Privatization

A view at developing countries

Feras Ahmad

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Feras Ahmad

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Author:	Feras Ahmad
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Supervisor (Arcada):	Andreas Stenius

Abstract:

The purpose of this thesis was to explore the steps and conditions which are necessary to implement a successful privatization plans, and to review privatization impact on firms' performance. The focus of this study will be on privatization in developing countries, and the impact that privatization has on firms operating in those countries. The theoretical part of this study will provide few definitions for privatization, and it will clarify its common requirements and methods. The empirical part of this study was conducted by using a qualitative research method. The results were based on one interview, and on three major international studies. The interview questions were regarding the prerequisites and steps required to implement a successful privatization program, while the studies used were regarding newly privatized firms performance in developing countries. The aim of this study was to find out what should be done to manage a successful privatization campaign in a certain developing country, and what impacts does privatization have on the performance of firms in general. The findings of this research showed a positive impact of privatization over firms' performance, and at the same time the research clarified the major and the most important steps which are required to implement privatization plans in a successful manner.

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1 INTRODUCTION:

Privatization has been considered by many as a magic tool to generate revenue for governments, and to increase efficiency and productivity for state owned enterprises. starting at the beginning of 80's, privatization has become a global phenomenon and the pace of privatization has accelerated during the 90's to reach its peak at the beginning of the current century before it slows down drastically after 2001. Despite facing a fierce opposition in the beginning, privatization's experience was generally considered successful, particularly in developed nations. On the other hand, the experience of privatization in many developing countries and transition economies was not so colorful, where the selling of state owned enterprises (SOE) did not yield its hoped results. Despite the developing countries experience with privatization, many scholars insisted that selling of SOEs in developing countries could improve their performance. A vast sum of literatures has been published around this topic; quite many of these literatures identified the ways and the conditions for a successful privatization by referring to some examples in industrial countries, while other scholars studied privatization impacts on newly privatized firms. To explore the correct path for successful privatization, this study is aiming at identifying these ways and conditions for a successful privatization campaign. In addition to identifying the correct path, this study will review the impacts of privatization over firm's performance in developing countries. Based on this information the research questions for this study are:

1. *What are the steps that can be taken and the conditions that should exist in order to insure the success of privatization?*
2. *What are the impacts of privatization on firms in developing countries?*

1.1 Description of materials

This study will be divided into three major parts, the Theory part, the Empirical part, and the Results and Findings part. In the theory part the author will go through the following topics:

1. The history of the state’s role in developing countries, and a review of the advantages and disadvantages of both state owned and private owned enterprises.
2. The history of privatization and its experience around the world.
3. The reasons behind privatization's decision and the steps and methods which are normally used to implement it.

1.2 Methodology:

The empirical part of this study will be divided in to two parts; the first part is the interview with an expert. The expert will be answering questions regarding privatization conditions and prerequisites and the steps which are necessary to ensure positive effects.

The second part will be referring to three major international studies regarding privatization impacts on firms. The author will focus on the impact of privatization over firms operating in developing countries. Both the interview and the international studies will be analyzed to answer the research questions of this study.

1.3 Limitation of the study

This study will be conducted over developing countries in general, and the findings are quite general and may not be suitable for a particular country or firm and due the fact that each country has its own history and culture, suitable privatization conditions and practices may vary between countries. Another point of restriction is that the international studies which are used as empirical evidence in this study has been conducted between the years 1994-1999 and the information and data which have been used are relatively old.

2 THEORY

2.1 State's role in developing countries

The state's role in leading the economy in developing countries has reached its peak during the 60's of the last century, but this role started to shrink one decade later at the end of 70's. On the other hand, privatization had gained popularity during the 80's and reached its peak at the beginning of the current century with an increasing role for the multinational corporations and globalization. *(Al-Roubaiee, 2003)* This shifting of roles in leading the economy between the state and the private sector was related mainly to the influence of the advance economies over the financial policies in developing countries. In addition to the advance economies influence, global and regional economic and financial policies inspired certain policies within developing countries, and this is considered as the main factor behind transferring the state's role from active to a more neutral role. *(Al-Roubaiee, 2003)* Even though domestic pressure for a major reform in the economy was pervasive in developing countries, the external economic and political pressures which have been practiced by developed nations over developing countries have shaped the form of reform or policy that these developing countries have adopted. The period when some current advanced economies lunched a reform plans and prepared the proper atmosphere towards economic development, is considered by many developing countries as the most important period to take lessons from, because it is in that period when the role of the state was crucial, and when the state's role towards reaching economic development, and towards protecting the national economy, was to support and help the capitalist class to push the economic cycle forward. *(Al-Roubaiee, 2003)*. However it is important to note that economic policies are not suitable for all countries with the same level. Each country went through different economical and political circumstances and each society has reached a certain level of development that may not be well prepared for a certain economic policy, and the application of such a policy might results in disastrous impacts on the economy and on the society as a whole, despite the fact that the same policy considered successful in some other economies. *(Al-Roubaiee, 2003)*According to *Mohyeldien (1975)*, the intervening role of the state in leading the economy and in determining the size of private sector's role is shaped by two major factors:

