Who is Driving Change?

Corporate Governance and Organizational Change in Estonia

Ruth Alas, Tiit Elenurm & Külliki Tafel-Viia

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WHO IS DRIVING CHANGE? CORPORATE GOVERNANCE AND ORGANIZATIONAL CHANGE IN ESTONIA

Ruth Alas, Tiit Elenurm and Külliki Tafel-Viia

Organizational change processes involve many stakeholders, but the roles of capital owners and managers have not received enough attention in research on organizational change. Exploratory research results in Estonia elucidate how the interplay of owners and managers influences strategic change efforts in an organization operating in a rapidly changing transition economy. In addition to linking theoretical approaches to organizational change and development to corporate governance challenges in transition economies, this article uses data from interviews with 26 prominent decision-makers in Estonia to highlight the differences between foreign and domestic owners in controlling managers in the strategic change processes.

Keywords: organizational change; corporate governance; Estonia; transition economy

Introduction

Organizational change (OC) is a sphere attracting increasing interest in all transition economies, including the Baltic countries. Despite the varied and frequent treatment of this theme, the authors find that some aspects still have not received sufficient attention. The literature on organizational change confines itself mainly to the internal context of the organization and neglects the corporate-governance level. Corporate governance (CG) is the system by which companies are directed and controlled (Cadbury 1992, p. 15). Corporate governance has become an important change factor in the Baltic countries as in many countries around the world that have gone through the process of privatization and radical changes both in the enterprises and institutions that regulate business life.
This article introduces the owner as a significant actor into the analysis of organizational change in transition economies. Interaction between owners and managers has to be understood in order to predict the results of organizational change processes. Owners are important actors in OC in transition economies and present a possible conceptualization of owner-side mechanisms in connection with OC.

The main research question is: in a business context where CG practices have emerged after two decades of transition to the market economy, which owner-side mechanisms influence organizational change? Data for this article derive from in-depth interviews carried out with top managers and owners in Estonia as part of an empirical study undertaken by the Estonian Business School and the Estonian Institute for Futures Studies in 2004/2005.

**Theoretical Background**

*The treatment of organizational change and its problems*

Most theoretical literature on organizational change concentrates on explaining the essence of OC, placing the primary focus on how to cover and define the topic and how to identify, differentiate and classify different types of OC. Usually, scholars analyze such features of organizational change as type and process. Changes in Estonian organizations have also been studied according to type, process and readiness factors (Alas & Sharifi 2002; Alas & Vadi 2006). The role of the owner in organizational change, however, has not been studied.

Additionally, most theorists divide change into two groups according to scope: change taking place within the given system and change aiming to modify the system. The most popular concepts for this classification are first-order change and second-order change. First-order change provides a method for managing stability. It helps one to manage current strategy more effectively and efficiently (Bartunek 1993). Guided by a specific objective, this type of change proceeds through a sequential, step-by-step assessment, making systematic and rational evaluations of an organization and its environment. A first-order change cannot produce transformation because it lacks the creativity to discover new strategic ideas (Hurst 1986). Second-order change calls for innovation in order to lead the change. It searches for agreement about what the end result should be and then considers how the organization could be changed to meet these new expectations. Second-order change is difficult to carry out because information-gathering in an organization will tend to reify the rules, culture, strategy and core processes that make up its current paradigm (Nutt & Backoff 1997).

In a rapidly changing business environment, second-order change often assumes the readiness of the owners to implement new business ideas or to carry out a complete restructuring of the company, which may mean substantial investments by existing owners and broadening the ownership base of the company. Existing owners may have to accept less control over the future development. Already in the early stages of privatization in the transition economies of Central and Eastern Europe, Saul Estrin pointed out the dangers of internal privatization that would not facilitate rapid restructuring of enterprises (1994, pp. 90–1). Mass voucher privatization does not
ensure adequate forms of corporate governance. Highly diffused ownership rights, leading to the absence of any dominant block of shares, mean weak control over the managers (Estrin & Rosevear 2003). However, in 2006, Tamowicz and Przybyłowski, referring to the situation in Poland, pointed out that as a result of privatization, opportunistic managers were replaced by opportunistic block-holders. In their view, one of the key elements of further corporate governance reforms in Central and Eastern Europe is making supervisory boards of companies more independent from large block-holders in order to oppose the tendency towards a concentration of corporate control.

In this article, the authors argue that facilitating or hindering the role of insider-owners and outsider-owners who control large blocks of shares depends on the stage of economic transition and on the nature of OC. Second-order change that means implementing process or product innovations based on R&D know-how inside the company may benefit from visions of entrepreneurial insider-owners. Organizational changes that lead to complete restructuring, downsizing or even to closing down a loss-making business operating in a declining market would get more support from outside block-holders. Nadler and Tushman (1989) divide change according to two criteria: the scope of change and the positioning of change in relation to key external events. In terms of scope, change can be divided into incremental change and strategic change. This division describes the changing of the subsystems of the organization versus the changing of the entire system. Strategic change addresses the whole company and helps an organization develop a completely new configuration. Incremental change focuses upon some components of the organization with the goal of maintaining or regaining congruence. In the corporate governance context, incremental change generally does not assume go/no go decisions by corporate governance bodies representing the owners. Strategic changes can be initiated either by management or by active owners, but have to be discussed and approved in the corporate governance system if the board and the supervisory board have real roles in developing the organization. Constantionos Markides (2000) presents strategy development as one of the key tasks of the supervisory board.

