Corporate value creation, governance and privatisation
Hailemariam, Stifanos

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Chapter 2

Privatisation

2.1 Introduction

Effective programmes of transition to a market-based economy involve many elements both of a macro and a micro character. Some of these programmes include privatisation, managing and restructuring enterprises, establishing an appropriate environment by liberalising prices, building financial intermediaries and promoting competitive market conditions [Ernst, Alexeev, Marer, 1996]. In this chapter, we will study privatisation.

We describe privatisation in section 2.2 and in section 2.3, we present the privatisation experience of developed economies. In section 2.4, we analyse the privatisation experience of the transition economies of Central and Eastern Europe and in section 2.5, we discuss the privatisation experience of Sub-Saharan African countries. Finally in section 2.6, we summarise the chapter and highlight the lessons that can be learned.

2.2 What Does Privatisation Mean?

A clear definition helps in avoiding ambiguity and facilitates a comprehensive analysis for an in-depth investigation of the issue in all its aspects. In the literature, several authors define privatisation differently. Some authors define privatisation narrowly to mean the sale of state-owned assets. Kikeri, Nellis and Shirley [1994] defined privatisation as the transfer of a majority ownership of state-owned enterprises to the private sector by the sale of ongoing concerns or assets following liquidation. Ramamurti [1992, p. 225] argues that privatisation “refers to the sale of all or parts of a government’s equity in state-owned enterprises to the private sector.” According to World Bank [1996, p. viii], privatisation is defined as “the divestiture by the state of enterprises, land or other assets.”

Several other authors see privatisation as a wider phenomenon encompassing interconnected activities that reduce the government ownership and control of enterprises and that promote private sector participation in the management of state-owned enterprises. Vickers and Wright [1988] view privatisation as an umbrella term for a variety of different policies that are loosely linked which mean the strengthening of the market at the expense of the state. Hartley and Parker [1991, p. 11] define privatisation as “the introduction of market forces into an economy in order to make enterprises work on a more commercial basis.” They argue that privatisation embraces denationalisation or selling-off state-owned assets, deregulation (liberalisation), competitive tendering, as well as the introduction of private ownership and market arrangements in the ex-socialist states. Cook and Kirkpatrick [1988, p.3] define privatisation as “a range of different policy initiatives intended to change the balance between the public and private sector and the services they provide.” They distinguish three main approaches to privatisation: a change in the ownership of the enterprise, liberalisation or deregulation, and a transfer of goods or services from the public to the private sector even if the government retains ultimate responsibility for supplying the service.
From a transition point of view, Blommestein, Geiger and Hare [1993, p.11] see privatisation as “any transfer of ownership of a state enterprise to other agents which results in their effective private control of the business.” They argue that privatisation does not require a majority stake to be held by any private owner or group of owners; it is also compatible with some shares being retained by the ministry of finance (or another body charged with holding state assets). Figure 2.1 shows the classification of activities associated with privatisation.

**Figure 2-1. Activities Included in Defining Privatisation**

<table>
<thead>
<tr>
<th>Market liberalisation, liberalisation of prices and trade and encouraging competition in the economy</th>
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<tbody>
<tr>
<td>Transfer operations of state-owned assets to private enterpreneurs, such as contracting out.</td>
</tr>
<tr>
<td>Sale of state-owned assets to private investors.</td>
</tr>
</tbody>
</table>

The Eritrean government in its macro policy outlined that the government is aiming at reducing the role of the public sector and increasing the role of the private sector in the economy. In 1991, the Government adopted a free market policy and liberalised trade and prices and in 1995, reformed the manufacturing enterprises into separate autonomous entities. At the end of 1996, the government announced the sale of 39 of these enterprises. In this study, we are examining the influence of the privatisation process on the creation of value and the responses and behaviour of managers to the economic reforms. Due to this, in this research, we define privatisation broadly to mean the process of transfer of state ownership to the private sector, the transfer of operations of state-owned assets to private entrepreneurs, and the liberalisation of prices and trade to encourage competition (see figure 2-1). It includes the sale of state-owned assets from the public sector to the private sector. The state may sell its equity in an enterprise wholly or partially such as establishing a joint venture. The privatisation arrangement is usually accompanied by regulatory policies to privatisate the economy, among others, controls on entry and exit, prices, outputs and services supplied. Defining privatisation broadly will help us to investigate the relevant issues and their implications for the restructuring and enhancing the value of the state-owned enterprises in the process of transition. The economic reforms, preparation of state-owned enterprises for privatisation and methods used in privatising influence the restructuring and viability of the enterprises during and after privatisation. In the following sections we will discuss the privatisation of state-owned enterprise in the developed economies of the West, in the transition economies of the Central and Eastern Europe and Sub-Saharan Africa to learn from their experiences.
2.3 Privatisation in Developed Economies

The literature on privatisation in developed economies reveals the objective of privatisation, the justification for privatisation and the forms of privatisation methods used as well as the privatisation experiences of these countries.

Objectives

Many state-owned enterprises are losing money and policy makers are trying to privatise these enterprises. One of the objectives of privatisation is, therefore, to transfer ownership to private investors so that the enterprise will become efficient and profitable. The objective of privatisation is based on the view that private sector operations outperform their public counterparts. The World Bank [1996, p. 49] reports that “In established market economies and middle to high income developing economies there is little doubt that private ownership is a significant determinant of economic performance.” The private sector enterprises are subject to economic disciplines not present in the state sector, and they respond to choices made by consumers. The disciplines of competition and the need to earn a profit keep private business leaner and more efficient than their public counterparts. A private firm can go bankrupt if it fails to keep up with the competition; public sector activities rarely face a similar prospect. The different penalties, which they face, seem to produce a difference in performance. The aims of a government once it has opted for privatisation include: increasing the size and dynamism of the private sector; attracting and facilitating private sector investments from both national and foreign sources, freeing public resources for urgently required investments in infrastructure and social programs [Bergen, Bauer and Kuber, 1994]. Privatisation may also have aims: like changing the behaviour of economic agents and promoting entrepreneurship; improving corporate governance by subjecting companies to the discipline of the market and finally reducing the budget deficit to harness savings and to promote wide share ownership [Nestor and Nigon, 1996].

Why Privatisation?

Is privatisation necessary? Does it matter whether property is public, private, or something in between? There are arguments in favour and against privatisation. Some of the arguments in favour of privatisation summarised by Boorsma [1994, p. 25] are: “1. Privatisation increases the (private sector and hence) economic growth. 2. Privatisation reinforces technological development and innovative capacity. 3. Private enterprises are more efficient than public enterprises. 4. Privatisation gives a budgetary advantage.” On the other hand also, Boorsma [1994, p. 29] presents the following arguments against privatisation: “1. Privatisation leads to higher costs. 2. Privatisation leads to reduction of employment. 3. Privatisation leads to quality loss.” However, according to Boorsma [1994, p. 28] “The arguments in favour of contracting out and the efficiency gain that can be achieved in that case have a theoretical underpinnings and have been tested empirically. Other arguments are hardly substantiated theoretically or little research is available to support them.”

Bishop, Kay and Mayer [1995] in describing the experience of privatisation in the UK explained that there are three factors that justify privatisation: finance, information and control. The issue of finance affects both the government and the firm in a privatisation situation. The government avoids paying subsidies to ailing state-owned enterprises and
raises revenue in the process of disposing of assets. The firms are also free to raise funds from the capital markets. However, their conclusions indicated that privatisation has had only modest effects on finances. The effect of privatisation on public sector accounts has been negative and the capital markets have not been a central source of funding privatised enterprises as predicted.