- Domestic factor related to the complex task faced by the newly independent states after World War II, of how to deal with structural imbalances, and in particular the imbalance of the relationship between the human and material resources and production structure, and the consequent need to define the ways and conditions to move towards development.

- External factor related to the intensity of international tension between the countries of the capitalist West camp and the socialist East camp, when countries at both camps, considered the economic policy of developing countries, especially those regarding the degree of state‘s intervention in economic affairs, dependent variable to changes in the political and economical international environment, and part of the game of the international balance. *(Al-Roubaiee, 2003).* According to Myrdal 1968, this political pressure and interference produced two major categories of developing countries:

A. The West camp allies, which contain the countries where liberal economic thought prevailed. Inside the countries of this camp, the private sector took the leading role in the process of economic development, and the free market mechanism was used, and state's intervening was partial. These policies resulted in forming a mixed economy were both public and private sector took roles. The public sector had the duty of providing the requirements of social capital as well as areas of production which surpass the investment's ability of the private sector.

B. The East camp allies, which contain the counties where the socialist ideology played a major role in determining the size of state's intervention in the process of economic development. These allies gave the public sector a leading role towards the economy, and it used the central planning method to achieve the goals of economic development. These policies resulted in an expanding role for the public sector and in a shrinking role for the private sector, especially in areas related to production activity and international trade. *(Myrdal, 1968)*

2.2 Public versus Private ownership in theory: advantages and disadvantages

There have been great sum of literatures concerning the relativity of the ownerships of firms to their performance and efficiency. Even though most scholars favored private ownerships over firms, there has been a consensus over some positive elements regarding public ownership of firms. Most of these literatures were regarding issues like incentive scheme of managers, efficiency, corruption and control rights. Control rights however are extremely important in case of contingencies or in the case of incomplete contracts, where contracts between government and private firms are limited and government cannot regulate or specify its objectives clearly. These control rights are affected by difference in objectives between government and private owners. Usually maximizing the profit is not the ultimate goal for government owned firms, the government has many other objectives like preventing monopolies, control quality, reduce negative externalities, encourage sectorial policies and national independence, and concentrate on investment and employment in recessions, these multiple objectives make it difficult for governments to contract upon. *(Roland, 2008)*

The following section will compare between public ownership and private ownership in terms of advantages and disadvantages.

2.2.1 Advantages of private owned firms

- Public ownership provides fewer incentives to monitor manager's behavior, which allows managers to pursue personal agendas. *(Vikkers & Yarrow, 1991)*

- Government owned firms are unable to commit to incentive scheme, which is considered as the source of inefficiencies. This will lead to two main problems: The first one is the Ratchet effect; where managers avoid overfilling their production plans in order to avoid any future increase in the production's target. The other problem related to government's commitment is soft budgeting; a major reason for inefficiencies in public owned firm is that they can always rely on the state for financial support, as it is rarely for any government to leave a public enterprise goes bankrupted. *(Roland, 2008)*

- Government of politicians might use government intervention to follow some private agendas. Such an intervention will be probably a source of inefficiency. Even though sometime, the state's intervention can be necessary to prevent monopolies of price, new regulations can lead private firms to more loss-making and thus the negative effects will be greater on the social welfare as a whole. *(Roland, 2008)*

- Assuming the efficiency of the market when stock market delivers true information on firms' performance, this will carry information about the quality of managerial investments and will lead to more incentives for managers to maximize profit. *(Laffont & Triole, 1993)*

- High government stakes in firms will tend to reduce market liquidity which will lead to less incentive to acquire information by the stock market participants. *(Laffont & Triole, 1993)*