In the majority of cases, models of change can be reduced to the basic model for an organizational change process developed by Kurt Lewin (1989). This model consists of three steps – unfreezing, moving and refreezing. Owners actively involved in OC may contribute their vision and ideas already during the unfreezing step. Timely decisions by corporate governance bodies are crucial for the moving phase to succeed.

Beside the type of change and the process of change there is also the question of the subjects connected to organizational change. In the organizational development literature, there have been attempts to define and classify the ‘change agent’ (Beckhard 1969). According to Caldwell (2003, p. 132), the change agent may take a variety of forms (‘advisor’, ‘educator’, ‘counselor’, ‘analyst’, etc.). For instance, Hartley et al. differentiate internal-change agents and external-change agents and claim that very little is known about their roles (1997, p. 62). They in turn (p. 92) point to Weisbord (1988) to make the argument that the literature has tended to produce idealized skills rather than detailed studies of the actual roles, activities and
performance of change agents in practice. Caldwell also argues that there are several weaknesses in the treatment of the change agent. He offers a complex approach consisting of the following four models: leadership models, management models, consultancy models and team models to encompass the treatment of change (2003, p. 132).

The role of owners in the organizational development process can be described from the point of view of using their legal power base, but timely identification of strategic problems and strategic choices and implementation of new strategic visions is also supported by cooperation between the management team and the owners. The classic organization development (OD) approach (Beckhard 1969) does not pay much attention to possible conflicts of interest between owners and their representative corporate governance bodies versus company managers. Although aligning the strategic priorities of the wider circle of stakeholders inside and outside organizational boundaries has become more integrated into organizational development programs during recent decades, conflicts between the strategic views of owners and managers are not the key focus of OD initiatives. The same applies to the learning-organization concept that identifies systemic archetypes (Senge 1990, pp. 378–90) inhibiting sustainable strategic solutions, but does not specify the roles of managers and owners in dealing with the underlying mechanisms enabling the organizational learning process. In the emerging market economy context, however, it would be especially important to understand the functions and dysfunctions of owners in the organizational learning process, since the first learning challenge for many inexperienced owners is to clarify their identity in this new role.

The authors would like to stress that conceptualizing the actors who have an influence on OC and who are involved in the ownership context is missing in the organizational development literature. The following are shortcomings in the treatment of the subjects involved in OC:

(1) The approach to subjects involved in OC is impersonal. The literature tends to concentrate on certain skills or roles that are important in managing and leading the OC. Defining the group of persons who are involved and have substantial influence has received little attention.

(2) The focus is on the people who are carrying out or leading the change, rather than on those who are behind the change. In other words, those who are controlling and/or approving OC (especially in the case of large strategic changes) have received little attention in organizational development literature.

(3) Attempts to personalize the subjects tend to (a) stay in the context of the organization’s internal environment (top manager/top management, middle managers, their teams, etc.) and/or (b) attach the key role to external consultants (from different consultant firms, etc.).

In order to understand and predict the OC process, the roles of managers and owners involved in OC have to be understood. That means leaving the narrow framework of the internal environment of the organization. In this article, the authors focus on analyzing the owners’ position in OC in the corporate governance framework of a Baltic transition economy.
Expanding the scope of approach: the owners’ position in organizational change

Mizruchi vividly describes a wider understanding, when he argues that it is generally believed within organizational theory and business management literature that the manager and management have been placed in the center (1983, p. 426). In other words, this approach means ‘forgetting’ the presence of owners and their influence on the organization. Citing Leonard, ‘The answer to the question “Who’s in charge?” is unmistakable – the “management”’ (1969, p. 5).

In many cases, however, initiating and conducting OC depends largely on the owners and their decisions and desires. Corporate-governance challenges, especially within the last decade, have continually been attracting more attention. Hendry and Kiel argue that recent media attention highlights more than ever that boards of directors are being held accountable for developing the organizations they govern (2004, p. 500).

In the context of corporate governance bodies that represent owners, it is possible to treat OC in a wider framework. As can be seen in Figure 1, corporate governance may play an active or passive role in OC through the interaction between owners and their representatives on boards that may significantly influence the OC and management activities in the organization. The owners’ position on the OC can be explained through the roles attached to owners and/or their representative bodies (supervisory board or boards of directors versus the management board). In order to understand the real influence of corporate governance and the role of the supervisory board and the management board, the corporate legislation framework has to be taken into consideration. In many transition economies of Eastern and Central Europe, the two-tier corporate governance system that follows German corporate governance legislation has been introduced. The German model of corporate governance, which, in joint stock companies, assigns CG to two boards – the supervisory board and the management board – has influenced CG not only in Estonia, but also in such transition economies as Slovenia (Rozman 2006) and the Czech Republic (Maly 2006).