Information is of relevance in setting prices and providing incentives to managers. Privatisation has helped companies to use stock market prices as a performance yardstick. Competition encourages efficiency by allowing consumers to purchase from lowest-cost suppliers and thus, it helps in achieving production efficiency by encouraging firms to minimise costs. By lowering costs, they are able to increase profits and raise incomes of managers and the remaining workers if their pay is related to corporate performance. The authors found out that greater information transparency has been achieved due to privatisation of state-owned enterprises.

Bishop, Kay and Mayer also argue that where price mechanisms alone are not adequate, control is of relevance. Changes in ownership are most directly associated with changes in control exerted by the state and a transfer of control to private investors. Privatisation of state-owned enterprises in the UK has transferred control of the enterprises to the private sector and weakened the control of trade unions. Moreover, the day-to-day government involvement of operating firms has been significantly reduced, but periodic interventions to undertake substantial restructuring of industries remain likely. Moreover, privatised industries improved performance, however, the improvement originated from the imposition of hard budget constraints by the government, clear commercial goals, performance pay and decentralised and accountable management reforms introduced prior to privatisation.

According to Bishop, Kay and Mayer [1995, p. 13] “privatisation had little effect on performance in the privatised state-owned enterprises in the UK.” The authors found that in some companies the improvements that were actually made prior to privatisation made privatisation possible and concluded that establishing correct structures before privatisation is essential.

Martin and Parker [1997] examined whether 11 British firms, privatised during 1981-88, improved profitability after being privatised and they found out mixed results. The authors found evidence of performance improvement relating to restructuring prior to being privatised (but not afterward). However, they could not determine whether performance could have been improved without the spur of incipient divestiture or subsequent privatisation.

More recent analysis of performance before and after privatisation in industrial and developing countries reaches stronger conclusions in favour of private ownership, that privatisation improves performance [Megginson and Netter, 1999]. Megginson et al. [1994] compared the financial and operating performance of sixty-one companies from eighteen countries (twelve developed economies and six developing economies) and thirty-two industries that experienced full or partial privatisation between 1961 and 1990. Financial indicators were used including profitability, sales levels, operating efficiency, capital investment, leverage ratios and dividend payout figures. They found that following privatisation firms typically increased sales, became more profitable, increased investment
and improved their operating efficiency (measured by sales per employee and net income per employee). They also found that on average employment did not decrease after privatisation, as might have been expected, but it actually increased. They also found out that the best performance results were related to privatisation when there were large changes in the senior management or in the control structure. This places the emphasis on internal reorganisation rather than on privatisation per se.

The privatisation of state-owned enterprises is also justified on the basis that there are also factors that differentiate public and private firms. Pirie [1988] summarised the following main characteristic differences: labour cost, consumer input, decision-making, conditions of equipment and responsiveness to cost control. According to Pirie [1988] labour costs are often the key to differences in efficiency between the private and public sector. Public enterprises are usually overstaffed. Moreover, he argues that the consumer is able to exercise a degree of control on private firms by deciding whether to shop with them or to seek satisfaction elsewhere. The goods and services have to be oriented towards consumer satisfaction in order to attract customers and to make profits. They have to be the goods and services which consumers will choose to buy, and they have to offer the variety and the quality sought. In addition, Pirie stated that decision making in the private side of the economy is heavily based on economic factors. The choices of when to expand and where, of the level of production to achieve, and the determination of a price - all of these decisions are made on the basis of economic considerations. Firms have to gear their decision making to the market. They have to deal with the level of demand and with the price and availability of capital. On the other hand, in the public sector many of the important decisions are made on political grounds. For instance, voter response to a price increase is an important factor in the management of state-owned industries. Therefore public sector companies do not follow the law of demand and supply: political objectives are pursued at the expense of economic ones.

Martin and Parker [1997] argue that there are similarities between the public and private sectors, but there are also certain differences in operations and focus. They identify six characteristics that highlight the differences between public and private sectors: management, goals, organisational structure, labour, responsiveness to cost control, and nature and location of the business. They argue that the proximate source of performance improvement lies within the organisation itself. They advocate for change from “production orientation” in which engineering and production staff dominate decision making to a “marketing focus”. In addition, they note that the existing thinking of managers needs to be challenged.

### Table 2-1 Distinction between the Public and Private Sectors

<table>
<thead>
<tr>
<th>Management</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agent-principal relationship:</td>
<td>Blurred</td>
<td>Clear</td>
</tr>
<tr>
<td>Orientation:</td>
<td>Inward and production focus</td>
<td>Consumer and marketing focus</td>
</tr>
<tr>
<td>Style:</td>
<td>Reactive</td>
<td>Proactive</td>
</tr>
<tr>
<td>Constraint:</td>
<td>Politically constrained</td>
<td>Stakeholders interests but less constrained</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Goals</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goal clarity:</td>
<td>Multiple and sometimes vague and conflicting (public interests)</td>
<td>Uni-dimensional (profit)</td>
</tr>
<tr>
<td>Focus:</td>
<td>On inputs</td>
<td>On outputs and outcomes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Organisational structure</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hierarchy:</td>
<td>Hierarchical pyramid and centralised</td>
<td>Decentralised and diversified</td>
</tr>
<tr>
<td>Type of structure:</td>
<td>Functional</td>
<td>Business based on profit centres</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Labour</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Union strength:</td>
<td>High unionisation and centralised bargaining</td>
<td>Lower unionisation and decentralised bargaining</td>
</tr>
<tr>
<td>Payment:</td>
<td>Salary grading</td>
<td>Employment based on performance</td>
</tr>
<tr>
<td>Security:</td>
<td>High security of employment</td>
<td>Low security of employment</td>
</tr>
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</table>

<table>
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<tr>
<th>Responsiveness to cost control</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Control</td>
<td>Less cost control due to tax financing</td>
<td>High cost control to become competitive</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nature and location of the business</th>
<th>Public sector</th>
<th>Private sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature:</td>
<td>Politically and geographically constrained</td>
<td>Commercially determined</td>
</tr>
<tr>
<td>Development:</td>
<td>Limited business development</td>
<td>Diversification, investment and divestment, mergers and overseas ventures</td>
</tr>
<tr>
<td>Location:</td>
<td>Mainly national</td>
<td>International and global orientation</td>
</tr>
</tbody>
</table>

Source: [Pirie, 1988; and Martin and Parker, 1997]

### Forms of Privatisation Methods

The different methods used in privatising state-owned enterprises are discussed in depth in this chapter in section 2.4 in relation to the experience of the transition economies. Therefore, to avoid duplication, we will discuss only the share issue privatisation method here, because it is a widely used method of privatisation in the developed economies. Share issue privatisation is a method of selling state-owned enterprise by offering some or all of government’s equity in a state-owned enterprise to investors. The objective of this method is to involve small shareholders and larger institutional shareholders in the purchase of state-owned assets. The advantage of this method is that it can be used to promote wide share ownership as all members of the public are invited to participate in the offer. However, there are a number of disadvantages with privatisation conducted solely through a public offer. According to Jenkinson [1998, p. 95] “Pricing the issue can be difficult because there is little
information available to the government or its advisors as to the likely demand for the shares and hence appropriate price. In addition, the price in a public offer has to be set some considerable time (typically five to ten days) before the shares are allocated, so that investors have time to receive the final prospectus and submit their bid. Such a time delay exposes the issue to uncertainty and affects its stock market price. Moreover, since the objective of a share issue is to encourage broad participation of the people, the government incurs large marketing costs to advertise the offer.” The availability of highly developed financial markets in the developed economies makes share issue privatisation there easier than in the transitional and developing economies.

