes raise additional governance issues to those experienced in buy-outs (Ellerman *et al.*, 1991). Both procedures can co-exist for different sized companies and recent property sales in Russia and Czechoslovakia indicate that it may be possible to include both elements in the privatisation of a particular firm. For example, according to Russian privatisation Law, a majority of shares (51%) can be acquired by managers and employees, including the possibility to exchange up to 80% of shares for vouchers. Moreover, employees and managers can also use their vouchers at the auction sales of the rests of the shares of their company.

The economic benefits of voucher-based buy-outs for incumbent managers and employees and continuing public concern about the nature of such deals have frequently caused problems for advocates of buy-outs. Indeed, according to the Russian privatisation programme, managers and employees can buy state assets at their "book value", which in the current hyper-inflationary environment is much lower than any reasonable economic estimates. Moreover, they are paying for assets by vouchers at their nominal face value, which is also lower than voucher's market price (currently it is just half of the face value). Incumbent managers and employees are thus able to obtain at least 41% (51% × 0.8) at double discount from their market price. Other voucher holders will bid for state-owned assets at the auction, where their vouchers will be valued at current market price. Obviously, the majority of the Russian population will try to get rid of their vouchers as soon as possible, and in the absence of any organized assets market in Russia it is quite plausible that large-scale sales of vouchers will bring their price down to the average cost of printing and distributing them. In other words, despite the arguments that voucher privatisation schemes best address social justice issues, the development of voucher buy-outs will inevitably be followed by substantial income re-distribution in favour of managers and employees at the expense of the broader society.

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(f) *Systemic issues*

Buy-outs may also raise ethical issues at the systemic or macroeconomic level. First, the underpricing of state assets in buy-outs noted earlier reduces the proceeds from the sales of state-owned assets, producing a sharp increase in the budget deficit with consequent adverse effects on public spending, inflation and taxes. For the budget deficit to be unchanged after privatisation, the given value of current transfers from public enterprises to the budget should be equal to the sum of the privatization proceeds and the discounted value of the taxes henceforth paid by the newly privatized firm. But if the state raises taxes to deal with the effects of underpricing, it will reduce the *real* net present value of assets! At a given level of budget deficit the population will suffer from a substantial future decrease in net income. In addition, raising tax rates may discourage the much needed creation of new firms.

The second problem concerns the effects of buy-out financing on the banking system. The credit capacity of the banking system may be insufficient to finance such transactions and produce adverse effects on other aspects of funding such as financing new firms. To the extent that start-ups are seen as riskier operations they would be less likely to be financed with consequent adverse implications for the growth of a sector which is crucial to the development of a market economy. As in the West, newly privatised buy-outs may become too heavily indebted. The experience of enterprises in CEE in the transition period shows widespread "collective mutual protection" against bankruptcy by granting each other quasi-credits, or by not insisting on due payments. The granting of inter-company finance can be a means of financing buy-outs in the absence of other institutional sources, but may contain serious dangers if enterprises become too heavily committed. Furthermore, the banking system in CEE is generally overloaded with a substantial amount of enterprise debt of poor quality. The repayment of this debt may not be legally enforceable, particularly in the absence of bankruptcy laws. In some sense "good" enterprises and banks may become hostages of "bad" enterprises and banks. Given the strong interrelation among banks and enterprises, the bankruptcy of one firm could cause a chain of bankruptcies in the whole system including the banks. Action taken by banks to deal with short term problems and to ensure debt repayment could well be at the expense of long term investment and economic performance.

V. Discussion and conclusion

So far the paper has identified and discussed the nature of ethical problems which buy-outs in CEE might produce and the economic context in which they occur. We have dwelt upon the ethical problems posed by buy-outs in the unique context of a CEE in the throes of political, social and economic restructuring. There are two major driving forces behind buy-outs in CEE. Incumbent managers and employees have a strong incentive to buy-out their enterprise only if they expect to gain in income over the longer term either through an increase in dynamic efficiency and, as a result, boost profits, or they are purely looking for short-term income redistribution through under-valuation of assets. Currently the second incentive seems most powerful. Buy-outs of this kind are fraught with serious ethical problems at both the individual firm and systemic levels.

In the West regulatory authorities have sought to create a regulatory framework preventing incumbent managers from exploiting the opportunity of obtaining the second type of gains from buy-outs. Corporate and managerial accountability have become increasingly high profile in both the U.S. and U.K. (Mintzberg, 1983; 1984). Divestment and public sector transactions in the U.K., for example, have involved performance-contingent pricing for buy-outs, clawback mechanisms on post buy-out real-estate transactions, auctions, retained equity stakes, requirements for wider employee share ownership, guarantees to maintain employment levels etc. (Thompson *et al.*, 1990). Such mechanisms can be enforced as standard features of privatisations from the public sector (Audit Commission, 1990; National Audit Office/CMBOR, 1991). In addition it may also be possible to devise schemes to compensate other stakeholders for the losses they incur.

In the CEE, however, both legal and regulatory developments lag behind the real processes in the economic system, and, as a result, the probability of economically and socially unjustified gains for in-

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cumbents is extremely high. The legacy of decades of state inefficiency/corruption makes the very idea of any over-arching regulative framework problematic. Indeed it is this very legacy that has led to the irresistible attraction of alternative market mechanisms. The problem for the CEE is to balance the possible efficiency gains of the move to markets, in particular, its contribution to "kick-starting" a moribund economy with the ethical risks facing the new agents of market forces. This is a social challenge. In the context of CEE buy-outs the question is whether the longer-term goal of galvanising the economy justifies the risk of unethical behaviour to those managers acting as agents of social and economic reform? It is perhaps ironic that it is from the West – where the ethics of buy-outs are still problematic – that the CEE has drawn this new idea!

Notes

[1] According to the new Russian Privatisation Law, managers and employees have a right to buy-out up to 51% of shares of their enterprise and up to 80% of buy-out contributions can be made by using vouchers.

[2] Evidence suggests that such buy-outs exit faster and at a higher rate than other types of buy-out.

[3] In the recessionary periods of the 1980s and 1990s in the UK at least a fifth of buy-outs have involved management taking the initiative to buy-out failed firms (Chiplin, Wright and Robbie, 1992).

[4] Land is typically excluded from accounts of business in centrally planned economies.

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