![Diagram](https://via.placeholder.com/150)

**Figure 1** The content and overlap of the terms of corporate governance and management

*Source: Amended from Gerndorf (1998).*
In East and Central European transition economies, the relation of managers to ownership in large companies depends on the privatization model that has been applied. Estrin (2002) stresses that only governments in Hungary and Estonia were willing or able to sell an appreciable share of formerly state-owned assets to foreigners. Orientation toward finding core owners has been stressed among the success factors in Estonian privatization (Terk 2000, p. 207).

Owners in foreign-owned companies may accomplish their corporate governance functions through the supervisory board, but if the subsidiary in a transition economy is part of a larger transnational corporation, they may prefer to use the chain of command linking functional units of the corporate headquarters to the management board of their overseas subsidiary. In this case the role of the supervisory board tends to be rather formal.

There is growing recognition that broader conceptualizations are required for how owners or their representatives (supervisory boards, boards of directors) add value to their firms (Daily et al. 2003). Nicholson and Kiel (2004) referring to Mace (1971) and Herman (1981) state that while early research tended to characterize boards as largely ceremonial bodies, more recent normative and academic literature, as Cohan (2002) and Sonnenfeld (2002) have pointed out, portrays the board as an increasingly active body seen as ultimately responsible for corporate success.

Corporate governance literature enables us to discuss the following four mechanisms and roles that determine the owner’s influence on the organization. To begin with, a central function of the owners is their control function. Dallas (1996, p. 2) refers to Eisenberg (1976), who states that boards are uniquely suited to perform monitoring functions. Eisenberg writes about ‘boards of directors’, a term that refers to the Anglo-American model of corporate governance. In the context of the German model of a two-tier CG, the board of directors cannot be fully identified as the supervisory board, but as a body that merges the functions of supervisory and management boards (in some cases also representatives of the trade unions and other stakeholders).

One of the most widespread definitions of corporate governance in relation to who holds the central position asks, ‘how do the suppliers of finance [the owners] get managers to return some of the profits to them...how do they make sure that managers do not steal the capital they supply, or invest it in bad projects? [All in all:] how do the suppliers of finance control the managers?’ (Shleifer & Vishny 1997, p. 737).

Beside the owners’ control function, no lesser importance can be attached to their ‘soft’ mechanism – their role in defining the vision, mission, values, etc. of the organization – in other words, the motives behind establishing the organization. Although the visionary role of the top management and his/her management team is essential, it can be argued that the business vision ‘starts’ from the owners. We also discuss the owners’ own values, understandings and attitudes, which are expressed in the shaping of the general atmosphere of the organization.

A third decisive role of owners becomes obvious in the context of who controls the development of strategy. If we view the development of the owners’ role in strategy-making over time, a change towards the increasing activity of the owners is noticeable. This change has taken place in parallel with the generally increasing importance of the role of the owners in the organization. Different degrees of
involvement by the owners or their representatives can be distinguished in the strategic management process, starting from being a ‘phantom’ – not being involved at all – to being a ‘catalyst’ by taking the leading role in establishing and modifying the mission, objectives, strategy and policies (see Hunger & Wheelen 1997; Hendry & Kiel 2004).

The fourth important mechanism for expressing the owner’s influence is the owners’ personnel policy – especially the selection of a CEO suitable for the organization. Mizruchi (1983, p. 429) argues that because the board is responsible for selecting, evaluating and, if necessary, removing the management, the board is in a position to set the premises, or the boundaries, within which managerial decision-making will occur. In short, the board has ultimate control over the management through their capacity to hire or fire the CEO (Mizruchi 1983).

A survey by Cvelbar (2007) in Slovenia on the effectiveness of management turnover as a CG mechanism presents evidence that the supervisory board in not an efficient corporate governance mechanism for changing underperforming managers. Furthermore, representatives of owners in the supervisory board do not protect the interests of the shareholders better than representatives of employees and managers. This conclusion can be related to specific features of the Slovenian heritage of employee ownership, which is also reflected in its present corporate governance practices. Steger (2004), however, has identified that even in East German SMEs, sensitivity to corporate governance is only weakly developed and supervisory boards do not have enough skills to use all relevant governance mechanisms.

CEO selection is linked to executive compensation. CEO compensation in small enterprises is based on different tools than the stock options in the large companies listed on the stock exchange (Conyon & Nicolitsas 1998). Eriksson (2005) has studied management pay and top executive turnover in the Czech and Slovak republics. In Estonia, corporate governance recommendations introduced in 2006 ask public limited companies listed on the stock exchange to disclose their CEO compensation schemes. CEO compensation in non-listed enterprises is, however, a field that so far has been reflected mainly in general salary surveys that do not disclose links between components of the executive compensation package and specific CG practices.

Generally, the mechanisms described above can be used to analyze the owner’s influence on OC. The selection of a CEO can be interpreted as a direct expression of OC, meaning that a change of CEO more than likely brings about changes in the organization. The mechanism of drafting strategy can be explained similarly. The owner sets a certain strategic direction for the organization. Through defining the vision and mission, the owner creates the framework or grounds for OC.

Another important question is the scope of the owners’ influence: how actively the owner participates in or interferes with the processes of the organization. Interpreting Hendry & Kiel (2004), two broad schools of thought on the scope of the owners’ influence can be distinguished, often referred to in the literature as ‘active’ and ‘passive’. The passive school views owners or boards as rubber stamps or as tools of top management, whose only contribution is to satisfy the requirements of company law. This line of thinking argues that board decisions are largely subject to management control, particularly to that of a powerful chief executive officer. On the other hand, the active school sees boards as independent thinkers who shape the
strategic direction of their organizations. The passive school is underpinned by managerial hegemony theory, while the active school relies on stewardship, agency and resource-dependence theories.