2.4 Privatisation in Transition Economies

The downfall of communism in the Central and Eastern Europe countries in 1989 and 1990 has marked a new era of transition from command economy to market economy. The Central and Eastern Europe countries have experienced several years of transition now and a description of what has taken place and an assessment of their experience can be useful for other countries such as Eritrea, which are in an earliest stage of transition. In the following, we analyse the general transition experience of the former socialist countries of Central and Eastern Europe. We refer mainly to the experience of the Czech Republic, Former East Germany (GDR), Hungary and Poland due to their relative advancement in the transition to a market economy.

In order to privatise their economies, the former socialist countries of Central and Eastern Europe have launched a programme of transition to a market economy. One important feature of this transition is the desire to achieve a rapid transfer of property from the state sector to the private sector. The principal steps of the transition programme are the liberalisation of prices and import restrictions, convertibility of their nation’s currency, expansion of the private sector, a macroeconomic anti-inflation policy, building financial intermediaries, promoting competitive market conditions, privatisation, managing and restructuring enterprises, social security and environmental policy.

In the following parts, we will describe the macro level issues in privatisation in the transition countries (2.4.1) and discuss the methods used in privatising state-owned enterprises (2.4.2). Moreover, we will analyse the obstacles encountered in privatising and restructuring these enterprises (2.4.3) in order to learn form their experiences and explore the issues and problems that need to be studied to facilitate privatisation and restructuring.

2.4.1 Macro-level Issues in Privatisation

The success of privatisation depends upon macro and micro level aspects. This research will focus mainly on micro-level aspects in order to investigate the problem deeply. However, we review the essential macro level aspects that facilitate privatisation and restructuring of firms such as political environment of a country, economic condition, government policy, legal environment, financial environment, infrastructure and human resources development in order to understand the environment in which the state-owned enterprises in transition economies are working [Ernst and Young, 1994].
**Political Environment**

Privatisation and restructuring enterprises may lead to lay-offs of employees. This leads to significant social tension in a country and thus politicians might refrain from approving privatisation programmes. If the workers union has a strong position in enterprise management, it hampers privatisation. The workers are also entitled to buy shares at discount to minimise political tension during privatisation.

The political stability of a country is also one of the important conditions that attract foreign investors. Political stability and government commitment to privatisation reduce political risk and thus, investors would be confident that their investment would not be expropriated. Countries with a more stable political situation enjoy higher foreign investment than those countries with a less stable political situation.

**Economic Conditions of a Country**

A stable macroeconomic environment helps the progress of privatisation. The basic objectives of macroeconomic stabilisation are to prevent hyper inflation, to eliminate price distortions caused by subsidies and lack of competition; and to establish monetary and fiscal balance in a market based economy [UNIDO, 1994]. In order to have a stable macroeconomic environment, relative prices have to be meaningful, that is, they should correspond to relative world prices; the exchange rate should be appropriately valued; and factor markets should not be excessively distorted or controlled.

Inflationary and recessionary economic conditions cause production declines and reduce the profitability of firms to be privatised. Therefore, privatisation might not progress well in bad economic conditions. On the contrary, a prosperous, booming economy improves the profitability and the saleability of the enterprises to be privatised. Moreover, stable exchange rate helps investors and managers to predict input and output prices.

**Government Policy**

Government trade policy, industrial policy, investment policy, tax regime and commitment to a market economy influence the privatisation process. Liberalisation of domestic and foreign trade and relaxation of price controls introduce competition to the economy. Foreign, as well as domestic firms will compete on equal grounds and thus those firms which cannot survive competition will become bankrupt.

The industrial policy of a government aims at enhancing the competitive advantage of domestic industry and managing orderly closure of surplus industrial capacity. Industrial policy embraces aspects of the development of efficient enterprises. Privatisation is part of the industrial policy of a country targeted to bring efficiency to the enterprises.

The reform of industrial relations institutions and labour law is essential to stabilise and focus labour relations on the enterprise level where productivity-enhancing decisions are made. The state needs to develop a comprehensive system of dispute conciliation and labour courts to arbitrate, where necessary, between employers and their employees in matters
relating to trade union recognition, wage negotiating rights and other collective issues in dispute.

The income tax, excise tax, custom tax and sales tax of a country should be attractive to foreign investors. Excessive taxes deter foreign direct investment in a country while low taxes lure foreign companies to a host country. Investors look for long-term profitability and temporary measures such as endowment of tax havens do not necessarily motivate investors and do not help in facilitating privatisation of state-owned enterprises. However, some transition countries provided special privileges to attract investors. In the former German Democratic Republic (GDR), the government provided investment grants and subsidies to promote investment and privatisation. Investors were offered investment grants for establishment, renovation and fundamental revitalisation of a commercial enterprise. In addition, investors received investment premiums (discount on the purchase price) of 12% of the cost of the acquisition. Moreover, investors were eligible for European Recovery Programme loans and they were allowed to use accelerated depreciation methods for tax purposes [Carlin, 1993].

Investment policy of the government also has to be attractive to both the domestic and foreign investors. The government has to maintain the transparency and stability of the policy environment and interactions between the administration and foreign investors. Competing enterprises must be treated in the same way by the authorities regardless of who owns them. Establishment of state investment agencies facilitates the process of investment in a country and helps foreigners in cutting the red tape and bureaucracy in different government offices. At the same time, the needs of domestic investors also should not be ignored [UNIDO, 1994].

**Legal Environment**

The transformation of centrally planned economies into market economies presents some special aspect of regulation vis-à-vis privatisation. Many of the legal structures and institutions for private business enterprises that are taken for granted in market economies need to be put in place before privatisation begins. Some of the legal institutions needed for the operation of private business go to the very foundations of the economy and legal system thus require constitutional amendments; that is, the recognition of the right of individuals to own property, in particular the means of production, called capital, in all its form, and the guarantees and legal protection of those rights that have to be recognised as part of the fundamental laws of the country [UNCTAD, 1993].

Legislation furnishes the legal framework necessary to reassure private investors and to guarantee the orderly functioning of the market economy. Privatisation generally starts with the promulgation of a privatisation act, which establishes new institutions to oversee the process and to set out the allowable forms of privatisation, each with its own approved procedures. General legislation on western type company forms, foreign investment, commercial code, accounting, bankruptcy, competition policy related matters is drafted before or in parallel with the privatisation laws [Blommestein, Geiger and Hare, 1993].

There are a number of key elements in the legal and regulatory infrastructure needed to support the introduction of a market economy. The first and basic element is an efficient constitutional mechanism for establishing the rules of conduct of the economic system. Other
laws based on a constitution facilitate the buying and selling, as well as, the operations of business. The legal infrastructure of a country should provide every market economy with security of private property, enforcement of contracts and assignment of liability for wrongful damage [UNIDO, 1994].