- In a government owned firm, managers cannot always be rewarded for critical cost reductions or profit maximizing decisions due the fact that government can use such an investment for alternative use than cost reduction or profit improvement. This will lead to strong incentive for managers to favor private firms, and that is why in the United States for example, the incentives schemes are controlled by shareholders and not by the government in the case of public utilities. The shareholders cannot agree on contract with government on all the details of managerial themes, and it is important for shareholders to use the innovation of their managers for such profit maximizing decisions. This superiority of private ownership will be stronger when the government cannot reach to its goal of maximizing social welfare; a non-benevolent or corrupted government will most likely end up with a reduction of social welfare. *(Laffont & Triole, 1993)*

- The threat of takeover or bankruptcy improve the managerial discipline at private firms, since takeover of public utilities are quite rare.
  (Vikkers & Yarrow, Privatization: An Economic Analysis, 1991)

2.2.2 Advantages of public owned firms

- In the case of contingencies or incomplete contracts, the public ownership will be more useful because it will be able to impose socially desirable adjustments to the firms. *(Laffont & Triole, 1993)*

- A major point of difference between the government and private ownership is corruption. There have been many examples of corruptions scandals in transition economies when it comes to privatization, like in Russia, Czech Republic and Argentina. Even though public ownership cannot eradicate corruption but there has been a reduction in bribery when transitions has accrued from private to public ownership in most of the American cities. According to Glaeser (2001) Corruption can take a form of underpricing of inputs bought from government, overpricing of outputs sold to government and subsidies used to internalize externalities. *(Roland, 2008)*

  - According to *Shapiro and Willig (1990)* and *Schmidt (1990,1995)* public ownership provide better information about firms for governments, which makes it not possible to a private firm to receive higher than necessary compensation to cover its cost or to receive the informational rent. However this may differ depending on how to view the government function. For example in a public owned firm the government is well acknowledged about the cost structure of the firm and will be always providing support for these costs in order to implement ex post efficient production levels. Which will lead to less incentives for managers to cut cost and thus to be more efficient, while on a private firm the case will be always to maximize profit by cutting more cost, and this in return can hurt the society in general, so nationalization may be less efficient but may reduce allocative inefficiency also. *(Laffont & Triole, 1993)*

- The conflict of interest that sometime happens between shareholders and regulators in private firms may produce less incentive for managers. *(Laffont & Triole, 1993)*

2.3 Privatization in developing countries

During the 80's of the previous century, developing countries had faced major challenges for economic development, starting by sharp increase in the levels of external debt, especially in the non-oil countries, sharp decrease in the rate of international trade with the continuing decline of the export's prices of primary commodity, high levels of deficit in balance of payments and of deficits in public budgets, decrease in the development of human resources as a result of high rates of poverty, sharp decrease of living standards associated with the decline in the rates of economic growth compared to the continuous rise in population growth rates, decrease in health and education levels, and ending by an increased rate of disguised unemployment, all these factors pushed some developing countries to rethink of the state role as a leader to the economy, even though there have been some achievements by the public sector regarding economic development. *(Al-Roubaiee, 2003)*

It was during these circumstances when privatization viewed as a magic solution for a major reform toward the inefficient state owned enterprises, and to prepare the path toward an expansion role for the private sector and during that time a major reconsideration of the state's role has been taken place in developing countries *(Al-Roubaiee, 2003).* This support for a larger role for the private sector was due a common believe that privatization could decrease the level of unemployment and increase efficiency in state owned firms, also privatization could participate in decreasing the subsidies that the state owned firms are receiving from the state. *(Al-Roubaiee, 2003)*
In addition to the previous circumstances, *Alessawi (1996)* pointed for additional factors that supported such a shift towards privatization:

1. .The collapse of the socialist system led by the Soviet Union. This collapse of the socialist giant and the low economic conditions of developing countries that adopted the method of central planning, considered as an evidence of the futility of the planning system, and as a necessity to move towards privatization and market economy.

2. The multiple economic crises that faced large number of developing countries, which sought to get out seeking help from the advanced capitalist countries and international financial institutions, where these advanced economies and institutions, considered the recent transition to market economy, as the price for its help in the preparation, implementation and the financing of structural economic adjustment.

3. The spread of Neo-Liberal ideas which have been pervasive due a variety of factors like:

   A. The victory of Neo-Liberal ideas on each of the Keynesian and Marxist ideas.

   B. The financial and technical support for developing countries that was provided by the advanced capitalist countries and international institutions notably the IMF and the World Bank, which implemented economic reform programs that contributed to an expansion of these Neo-Liberal ideas.

   C. The climate crisis experienced by the developing countries tempted to turn the idea into its opposite. So from the adoption of ideologies in the far left (the call for the development of central planning and the leadership of the public sector) to another in the far right (call for privatization and the market system) maybe as a despair of the routes addressed and as a hope that the new road with its gravity and its price magnitude will lead to the desired target.