Additionally, the influence of the owner is dependent upon the types of corporate governance used in different countries. Each system results in different ranges of owner influence. The CG roles in the Anglo-American system’s predominantly dispersed ownership, combined with the influence of institutional investors and the Continental European core owner, need not be directly comparable. Secondly, the owner’s influence is further differentiated by the types of the enterprises. On the one hand, this depends on whether we are dealing with a large, medium-sized or small enterprise. Obviously, in the case of a medium-sized or small enterprise, the owner’s direct impact on the organization’s activities can be and is significantly greater than in a large enterprise. In the case of a small enterprise it should be especially pointed out that the owner can also play the role of top manager and frequently does so.

Thirdly, a significant difference in the owner’s potential influence can be noticed when observing enterprises in terms of the organization’s stage of development. In the initial stage, the owner’s influence tends to be greater in emerging enterprises than in enterprises that have reached maturity. Fourthly, depending on whether we are dealing with a passive or active owner, or a strategic or financial investor, there is considerable difference in the range of influence.

The following framework can be developed to conceptualize the influence of the owner on the organization (see Figure 2). Theoretical approaches conceptualizing the influence of owners and also various contextual factors have to be taken into consideration when studying the interaction of CG and OC in Estonia. The arrow with the ‘boxes of mechanisms’ (control function, etc.) in Figure 2 represents the
influence of the owner on the organization. The authors hold the view that through these mechanisms, the owner has the power to influence or even lead organizational change. Through the control function, the owners have the power to control the organization, including controlling OC. The owners’ vision and values have an impact on OC. At the very least, principal and strategic changes in the organization cannot take place without the owners’ acceptance and approval. Strategy-making as a mechanism is closely attached to OC. Owner-manager interaction, conflict and cooperation in strategy-making is an important research focus.

In summary, one can conclude that there are various mechanisms through which the owner can bring about changes in an organization and/or influence OC by providing the framework within which OC can take place. The authors also argue that the more strategic and central the change is, the less it can be explained in the context of the internal environment of the organization. Consequently, the need for the broader framework of interaction between owners and managers becomes more important. The following hypotheses can be formulated on the basis of a theoretical discussion of links between the field of organizational change and corporate governance:

1. In a rapidly changing transition economy, the roles of owners and managers in drafting strategy and initiating strategic change are an area where conflicting perceptions of managers and owners are manifested.
2. In the post-privatization framework, domestic and foreign owners use different mechanisms to influence organizational change and daily management practices.
3. In a transition economy, the criteria for selecting the manager change, depending on the stage of economic transition and the owner’s personal involvement in business initiatives.

Owners as the Drivers of Change: The Case of Estonia

The background and situation for conceptualizing the influence of the owner

During the last decade, Estonia has undergone a change from a hierarchical, centralized system of state-ownership and command planning to a decentralized, market-driven economy founded on private property and based on different values. This transformation could be described as social transience, in which a complex set of normative and operating principles, embodied in historical structures, systems and practices, is replaced by another unknown set, making this period very ambiguous and uncertain for actors.

The emerging patterns of corporate governance in transition economies are quite difficult to interpret according to traditional Western models, because various institutions and the business environment as a whole do not work in the same way in transition countries as in advanced market economies, or they have only recently started to function in such a manner (Tafel et al. 2006). Therefore, CEE countries represent a very good testing ground for corporate-governance related research.

The legal framework for corporate governance in Estonia was created with the enactment of the Commercial Code in 1995, within which a two-tier system was
legally stipulated. The main features of this system have not changed since then. The establishment of a two-tier system sought to bring clarity to the legal landscape in Estonia during the confusing period in the early 1990s. The number of state enterprises was relatively large at this time. Compared to the one-tier system, the roles of managers and owners are more clearly separated in the two-tier system, a factor that played a decisive role in selecting between these two systems. By the beginning 1995, the period of privatization in Estonia was predominantly over and the first legislative framework related to the operation of corporations in the Western sense had started to develop. The second turning point is represented by the year 2000, when the ‘purge’ following the Asian and Russian crises presented new demands upon economic activities and economic thinking as a whole.

Estonian ownership patterns are to some extent similar to the Italian model, as many enterprises are family-owned, but the concentration of domestic outsiders and foreign investors is also high (Hannula 2006, p. 81). Jones et al. (2005) have studied the process of ownership change in Estonia after privatization and concluded that ownership change from employees has speeded up restructuring. Their research results suggest that manager-owned firms have displayed better performance than domestic- or employee-owned enterprises. Besides, in Estonia’s case the period should be emphasized separately. In the 1990s, the Estonian business environment developed largely by relying on cheap labor for its competitive advantage. In recent years the need for more innovative, high-value-added business models has emerged as a result of economic convergence with the European Union. All these factors highlight that in such cases the role of managers and external owners may change.