Measures are necessary to strengthen private property rights and corporate structures, legal instruments and financial institutions. The country's laws have to provide protection against arbitrary nationalisation or expropriation and assurance that if the expropriation takes place, fair compensation would be paid. Capital market regulations regarding registration, transferability of interest, investors’ protection, reporting and disclosure should be outlined. In addition, employment and labour laws, taxation laws and investment laws that match with the private investors’ needs should be issued to attract foreign and domestic investors.

**Financial Environment (Banks)**

The financial sector has a prominent role to play in the process of privatisation and in the post-privatisation period. High priority should be given to the creation of a competitive banking sector and the establishment of a proper regulatory framework for investment funds and other financial institutions.

In market economies, banks traditionally play a pivotal role in the restructuring process through their intimate knowledge of the intricacies of corporate finance. While working with the management, banks introduce financial instruments necessary to support expenditures compatible with needs of the enterprise. By contrast, under the system of central planning, banks were entirely passive and the bankers did not have experience of commercial project appraisal techniques. Perhaps more damaging was that the central planning mechanism discouraged the development of a banking culture that emphasised working with and assisting enterprises.

The financial restructuring of enterprises may directly involve the creditor banks, for absorbing loan, losses and /or by identifying non-performing loans that the fiscal authorities may be willing to take over by swapping them against long-term government issued securities. The provision of new loans for the modernisation of privatised enterprises may prove crucial for the survival of these firms in a competitive environment. The ready access to credit by 'good' private enterprises will be an important determinant of the success of the privatisation process. Another key function of the financial system is to provide an efficient payment system. Thus, in transition economies, it is necessary to examine the progress made in putting into place the structural conditions for a well functioning financial system.

**Infrastructure and Human Resource Development**

Developing the energy, water, telecommunications and transport facilities required for business to obtain needed goods and materials, to communicate with suppliers and customers, and to bring the final product to market quickly and efficiently is relevant in a transition economy.

The adjustment of a state-owned enterprise to a changing new environment is to a large degree dependent on the capacity and capabilities of its work force and of its management.
Thus the provision of management training in aspects of competitive market realities, and financial management is an important component of the restructuring process. Without proper training and systematic management development it is very difficult for the management team to begin to focus on the necessary changes in business strategy required to improve technology and organisation, to adjust products and marketing to face the new competition, to reorganise production to increase efficiency, to access appropriate financing to fund restructuring, and to streamline operations through the disposal of peripheral operations [UNIDO, 1994].

2.4.2 Methods of Privatisation Used in Transition Economies

There are alternative methods of privatising state-owned enterprises in transition countries [UNECE, 1992; Brabant, 1995; Megginson & Netter, 1999]. Here we will present the main methods, selling of assets, free distribution and leasing and management contracts, which are widely used methods in transition economies. The selling of shares used frequently in developed countries has already been discussed in section 2.3. The methods discussed here include techniques of placing managerial control over the use of state-owned assets into the hands of those who can credibly promise to maximise net asset values; that includes effective monitoring and adequate incentive mechanisms, positive as well as negative ones. The key issue is how quickly and in what form assets can be taken out of the immediate control of the state or its political power centres. The method selected in privatising state-owned enterprises has an impact on the restructuring of the enterprises during and after privatisation.

Sale of State-Owned Assets

Sale of assets involves the outright sale of state assets through auctions or other discretionary channels, public offering at the stock market (see section 2.3), the negotiated sale of shares or assets, workers and/or management buy-outs, a non-subscribed increase of capital and debt–equity swaps. Apart from the fact that auction markets would have to be organised, the sale of state assets calls into question the availability of funding, given that private savings in these countries are highly limited. Whether society would be prepared to put even these limited funds into company shares and at what price the auction should be reserved are issues that need to be addressed [Brabant, 1995]. In the former German Democratic Republic (GDR) the Treuhand’s basic privatisation strategy was to sell enterprises to buyers who have western management expertise and knowledge of western markets and technology. Therefore the most common form of ownership of large privatised East German companies (with at least 100 employees) sold by Treuhand is one in which there is a dominant (with a stake of at least 50%) West German company. In other words, East German companies became West German companies’ subsidiaries [Carlin, 1993]. Selling state-owned assets to a strategic investor helps in concentrating ownership and restructuring of the enterprise after sale.

The greatest advantage of a widespread sale is that it widens effective ownership. It forestalls any criticism of the state encouraging the very rich or foreigners or insiders to acquire real wealth at a low price. Second popular capitalism may instil a shareholder culture in the populations at large and abate the strong risk aversion that is still pervasive in most Central and Eastern European Countries. Third, it would provide a strengthening of the capital and securities markets by those having built up a financial interest from their own resources. Among the drawbacks of large privatisation are the problems of ensuring effective
monitoring (proper management) of these privatised firms. In the process of readying firms for privatisation widespread disruption in the retail and wholesales distribution networks have been observed. In addition, firms to be privatised are plunged into considerable uncertainty for the duration of the privatisation campaign and until effective monitors are in place, something that is unlikely to be realised immediately upon the sale of shares [UNECE, 1992].

**Free Distribution**

Free distribution is a method of transferring the title to assets free of charge. The most common forms of free distribution have been distribution to workers and free distribution of shares to society at large either on an individual basis or to households. Free distribution to workers is based on the ground that ownership in the state firms should be transferred to those employed, who will be requested to ameliorate the firm’s profitability. The key assumption of such transfer is that property owners automatically improve the allocation process and render the firm profitable [Brabant, 1995]. In transition economies of the Central and Eastern Europe, workers received some privileges, but not necessarily a monetary concession. The free distribution of assets to workers fails to provide funding for the government to remove some liabilities and it also does not bring change in management and present labour force, which are essential in restructuring enterprises. This also results in unequal distribution of wealth among workers. Those workers in profitable companies benefit while those in non-profitable companies lose.

Free distribution (Voucher Privatisation) of shares involves the giving away of shares to the population at large. The basic philosophy on the free distribution is that, once restitution and perhaps other claims are settled, remaining state assets are common property and should, therefore, be distributed free of charge. In Czech Republic and Poland, the governments introduced the voucher method for privatising large enterprises. Free distribution can take a number of forms of which the following three cover most alternatives [UNECE, 1992]:

- **Distribution of society’s wealth directly to the population at large:** distribution of financial intermediaries (such as divestment, mutual or investment funds) and distribution of shares in these funds to the population at large and the establishment of holdings to manage groups of state-owned enterprises according to commercial criteria and subsequently sell them off in an orderly mode. **Divestment holdings** are firms created for the specific purpose of selling state-owned enterprises. What is involved essentially is that fund managers will be placed in charge of enterprise restructuring and privatisation. **Mutual funds** are conceived largely as their counterparts in market economies. The mutual fund managers distance themselves from individual companies and engage mainly in monitoring assets. Individuals hold shares in the mutual funds and are expected to monitor the mutual fund managers. Finally **investment funds**, as their name suggests, are more directly involved in reconstructing the enterprises entrusted to them. Shares in those funds too are widely owned and individuals are assumed to monitor investment managers. In Czech Republic government passed coupons, which may be used for payments in the transfer of state-owned property to private ownership. According to Bergen, Bauer and Kuber [1994], the voucher privatisation scheme proved to be rapid and efficient. It is based on selling vouchers (quasi-money applicable only in the privatisation process) to every adult citizen at a symbolic price. The vouchers are redeemable for shares of privatisation firms. Voucher Privatisation turned more than 75% of Czech adults into shareholders, with shares either in the 1,500 privatised companies or in the investment privatisation funds. The voucher scheme has also facilitated application of standard
privatisation techniques in the rest of the economy and indirectly, speeded their implementation.