The authors were involved in conducting a survey in January–February 2007 that included 373 companies randomly selected by the Estonian Statistics Bureau. Among 117 companies that gave full and complete responses, 55 were foreign-owned and 62 domestic. Forty companies had more than 100 employees and 77 had from 50 to 99 employees. Only 10 companies in this sample were listed companies. In one-third of all domestic companies in the sample, the company belonged 100% to the CEO or top management team and to their closest family members. The majority of management boards had one or two members (38.5% and 22.2% respectively), 14.5% had three members and 10.3% four members. Management boards meet one or two times per month, on average 1.5 times per month.

As many as 44% of supervisory boards have three members who possess voting power. Only 11% of them were elected by the employees. In foreign firms, most of the supervisory board members are foreign residents. Thirty-seven percent of supervisory board members have the job of CEO or a similar top-executive role in some other company. Sixty-five percent of supervisory board members had no business ties to the firm. At least a portion of them can be seen as independent supervisory board members. Although supervisory board meetings on average take place four times per year, formal board decisions are also made outside regular face-to-face board meetings (e.g. via conference calls, e-mails, faxes). In 35% of companies, the work of board members was compensated, but only 15% had explicit rules for compensation. Contributions by the supervisory board were assessed to be the most significant factor in controlling business results and business decisions, followed by the function of replacing top management if needed. The survey results
highlighted that conflicts in the supervisory board arise most often in discussions about what is best for the firm.

The survey format alone, however, is not the best tool for exploring deeper mechanisms of conflict and cooperation in CG as a sensitive field of business interests. Although the survey gave some statistical background for understanding the present role of management and supervisory boards in Estonian CG, additional qualitative research methods were used to understand owner-side mechanisms that influence organizational change and to reflect relevant CG practices. For a more detailed analysis of Estonia’s actual situation, the authors used the results of generalist interviews. These interviews make further analysis of the influence of the owner possible as well as of the extent of this influence on the organization.

The methodology of the generalist interviews

The study of CG in Estonia is a multi-year joint research program between the Estonian Business School and the Estonian Institute for Future Studies, but involves partners from other universities as well. Within the framework of the first stage of this research program, in-depth interviews with owners and top managers were carried out. These interviews were rather extensive, relatively un-standardized, but nevertheless structured. They lasted two or three hours and concentrated on issues relating to the levels of management in the corporation and its capital, the ties between these levels and the influences from the environment in which the corporation and capital operate.

The interviews contained 60 questions and were recorded. With nearly every question, two aspects were addressed: the difference between the periods 1995–1999 and 2000–2004 and the difference between enterprises based on foreign and domestic capital. A total of 26 individuals were interviewed. The criteria for inclusion in the sample were broad experience in business and the resulting ability to generalize. Therefore, a ‘traditional’ division – dividing the respondents by sphere of activity and by size and type of company – could not be used since the key criterion was having had broad experience in different areas and in different positions. The selection of interviewees observed the principle of more or less equal representation of owners and managers, as well as a separate group of owners/top-managers – those who had had experience of both roles. Business experience during the two decades of transition to a market economy was gained from different sectors. Experience from industrial and service companies was almost equally represented, but the interview results did not reveal any crucial sectoral differences relevant to the main research question. The interviewees had the most extensive experience as owners and managers in the following business sectors: banking, real estate, wholesale and retail, logistics, energy, hotels, publishing, telecommunications, information technology, food processing and clothing. The same people during the transition process were involved in several ventures in different business fields, for instance acting in small producer co-operatives first, setting up the largest commercial banks in Estonia in a second stage and initiating new ventures by using their accumulated capital in recent years.
It should also be emphasized that the respondents were asked to generalize based on several years of experience and not to give answers based on the specific enterprise they were concerned with at the moment. This interview focus followed two aims:

1. to avoid barriers that can emerge if the respondent has to disclose sensitive corporate governance issues linked to his/her current business initiatives and relations with present partners; and
2. to reveal trends and changing CG practices based on lessons learned and comparing the experience of the respondent with other actors in the CG field.

Such a focus made it possible to treat the respondents as experts able to reflect on the CG trends and problems they have confronted in different organizations and corporate governance bodies. The interview results, however, cannot be treated as input for statistically representative empirical generalizations. In line with explorative research, they instead reveal the essential mechanisms and contradictions for understanding CG and developing concepts for further research of enterprise samples in specific business sectors. Using the main research question as the departure point, the following specific questions were selected for analysis of the data collected through in-depth qualitative interviews:

- The owners’ strategies for allocating capital: what motives do the owners have and how different are they?
- How in general has the division of labor in the drafting of strategy been organized between the owners and the top managers?
- Which qualities do the owners value in their top managers and how have these indicators changed during the period 1995–2004?
- To what extent do the owners (board) interfere with the enterprise’s strategic management and daily issues?

The results: from interference to transformation

Conceptualizing the owner’s position in OC in Estonia. In terms of our theoretical perspective, the owner’s position in OC can be explained through the control over the organization. In other words, to what extent does the owner interfere with the organization and its management, to what extent does he or she hold the central position. The results of the interviews make it possible to interpret the owner’s interference at two levels: on the one hand, the owner’s interference at the strategic-governance level, and on the other hand, the owner’s direct interference with daily management issues. With regard to the question — how in general is the owners’ and top managers’ division of labor organized in the drafting of strategy? — the authors were primarily interested in the extent to which strategy is tied to the owners’ ‘sole competence’ and the degree to which the top managers carry only the executive role (since, despite various approaches, the setting of strategy pertains predominantly to the owners’ competence).

The extent to which strategy-making is the domain of the owners or the top managers turned out to be one of the questions that provoked the most emotions. Obviously, strategy-making is an area where the priorities of top managers and owners...
meet and the result determines the direction of the organization's activities. The responses from the interviewees enable us to define three approaches to dividing up responsibility for strategy: first, where the strategy is predominantly within the competence of the top manager (and his team); second, where a clear owners' strategy is adopted; and third, where the strategy is formulated through close informal cooperation between the owners and the top manager.

The type of owner in Estonia varies: we can see phantom owners, owners as catalysts or as active participants, and in a third intermediate case, both owners and managers have room for action. Here it is important to stress that the results of the interviews enable us to claim that the role of owners in strategy-making and their influence on it is clearly evident and, also, that they can take the leading role in drafting the strategy. The interviews show additionally that for Estonians the top managers’ perspective is the most problematic when the owners reserve strategy-making for their exclusive competence or for the catalyst or the active-participant type of owner. To quote from the respondents (hereafter the number indicates the code of the respondent):

... especially the owners, who began early and have been successful, remain of the opinion that they are the best strategists. And they would not let anyone else close to it. (top manager 15)

More frequently than not the owner wants to decide the strategy. He would decide anyway, but he is not too good at it. ... And the owner always has the right to come three months later and say that we shall now do it another way. (owner-top manager 20)

In this case, the authors claim that the owners play a decisive role in the organization, including leading the changes. Managers in a transition economy, however, are skeptical about the abilities of many owners as strategists, especially if the business environment has changed and the original business-success model might not be sustainable. They tend to share the view that becoming an owner in a transition economy is more often the result of being in the right place at the right time rather than an indication of more entrepreneurial competence than they themselves possess.

Besides defining the strategy, there is also the possibility of the owner’s interference with the daily problems of the enterprise, which relates (more) clearly to the top manager’s competence. The interviews contained a separate question about the extent of the board’s (owner’s) interference with the management of the firm and its daily problems. Based on the answers, we are able to generalize that the domestic owner (at least in the initial period of 1995–1999) tended to interfere with operations quite actively. The interviewees remarked that the owners could grant the top manager ‘superficial’ freedom of action, by failing to determine the exact activities/roles. In other words, Estonian owners in reality reserve greater freedom for themselves to interfere in the activities of the top managers. Quoting the respondents:

... the owners cannot really draw the line between being owner and actively managing the firm. ... the owner comes up very frequently and interferes with some details he considers important. ... Yet he cannot understand whether or not
his interference will earn him more money. Very often it does not earn any and results in a great confusion. . . . (top manager 8)

The owners tend to interfere with the management all the time. If the owner is an engineer and knows his pipes, he wants to run the pipe business; if he is a timber man and can set up a sawmill, he wants to carry on with that. . . . If people have one, two or three favorite businesses, which were successful, such owners find that their businesses were successful because: a) they set it up once and b) they keep interfering with their activities. Such people, who understand that what they did in the early 1990s need not be valid any more in 2004 and thus it would be better not to interfere, such people are practically nonexistent. (top manager 15)

To quote an owner:

Probably there are not many such passive owners in Estonia. . . . and the development has not progressed so far that you could just give some capital to a great idea, like take the money and do it. Yes, people want to interfere. . . . (owner 17)

One reason for being actively involved in daily management, however, is the limited skills of owners in applying CG mechanisms of control and strategic guidance through the board structure. They try to act as co-managers, not as owners governing their agents.

Foreign owners, especially strategic foreign owners, impose many more instructions on top managers and much greater formalized restrictions on the top manager’s freedom of action than Estonian owners. In fact, involvement of larger transnational corporations in the Estonian business landscape has resulted in more detailed procedures and reporting rules. As one of the interviewees described: ‘the foreign owner has all kinds of procedural rules: regarding this matter see Article 3 §29 prim etc. – it has been written down and has to be done that way’ (top manager 15).

In brief, owners in Estonia can be described as interfering owners. Additionally, the owner’s influence is expressed not merely within the limits of the owner’s role, but also by transcending them through interfering with daily management. There are differences in interference between domestic and foreign owners: the interference of foreign owners tends to be in a more regulated form. At the same time, the domestic owner tends to take unforeseen actions.

The most important mechanisms for revealing owner influence on organizational change.