There are a number of advantages and drawbacks of promoting free distribution. The advantages are mainly the egalitarian and transparent nature and speed with which the privatisation process can be carried forward under some semblance of government supervision. But there are drawbacks and dangers. First of all, there are bound to be losers as well as beneficiaries, as valuation problems will crop up even in the most egalitarian designed scheme. Furthermore, free distribution yields no revenue to the government and may erode future fiscal revenues for as long as the fiscal base cannot be radically revamped. According to Goldstein [1997, p. 534] “The cost of setting up the voucher auction mechanism is a dead-weight loss to society after the process is complete. Voucher schemes require the creation of an entirely new additional market; the voucher auction bidding market, which is a sunk cost and is worthless as soon as the auction process ends. The high fixed costs included in the voucher system including the cost of designing such a system, educating the people, creating the proper infrastructure for the bidding process and others could make it likely that the total societal cost will be greater under a voucher scheme.” Moreover, any large-scale distribution would introduce the principal-agent problem. Unquestionably the most serious shortcoming of this approach would be that privatisation through near universal free distribution can exert at best weak influence on managerial behaviour [UNECE, 1992].

**Leasing and Management Contract**

The principal purpose of separating user rights from ultimate ownership through leasing and management contracts is to increase the role of non-state decision-makers in the usage of state-owned assets. Private investors take the day-to-day affairs of the assets for which the contract is signed, hopefully with a view to maximising residual benefits after paying operating costs, as well as the contract fee. But there will not be a transfer of the ultimate ownership of the economic activities or enterprises concerned. These methods provide the government time to divest the enterprises and remove the responsibility of financing them. However, there are problems of enforcing the contracts and negotiating a proper fee.

In Poland, widespread lease-buy arrangements are used, under which private parties take a multi-year mortgage on the property, or a lease with option to buy. This approach was considered more equitable because it enabled thousands who had been working in shops and other small establishments to take them over quickly. In Hungary also the Government is using management contracts as an alternative to outright privatisation of a state enterprise or public service, whereby the government retains ownership but pays a contractor an agreed fee to operate it. It involves management fees, or success fees, or an equity investment with the option to buy. The most creative Hungarian thinking is to privatise state firms incrementally, to prioritise the restructuring of a firm, where the entire firm cannot find a buyer in the market. This requires that the contract manager put up considerable capital of his own in return for a potentially high return on his investment. The problem of course is to ensure that the investment is used for restructuring and not to maximise short-term income for the managers. In the former German Democratic Republic (GDR) the Treuhand embarked on an experiment by setting up two new companies to introduce high-powered incentives into the restructuring and privatisation process whilst retaining the ownership of enterprises in state hands. The Treuhand believed that such a new strategy was necessary because a large number
of potentially viable enterprises had failed to attract a buyer [Carlin, 1993]. An individual experienced western manager takes on the responsibility for turning the group of enterprises around and can earn a large bonus from a successful privatisation. The Treuhand provided the finance for the restructuring needed, though it also set budget constraints.

2.4.3 Obstacles to Privatisation in Transition Economies

The literature on transition economies reveals problems encountered in privatising state-owned enterprises. The following discussion is mainly based on United Nations Economic Survey of Europe (UNECE) [1992], which has categorised the problems into salient, technical, economic, managerial and attitudinal problems. Figure 2-2 summarises the main obstacles to privatisation.

**Figure 2-2 Summary of the Main Obstacles to Privatisation in Transition Economies**

<table>
<thead>
<tr>
<th>Obstacles to Privatisation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Salient Problems</strong></td>
</tr>
<tr>
<td>- speed</td>
</tr>
<tr>
<td>- priorities</td>
</tr>
<tr>
<td>- restructuring</td>
</tr>
<tr>
<td>- new owners</td>
</tr>
<tr>
<td><strong>Technical Problems</strong></td>
</tr>
<tr>
<td>- market structure</td>
</tr>
<tr>
<td>- absence of capital markets</td>
</tr>
<tr>
<td>- valuation</td>
</tr>
<tr>
<td>- initial condition of privatization</td>
</tr>
<tr>
<td><strong>Economic Problems</strong></td>
</tr>
<tr>
<td>- absence of capitalist class</td>
</tr>
<tr>
<td>- distribution aspects of divestments</td>
</tr>
<tr>
<td>- organisation of auctions</td>
</tr>
<tr>
<td>- macroeconomic environment</td>
</tr>
<tr>
<td><strong>Managerial Problems</strong></td>
</tr>
<tr>
<td>- principal-agent problems</td>
</tr>
<tr>
<td>- information</td>
</tr>
<tr>
<td>- managerial capabilities</td>
</tr>
<tr>
<td>- corporate governance</td>
</tr>
<tr>
<td><strong>Attitudinal Problems</strong></td>
</tr>
<tr>
<td>- consumer preference</td>
</tr>
<tr>
<td>- sell off to foreigners</td>
</tr>
<tr>
<td>- entrepreneurship and market entry and exit</td>
</tr>
</tbody>
</table>
Salient Problems

Salient problems are critical policy decisions that must be resolved before any headway with privatisation can be made. In looking at the mechanics of privatisation policies, the key issues to be tackled are the speed of privatisation, prioritising, restructuring and the sale to new owners. The speed of privatisation has been at the centre of the debate on the economic transition because it affects other aspects of socio-political stability in the region. Rapid privatisation results in a quick transfer of ownership, but the governments need to assure that the transferred resources are used adequately in order to have a maximum economic, social and political effect. However, there are severe constraints faced such as a lack of institutions to facilitate privatisation. The privatisation process in the Central and Eastern European countries could be categorised into two groups, those countries which used rapid transformation (big bang approach) and those countries which used gradual transformation (gradualist approach). In a rapid transformation of the economy, the target is to transfer as many state-owned enterprises as possible to private hands without considering its consequences. Many companies may fail to survive after privatisation and also many workers can lose their jobs. In a gradual transformation, the emphasis is to try to find investors who would be able to run the companies by injecting more capital and skill so that the enterprise will compete in the free market. In gradual transformation governments usually try to avoid drastic measures of plant closure and workers lay-off. Aghion and Tirole [1993] and Katz and Owen [1993] both argue that the gains from hasty privatisation must be weighed against the social costs of speed. In both of their models, instantaneous privatisation leads to costly unemployment; the optimal privatisation path involves some delay. Murphy et al. [1992] disagree and argue that there are substantial costs of slow or partial reform. Regardless of the merits of the two sides in this debate political realities seem to mandate a slow or, at least, not an immediate privatisation process in most of the transitional economies [Glaeser, 1996].

The government has to establish some order of priority as well. For instance, “small” privatisation such as shops and restaurants are privatised first and then “large” privatisation such as light and heavy manufacturing enterprises. The experience of the former socialist countries in Central and Eastern Europe reveals that the privatisation of small-scale enterprises was successful [Earle, J., et. al., 1994] while large-scale enterprises’ privatisation was slow and difficult. Privatisation of small retail shops, service establishments, handicraft shops and small construction contractors was generally managed quickly and effectively because the process was decentralised to local administrations and because many shortcuts were used. Foreigners were, moreover, generally excluded from small-scale privatisation. Large scale enterprises were plagued with various problems, such as outdated technologies and production processes, a huge accumulation of debt, rigid work rules, strong resistance to reorganisation and lay-offs, a lack of marketing and finance skills and inefficiency in production. All these factors made privatisation of large-scale enterprises difficult and thus various restructuring activities were conducted to make these enterprises saleable.

Restructuring is important for medium-sized and large industrial enterprises in order to make them saleable. Some are quite large and must be disaggregated into separately manageable components and they have to institute clear operating criteria with incentives for management. The large firms may be grouped into those that can be sold-off relatively quick and that will be left in state hands in the first instance. The firms that will be left with the state need to be allocated to a group to be wound down or to another group of firms in need
of restructuring prior to being privatised. In Central and Eastern Europe, state-owned enterprises are being privatised and are undergoing restructuring. Wide spread plant closing and massive lay-offs have, however, generally been avoided. The main reasons are the fear of exacerbating already high unemployment and the sectors’ political importance, as well as their size. In Poland, workers are more powerful than in any other country in Central and Eastern Europe and their views must be taken into account in any major change contemplated by both the government and the management. The power of workers dates back to 1981 when the Solidarity Movement had revolted against the socialist system and from their contribution to topple down the communist system thereafter. Workers councils acquired de facto control of many enterprises when the government control system collapsed in the last days of communism in Poland. During the transition the workers had to approve any decision to convert an enterprise into a corporation and to privatise it. Moreover, Polish workers tended to view themselves as the natural heirs of the state in the ownership of enterprises. Polish trade unions have a long tradition of activism and were the principal base of Solidarity movement. Consequently, subsidisation and protection of large inefficient industries are continuing, through grants, preferential loans and debt relief by state controlled banks. In addition, tax exemptions, social security contributions and customs duty arrears as well as import protection are used to help companies. This is a heavy burden on the transition economies, because it is drawing scarce funds away from other profitable investments [Ernst, Alexeev and Marer, 1996].

The government also has to decide whether the state assets are to be returned to previous owners (restitution) and whether property can be sold to foreigners. Identification of previous owners after several decades of nationalisation of the state-owned enterprises was difficult.

**Technical Problems**

According to UNECE [1992, p. 219], “At the inception of the transition process, the former centrally planned economies found themselves literally without capital markets for two reasons. One was the limited ability of individuals to acquire and hold financial wealth under communism, coupled with the considerable degree of social protection (in terms of jobs, wages, pensions, medical care, and others aspects) enjoyed under administrative planning.” The absence of capital markets hindered valuation of state assets. This resulted in below-value sale of assets due to a lack of transparency. Lack of a proper accounting system also hindered the valuation of net worth and at times, some international accounting rules were applied in the state-owned enterprises to have its profit and loss situation assessed. The initial condition of the enterprises also affected their privatisation. Enterprises with a good financial condition were able to survive market competition, while those that were in poor financial condition encountered problems when the market was liberalised, but managers faced difficulties in restructuring enterprises which were in poor financial condition during the transition.

**Economic Problems**

The economic aim of privatisation is improving the efficiency of the existing assets while protecting their value. To begin with, there is insufficient indigenous saving available to purchase outright a sizeable portion of state assets. In some cases, setting up proper financial institutions, such as independent pension funds, insurance schemes and commercial banks to
whom state liabilities are sold as distinct alternatives to the institutional monopolies in place can assist in the intermediation. But this cannot be a panacea. In the absence of widespread experience with such divestment, however, careful experimentation is warranted both in the methodology of organising markets and in phasing the privatisation. Without progress in the sphere of monetary and fiscal institutions, policies and instruments, the advance towards privatisation is likely to run slow. The macroeconomic environment as discussed before in this chapter also influences the privatisation of state-owned enterprises.

**Managerial Problems**

There is also a large array of questions connected with the order in which privatisation, (mainly large enterprises privatisation) should be pursued to minimise transition difficulties and avoid delays in getting the economy going again and obtaining a more efficient utilisation of available capital assets.

If privatisation is to enhance efficiency and raise revenue, the principal-agent problems that arise in managing state-owned enterprises need to be minimised. Many aspects of the problems of managerial abilities and behaviour, fostering the rapid emergence of a competitive environment, and putting in place sufficiently comprehensive regulatory mechanisms could usefully be considered here. Those measures designed to induce enterprise management to behave like private owners remains acute, regardless of ownership. This is true even in cases where the state retains control and enjoins enterprise management, for example, through management contracts, to behave as its counterpart in a privately-owned corporation. It is therefore important to monitor management and put in place transparent incentive schemes that are likely to induce managers to serve according to the instructions of the owners regardless of whether they are private or public. Accounting information on cost reduction and relative costs of services supplied by multi-product firms is essential.

It is possible that the inefficiency of state-owned enterprises under central planning stemmed, at least in part, from incompetence on the part of those running the firms. One reason for this was that manager was frequently entrusted to political appointees, but it would be wrong to extend this to all managers. Neither would it be appropriate to assume that all of the appointed managers are incompetent. However, few individuals have had experience with proper enterprise management because planners did not encourage acquisition of an economic or managerial culture. Such culture cannot be quickly assimilated. Hence years to come, for better or worse, the transition mainly has to rely on those who formed the backbone of the old managerial technocracy.

**Attitudinal Problems**

Some of the most important legacies of the long years of socialist economy are implanted in the behaviour and expectations of economic agents. These concern consumers' preferences, sell-off to foreigners and entrepreneurship and market entry and exit. The consumers in the transition economies have a low saving attitude influenced by the past conditions of the socialist experience. There is little doubt that all transition economy countries have been looking towards a significant influx of foreign capital, including through the formation of joint ventures and outright sale of state-owned to foreign owners. This would furnish badly needed capital, but also managerial expertise, technology, marketing skills, an easier entry
into established markets, and other benefits. However, economic sovereignty in the countries in transition matters because the people complain about selling off to foreigners, especially selling strategic enterprises to foreigners. The question, then is less whether to sell assets to foreign owners as such than in what sectors, to what degree and how will foreign ownership be regulated.

Managers of state-owned enterprises are on the whole entrusted with priorities and rules that have little to do with their ability to enhance the firm’s net worth. So even if the state and its appointed officials were to withdraw quickly from microeconomic decision making, who would take their place? Furthermore, will would-be managers and entrepreneurs successfully manage or protect assets? A well functioning banking sector is critical as an intermediator between savers and investors, ensuring expeditious settlement of reciprocal claims, and indeed to facilitate initially the transfers of title and payments for parts of publicly quoted enterprises [UNECE, 1992]. Conflicts of interests have been especially conspicuous in the privatisation campaign, with managers or bureaucrats privatising themselves, politicians involved with privatisation also being on company boards, and banks entrusted with the implementation and supervision of some aspects of privatisation campaign being funnels for the acquisition of property.

2.5 Privatisation in Sub-Saharan Africa

Many African countries became independent during 1960s and followed a state led development strategy due to the influence of socialism and due to the perception of the state as a provider of employment. The newly established governments of Africa nationalised the already existing enterprises mainly owned by ex-colonial powers and also established new state-owned enterprises to promote economic growth and provide employment to their citizens. Yaffey [1995] argues that the rationale of nationalising enterprises in 1960s, which belonged to a wealthy upper class, was aimed at reducing the share of profits consumed by few private individuals and increasing the share of profits reinvested in productive assets and the rate of growth of gross domestic production. Yaffey further elaborates his argument as follows [1994, p.203]: “the requisite circumstances are, first that the elite formerly enjoyed high income; second, that they enjoyed a high average propensity to consume; and third, that the new system (governments) can make effective use of the funds diverted into national development budgets.” However, the state-owned enterprises’ performance was dismal because most state-owned enterprises were poorly conceived to begin with and thus became economically inefficient. They accumulated huge financial losses and absorbed a disproportionate share of domestic credit and had become an unbearable burden on government finances.