1. Owners’ strategy and vision as a framework for organizational change.

The interviews included a group of questions about the owners’ strategies for allocating capital. The interviewees were asked about the strategies behind establishing the enterprise and/or making an investment. The responses revealed that the logic and motives of the strategies varied quite substantially and that enterprises belonging to one owner may be established to follow very different strategies. Quoting the respondents:

. . . we established one enterprise with the strategy to build it for selling it; the second investment we make may be based on the strategy to privatize the
company and to take it to the stock market. Or we can have a strategy in which we establish the company, we develop it without having any interest in selling it, despite the fact that there could be better times and worse times and that the company cannot be a ‘strawberry’ all the time – this is the case if we are especially interested in developing this enterprise. In brief, the strategies for establishing the enterprise are very different. (owner 2)

One enterprise is like your favorite child and hobby. The other enterprise is a ‘cash cow’ and it is natural for you to support your ‘favorite child’ with the money coming from the ‘cash cow’; this is the way things are . . . . (owner 17)

The authors claim that the owners’ strategies for allocating capital constitute a framework for organizational development, including the type of organizational change that can be implemented successfully. For instance, first-order changes (i.e. managing stability, using step-by-step movement towards the objective, etc.) may not be very likely in organizations established with the strategy to sell the enterprise quickly to new investors.

(2) The change in the profile of top manager as a reflection of organizational change.

The interviews revealed that the selection of top manager by owners was one of the most important owner-side channels of influence. The interviewed owners pointed out that owner-managers in successful growing companies tend to hire a managing director in order to concentrate themselves on new business initiatives. In some cases, owners are also tired of everyday management problems and they wish to enjoy a more relaxed lifestyle and consume the profits they have accumulated. The interviews compared the transformation of the profile of top managers in two periods – 1995–1999 and 2000–2004.

As a contextual factor in choosing a top manager, the interviewees clearly emphasized the significance of the period – either as a stage in the transition to a market economy or as a stage in the life cycle of an enterprise. The owner’s influence seeks to ensure that the top manager meets the enterprise’s needs at a certain moment; this is essential for ensuring the top manager’s own motivation and, furthermore, his ability to motivate employees. To quote one of the owner-interviewees:

...businesses have different stages. [Let us presume] that we have been growing full throttle for five years, we have had a really hot top manager [but] now we, the owners, cannot see opportunities for continuing this growth trend. [In this situation] the man [the top manager] who has been [acting vigorously] all the time will become bored. It seems to be all right, but there is no big leap ahead. The owners will then become worried about him [the top manager]...getting complacent, this is not good. This is not good for the employees, they will also relax...[To sum up:] different strategies require different top managers – it is very rare that one person can handle them. (owner 2)

The significance of the issue of owner-side selection of a top manager as well as the related time factor becomes even more prominent when we analyze the position of
the owners with regard to the preferred profile of the top manager. The basic types of top managers emerging from the interviews show quite clearly the decisive influence of the owner in choosing a top manager. The interview results primarily presented two different types of top manager. On the one hand, the interviewees mentioned the active developer-type and, on the other hand, the maintainer-type. It is important to add here that the owners’ preferences were largely sensitive to the period. The two periods being compared presumed the need for different types of top managers due purely to objective requirements: in the 1995–1999 period we most often find the top manager as the developer-type and in the 2000–2004 period, as the maintainer.

With regard to the developer-type of top manager, the owners preferred ruthless managers, capable of making many unpopular decisions (e.g. streamlining, restructuring, massive dismissals of staff, etc.) or, alternatively, managers capable of establishing entirely new businesses, which also called for a strong, resourceful, decisive and risk-taking round-the-clock manager. The developer-type of top manager, it is important to note, encompasses two different types: on the one hand, someone capable of creating an organization, showing initiative, inspiring a team, while on the other hand, someone who is a reorganizer, unafraid of taking action, including downsizing or other unpopular changes.

According to the interview results, top managers valued by owners possessed the following qualities: they were well-connected, ‘launcher-types’ with a strong business sense, tough and possibly even ruthless. The interviews also quite clearly revealed that in the case of the developer-type of top manager, soft values and soft management style would not have been favored. In terms of the maintainer-type of top managers, the owners predominantly envision those who can maintain current successes, who can retain and/or improve an established system and who can better satisfy the needs of existing customers. For this type of top manager, it is important to identify values (including soft values), education and erudition, an ability to operate within set rules, good administrative skills, strong verbal skills, etc.

To conclude, the results of the interviews enable us to claim that the type of top managers preferred by the owners quite directly defines the type of OC possible in Estonian companies in certain periods. It can be concluded that developer-type top managers were more prepared to carry through the ‘bigger’ and more strategic changes that were also expected from them. At the same time, maintainer-type top managers are better suited to cope with ‘smaller’, adaptive types of organizational changes. In a rapidly changing business environment, CG bodies have to be able to find and select new top managers quite quickly in order to have the right type of manager in the organization in time.

Conclusion and Discussion

In this article the authors attributed considerable significance to the influence of the subjects at the governance level – the owners – on change processes taking place in organizations operating in a transition economy. The corporate governance framework enabled us to discuss different mechanisms of owner influence and to define the owner’s position in the OC. In the research on organizational change, the theoretical
literature on corporate governance has demonstrated that the owner’s influence should be taken into more consideration than it has been in the past in defining organizational development concepts.

In East and Central European transition economies, the influence of owners and corporate governance bodies on organizational change depends not only on the process and results of privatization, but also on the role of management and supervisory boards in the corporate governance model. For several reasons, Estonia is a well-suited case for studying owner-influence on organizational change. The contextual factors typical of Estonia and emphasized by the authors include the domination of small enterprises, ‘core owners’, as well as rapid economic transition and active involvement of foreign investors in Estonia. All favor significant owner-side influence. The interviews carried out with Estonian top managers and owners, while allowing preliminary conclusions based on the limited number of respondents, also point to rather clear owner-level influence.