In early 1980s, there were increasing calls for reform of the state-owned enterprises and the World Bank (WB) and International Monetary Fund (IMF) started advising many African countries to implement structural adjustment programs (SAPs). Over the past two decades, under pressure from the World Bank and the IMF, most African countries initiated economic reform programs and became committed to the transition to a market-and private sector-based economy. These structural adjustment programs were first concentrating on the reform of the state-owned enterprises. However, “in most Sub-Saharan Africa, the dynamics of reform have led neither to a fundamental economic transformation nor to a collapse of adjustment
efforts [Gordon, 1996, p. 1530].” Gordon [1996] further argues that the structural adjustment program in Africa has not yielded more dynamic results due to both conditions in Africa and aspects of donor policies. Within Africa, according to Gordon [1996] three reasons help explain the limits of adjustment’s success. The first is the general context of underdevelopment—a weak human resource base, an inadequate infrastructure, and less diversified economies—which limits a more dynamic supply response. Thus the longer term success of African adjustment efforts depends on addressing these underlying constraints. A second explanation is that in Africa both markets and states are weak and fragile. In general, adjustment efforts focussed on cutting back inappropriate state intervention on the assumption that markets will then operate effectively. However, this was not automatically possible due to undeveloped markets in Africa. The third explanation for the limited impact of adjustment is that the existing programs have not been very successful in promoting reform in several crucial areas such as fiscal policy and the regulatory environment which affect private investment and export crop pricing and marketing.

Schneider [1999, p. 327] “While each African country has unique elements to its development, there are certain institutional characteristics common to most Sub-Saharan Africa countries, each which undermines the effectiveness of market based structural adjustment programs.” According to Schneider [1999], these institutional characteristics are as follows: an oligopolistic banking sector, a weak, insecure state, a large agricultural sector dominated by peasant farming, inadequately deteriorating infrastructure designed during the colonial era to extract resources from Africa, rather than to facilitate internal trade, an export sector dominated by primary products, many of which are facing declining terms of trade, a small industrial sector that usually is not internally competitive partly due to the small size of the domestic market and poorly funded education and health care system.

Industrialisation is an essential aspect of long-term development. As Lall [1992, quoted in Stewart, 1994, p. 105] stated: “In nearly all economies, manufacturing industry has been the critical agent of the structural transformation that makes the transition from primitive, low productivity, low income state to one that is dynamic, sustained and diversified.” For many Sub-Saharan Africa countries, most of the 1980s were years of industrial stagnation or even deindustrialisation [Stewart, 1994].

The poor performance of state-owned enterprises led the International Monetary Fund (IMF) and the World Bank (WB) to advise African governments to privatise the enterprises. Based on the pressure from the IMF and WB, many countries embraced privatisation, with activity reported in at least 41 of the 48 countries in 1997 in Sub-Saharan Africa [Sarbib, 1997]. The growing interest in privatisation stems from pervasive dissatisfaction with the performance of state-owned enterprises, worsening economic conditions and severe fiscal crises which have been endemic in several African countries [Ariyo & Jerome, 1999]. The objective of privatisation in Sub-Saharan Africa according to Mkandawire [1994] are to reduce the fiscal budget deficit, to bring greater efficiency and to free both domestic and foreign private capital from the tentacles of corrupt and inefficient bureaucracies. Table A2-1 in the appendix presents the number of transactions and the proceeds from privatisation data reported by the World Bank for the years 1990-1996. The number of privatisation transactions has increased from 171 in 1990 to 474 in 1995, but declined to 428 in 1996. This indicates that governments in Sub-Saharan African countries are implementing privatisation programs to divest state-owned enterprises. The sales proceeds from these transactions
reached US$ 2,704 million at the end of 1996. This trend is expected to continue because new countries are embarking on privatisation programs and those governments who have been divesting small enterprises are now engaged in the privatisation of large enterprises such as utility companies.

The geographical distribution of the number of privatisation transaction differs among the countries. In terms of number of transactions it is neither the Anglophone nor the Francophone countries which have recorded most privatisation activities. Mozambique and Angola sold 548 and 331 enterprises respectively. Both countries had been following a socialist path of development and after the break-up of the former Soviet Union, they had been divesting state-owned enterprises in order to build their war-torn economy. However, though the numbers of transaction are many their sales value may not be high because these two countries had nationalised small restaurants and retail shops. In terms of the sales value of the transactions, South Africa and Ghana earned US$ 761 million and US$ 417 million from privatisation proceeds. South Africa has been attracting foreign direct investment due to its size of the economy and Ghana was one of the first African countries to start privatisation in 1983 due to the adoption of structural adjustment programs.

Table A2-2 in the appendix shows the top 20 transactions accounting for more than a third of the total value of divestitures in Sub-Saharan African countries. It also shows the government ownership pre and post privatisation and the sales proceeds at the time of privatisation. The highest sales value was of Ashanti Goldfield Corporation of Ghana which was sold for US$ 316 million and reduced the government share ownership from a majority of 55% to 30%. In most of the transactions the government ownership declined from a 100% before sale to 0% after sale. This evidences that the governments are committed to privatising their ownership fully.

Table 2-2 Shows Privatisation Methods used in Africa up to the End of 1996.

<table>
<thead>
<tr>
<th>Method</th>
<th>N</th>
<th>%</th>
<th>Method</th>
<th>N</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share sales by competitive tender</td>
<td>854</td>
<td>31</td>
<td>Joint ventures</td>
<td>47</td>
<td>2</td>
</tr>
<tr>
<td>Liquidations</td>
<td>458</td>
<td>17</td>
<td>Management contracts</td>
<td>39</td>
<td>1</td>
</tr>
<tr>
<td>Asset sale by competitive tender</td>
<td>421</td>
<td>15</td>
<td>Restitution to former owners</td>
<td>36</td>
<td>1</td>
</tr>
<tr>
<td>Non-competitive sales of shares</td>
<td>291</td>
<td>11</td>
<td>Transfer to trustees</td>
<td>27</td>
<td>1</td>
</tr>
<tr>
<td>Leases/concessions</td>
<td>187</td>
<td>7</td>
<td>Non-competitive sales of assets</td>
<td>25</td>
<td>1</td>
</tr>
<tr>
<td>Pre-emptive rights share sales</td>
<td>76</td>
<td>3</td>
<td>Debt/equity swaps</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Public flotation</td>
<td>69</td>
<td>3</td>
<td>Unspecified methods</td>
<td>100</td>
<td>4</td>
</tr>
<tr>
<td>Management/employee Buyouts</td>
<td>48</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Overall Total</strong></td>
<td></td>
<td></td>
<td></td>
<td>2,718</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Sarbib [1997, p. 7]
Note: N represents number of transactions.

The above table shows that the governments have used share sales using competitive tenders as a principal method to divest state-owned enterprises. In addition, liquidation of state-owned enterprises and asset sale by competitive tenders have also been used. Liquidation reflects the poor state of the companies that are sold. Though broadening ownership has been one of the objectives of privatisation, there was no free distribution of shares to the people. There is a growing concern about the limited involvement of African
citizens in large divestitures due to their limited savings [Bennell, 1997]. The use of pre-
emptive rights of shares (issuing shares with preferential rights such as buying before others
on new issues) also raises the concern about transparency of the transactions [Sarbib, 1997].
The state of the capital markets has restricted both the pace of privatisation, in terms of how
many enterprises could be put up for sale and the methods available for broadening
ownership.

Despite the increase in number of privatisation transactions each year, many Sub-Saharan
countries face difficulties in privatising state-owned enterprises and the number of privatised
enterprises is far less than the target set by the countries [Bennell, 1997]. In the literature
several authors presented problems that the Sub-Saharan African countries are facing in
privatising enterprises. There are many obstacles to privatisation in Sub-Saharan African
countries. Most state-owned enterprises are over-staffed and are highly indebted. For
instance, according to The Economist [1999], in South Africa, the government reckons that
27,000 jobs need to be reduced at Transnet, transport company and 10,000 jobs at Telkom,
telecommunication company. State-owned enterprises were frequently undercapitalised and
the difficulties encountered in financing operations from their own resources fostered a
many state-owned enterprises have such enormous debts also seriously affects their
saleability. Unless governments are prepared to take over these debts, there is little real
prospect of these state-owned enterprises for privatisation.” The management and workers
represent a powerful political constituency in most Sub-Saharan Africa countries. Trade
union strikes deter investors. The government tries to give preferred access to unions at the
time of privatisation such as purchase of shares at a reduced price to facilitate divestiture
owned enterprises in particular the large ones has remained a key constraint in most Sub-
Saharan countries. Investors focus on the “fundamentals” of an economy as a whole as well
as a specific product markets they are interested in.” Even when African countries have
opened their doors to foreign investment, the responses of investors have often been
Africa as highly risky. Investment in Africa is more difficult to reverse than in the case
elsewhere. One reason for this is that equipment once purchased is less readily saleable, since
markets in second hand capital are weak. Another reason is that the market in firms as going
concern is also very limited. This is due to a combination of a lack of finance and severe
problem of asymmetric information in the absence of reliable audits.” Lack of transparency in
state-owned enterprise sales transactions has been a major concern among prospective
investors in most Sub-Saharan African countries.

In Sub-Saharan Africa, few countries possess the characteristics that make for successful
privatisation, developed capital markets with considerable depth and absorptive capacity
through which privatisation could be mediated and effectively supervised, lack of legal and
judicial framework, the generally low per capita income and conducive regulatory structures.
Privatisation in Africa, according to Ariyo and Jerome [1999], tends to concentrate on very
small enterprises leaving the larger concerns untouched.

The divestiture programs have typically been introduced into public enterprise sectors in a
financially unhealthy condition, with individual enterprises losing money, heavily indebted,
operating with inadequate records or accounts, or substantially overmanned [Young, 1995].
Due to this, many state-owned enterprises need substantial restructuring to make them saleable [Mkandawire, 1994; Gordon, 1996; Bennell, 1997]. In many cases, according to Mkandawire [1994], “privatisation has been accompanied by measures to “fatten the calves” before selling them to the private sector, which include writing of debts, retrenchment of labour force and payment of redundancy money, guaranteeing pension rights and so on.” Moreover, governments need to operate more effectively the enterprises that will remain temporarily or permanently in the public sector. According to Bennell [1997, p.1799]: “In order to make enterprises saleable many state-owned enterprises must first be restructured and modernised which is invariably costly and time consuming and normally requires some form of management performance contract with private sector operators.”

The evaluation of performance in privatised enterprises in Africa, taking into consideration the recent phenomenon of privatisation, is too early. However, some research has been undertaken on those early privatising countries. Senegal was included as one of the nine case study countries in the World Bank [1995, as quoted in Bennell, 1997] and found out that the state-owned enterprise performance deteriorated after privatisation. Schneider [1999, p. 327] also argued that “Privatisation efforts and reductions in the role of the state have not improved efficiency as predicted. Instead, the same government officials who extracted resources from government programs are often the ones who are able to take greatest advantage of privatisation efforts. They have the resources and connections that allow them to move into the private sector.”

The privatisation phenomenon in Africa according to Young [1995] has already had a significant impact. This impact has nonetheless remained uneven, the obstacles formidable, the levels of domestic support limited and the future prospects uncertain. There is a concern, however, that the privatisation policy in Africa may have been imposed by external agencies (IMF, WB, USAID) on countries that were not necessarily ripe for privatisation [Ramamurti, 1992]. The countries in Africa have thus gained experience of the privatisation process, but the future emphasis will be on privatising large enterprises, on the creation and growth of capital markets and an improved efforts to stimulate private sector investment.

2.6 Conclusions

This chapter provides an overview of the literature on privatisation experiences of the developed economies, transition economies and Sub-Saharan Africa. The experience of the United Kingdom (UK) revealed that the British government has prepared the state-owned enterprises to be privatised by imposing hard budget constraints, clear commercial goals, performance pay and decentralised and accountable management reforms [Bishop, Kay and Mayer, 1995]. Researchers have found out that these reforms have helped the privatised companies to improve their performances after privatisation.

The experiences of the Central and Eastern Europe countries revealed that the transition policies resulted in a large drop in output and inflation at the beginning because of slow response of producers to the changing market environment. Privatisation in the Central and Eastern Europe countries has turned out to be a slow and a difficult task due to technical, economical, managerial, attitudinal and policy related problems. Different methods were used in transferring ownership and control of state-owned assets; however, the most common were
sale of state-owned assets in auctions or public offerings of shares and negotiated sales, free
distribution and leasing and management contracts. Sale of state-owned assets generates revenue and brings strategic investors, but it is slow. Free distribution (voucher distribution) transfers ownership title fast, but results in dilution of ownership control in post privatisation of the enterprises and leaves managers and workers unchanged. Small enterprises such as shops and restaurants were quickly privatised in Central Europe, but large scale enterprises privatisation was slow because of problems such as outdated technologies and production processes, a huge accumulation of debt, rigid work rules, a strong resistance to reorganisation and lay-offs, a lack of marketing and finance skills and inefficiency in production [UNIDO, 1994].

The experiences of Sub-Saharan African countries also indicated that though the number of privatisation transactions are increasing there are difficulties in selling loss making enterprises and investors consider Africa as high risk for investment. There is a concern also that the IMF and WB are imposing privatisation on African countries, while the condition for privatisation is not ripe.

The literature review revealed that governments were concentrating on rapid privatisation and did not give much thought to modifying the state-owned enterprises, while recent research shows that state-owned enterprises can adapt to a market environment even before privatisation [Portes, 1994]. Moreover, the literature reviewed indicated that reforms designed to induce enterprise management to behave like one acting on behalf of private owners remain acutely needed, regardless of ownership. Therefore, it is important to monitor management and put in place transparent incentive schemes that are likely to induce managers to enhance value regardless of whether they are public or private during a transition period. According to UNECE report [1992], managerial problems such as principal agent problems, managerial capabilities and corporate governance problems are some of the obstacles delaying privatisation of state-owned enterprises. In the following chapter, we present issues of corporate governance that enterprises encounter during transition to a market economy.