The first hypothesis, concerning conflicting perceptions of owners and managers in drafting strategy and initiating strategic changes, was confirmed. Furthermore, the research also revealed the conflicts related to a mismatch between different types of managers (the developer versus maintainer) preferred by owners. The interviews provided evidence that in the context of a transition economy, the managers often do not trust the strategic visions offered by owners who were successful as entrepreneurs during the earlier stages of economic transition.

The results of the interviews enable us to conclude that owners in Estonia can be described as interfering owners. Additionally, the owner’s influence is expressed not merely within the limits of the owner’s role, but also in exceeding that role by interfering with daily management. In light of the theoretical literature, owners in Estonia can be described primarily within the limits of approaches that stress the central role of the owner (e.g. active school). The authors argue that in the case of such a ‘hands-on’ owner, we can also assume their ‘presence’ in the context of organizational changes – their taking control of changes and leading changes. The authors claim that conceptualization of the owner’s position in OC starts, on the one hand, from certain direct mechanisms the owner controls and which bring along changes in the organization, while, on the other hand, there is the question of how actively the owner participates in or interferes with (or wants to participate in and interfere with) the processes of the organization.

The second hypothesis about different mechanisms used by domestic and foreign owners to influence organizational change was supported by evidence about the interference of foreign owners in a more regulated form compared to unforeseen actions by local owners. More evidence, however, has to be collected in order to assess the extent to which existing regulations and reporting systems in large international corporations are a reasonable way to accomplish corporate governance in subsidiaries operating in a new EU-member state. Excesses in formalized corporate-control practices can weaken entrepreneurship opportunities and inhibit the innovative capabilities of local managers who belong to the developer-type. Although extensive harmonization of business legislation was carried out by Estonia before joining the EU, differences in emerging markets should not be underestimated by corporate governance bodies.
With regard to the various mechanisms through which the owner’s influence could be expressed, the results of the interviews support the important position of the owners in Estonian organizations. The results enable us to conclude that the owner’s main influence in Estonia is in drafting strategy and selecting the top manager.

In the context of OC, the owner’s role in selecting a top manager for different stages of organizational development should be especially emphasized. The results of the interviews support the conclusion that through this mechanism the owners have brought about second-order changes in the organization. The change of top manager refers to changes in the organization as well as determining, to a certain extent, the type of change that can take place. More changes could be expected to take place during the earlier period (1995–1999 and before) than in the second period (2000 and afterward). Preference for the developer-type of top manager in the earlier period points to the fact that ‘bigger’ and more strategic changes were expected in organizations. When owners moved towards preferring the maintainer-type of top managers, their action indicated a move toward a ‘smaller’ and adaptive type of organizational change.

This tendency supports the third hypothesis concerning the criteria of top-manager selection and specifies the main trend of change in the owners’ priorities so far. It can be anticipated, however, that development toward a knowledge-based economy may in the future again lead to higher demand for developer-type managers, especially by risk capitalists who invest in high-tech ventures.

The owners’ strategies for allocating capital were a separate important mechanism revealed by the interviews. In general, the strategies or motives behind investment are rather diverse. In the context of organizational change this mechanism performs as a limiting or framing factor for OC.

Owner influence is also expressed through interference beyond the limits of the owner’s role – interfering with daily management. The owner wants to make decisions himself, to do it himself and to monitor the ‘heartbeat’ of the organization, including the changes taking place. It is important to add that owner-side domination also depends on time factors. In general, it can be claimed that in Estonia the vision of a ‘hands-on’ owner is declining rather than increasing.

In the estimation of the authors, the position of the owners with regard to OC certainly cannot be ignored. Here, the explorative nature of the generalist interviews produced new insights, despite such limitations as the impossibility of linking the generalist interviews to economic data of a pre-defined sample of business organizations. For the time being, the frequency of applying different mechanisms of owner-influence, their effect on short-term and long-term business growth and the future position of the owner in the OC remain untreated topics that will require further study.

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Ruth Alas is the Vice-Rector for Scientific Affairs and Head of the Management Department in the Estonian Business School. Her research focuses on employee attitudes, learning abilities, organizational culture, leadership, crisis management, business ethics and corporate social responsibility. She has written 23 management textbooks and more than 100 articles. Ruth Alas has organized several international conferences in Estonia and is chair of the EIASM workshop series ‘Organizational Development and Change’. Ruth Alas is on the editorial boards of nine journals. (ruth.alas@ebs.ee)

Tiit Elenurm holds the professorship in entrepreneurship at the Estonian Business School. He earned his PhD in 1980 for the dissertation ‘Management of the Process of Implementation of New Organizational Structures’. His vision is to develop synergy between management training, consulting and research activities. Research interests include knowledge management, corporate governance, change management and international transfer of management knowledge.

Külli Ki Tafel-Viia is a researcher at Tallinn University in the Centre of Educational Research and in the Estonian Institute for Futures Studies. She has an MSc in social sciences from Tallinn University of Technology and she is continuing with doctoral studies in the field of public administration. Her current research interests include creative industries/creative economy, social innovation and communicational issues in society and in organizations.