4. The attraction of the Asian model, which explained the success that came from its dependence on the market system and its openness to the global economy. Although the reality is that the development which occurred in this group of

countries, was led by the State, and the markets which were allowed to operate, were governed and directed by the State, and were subjects to its direct and indirect directives, and this means that the development process was taken through the leadership of the State to the market and not by market's leadership to the development process. *(Al-Roubaiee, 2003)*

2.4 Privatization (Definitions)

"The term privatization has two meanings the first: is a financial transaction-the sale of a publicly owned asset to the private sector. The second is the transfer of the authority to make resource allocation decisions from the government to the market place." *(Gabel, 1987)*

"a generous stance would admit any transfer of ownership or control from public to private sector. A more exacting definition would require that the transfer be enough to give the private operators or owners substantive independent power. Transfer techniques can include trade sales to strategic investor, public offer, closed subscription joint venture, liquidation, concessions, auctions, voucher or certificate based transfers, employee or management buyouts or most combinations of all of these." *(Donaldson & Wagle, 1995)*

" *privatization is the entire process of expanding the sphere of the market through a host of regulations that create an enabling environment for free enterprise to operate as a strategy for sustainable economic development.*" *(Moyo & Njenga, 1998)*

P*rivatization is broadly defined as the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents*" *(Megginson & Netter, 2001)*

Based on the above definitions, privatization could be considred as a way to expand the role of the private sector into the economy, and a way to reduce the state's intervention role in that economy, by offering more ownership and more control to the private sector over public owned firms. The selling of the state owned enterprises (SOEs) could be partial or full, and can take many forms and methods.

2.5 Privatization around the world

The first large-scale denationalization campaign was made by the Western Germany government of Konrad Adenauer in 1961, which it started by offering public shares of Volkswagen for mainly small investors, Volkswagen was followed few years later by VEBA a giant chemical firm. However the German experience during that time was not very successful. The first successful privatization campaign was made by Thatcher's government in Britain during late 70's, the British experience is considered as the spark which started the spreading of privatization throughout the globe. The main common objectives for privatization according to *Price Waterhouse (1989a; 1989b)* are:

- Raise revenue for the state.
- Promote economic efficiency
- Reduce government interference in the economy
- Promote wider share ownerships
- Provide the opportunity to introduce competition
- Expose SOE's to market discipline.

(Parker & Saal, 2003)

2.5.1 Europe:

The first massive public share offering was the British Telecom; the offering was met with a huge demand on the domestic scale and on the international scale as well. The $4.8 Billion shares sold to 2.25 million shareholders of investors and employees only in Britain, And later the large BT's shares trading response in Japan and USA, were considered a positive signs for the future of privatization. *(Megginson W. , 2005)*

The French privatization experience was very important to the global spreading of privatization, even though the French had a long history of state intervention in the economy, it didn't stop the massive privatization campaign to spread throughout the country. Until September 1986, over 22 major public company worth of $12 Billion has been sold in 15 months. A $7.1 billion initial public offering (IPO) of France Telecom and later a $10.5 billion seasoned France Telecom were considered as the largest IPO in the French history. *(Megginson & Netter, 2001)*

In 1999 the electricity Italian company ENEL marked the largest IPO in the history of finance raising up to $18.9 billion for the Italian government, and that was only few years after the complete dismantle of IRI which raised up to $90 dollars to the Italian Treasury.
(Megginson W. , 2005)

2.5.2 Asia

The Japanese giant NTT (Nippon Telegraph and Telephone) sat a new record of $15.1 billion for IPO's issue size; this offering could yield up to $188 billion of implied market capitalization for NTT. In 1988 the third tranche for NTT marked the largest security offering in history, $40.6 billion, and the three tranches of NTT could collect raise over $80 billion. *(Megginson & Netter, 2001)*
However the privatization process didn't always take the form of IPO, most of the developing countries were selling the SOE straight to private firms or individuals in a step termed "asset sales". During the 90's China was the second largest economy on the basis of purchasing power parity. Even though during the 70's the Chinese government launched a major liberalization campaign and economic reform, privatization was

limited. The reason for this was that there were relatively few outright sales of SOEs, and most of the privatizations that took place were on small scale. However this campaign could make a big influence on the productivity of the whole economy. Another major Asian country which adopted privatization was India which during the 90's considered to be the 5th largest economy on purchasing power parity. India had some similarities with China regarding the role of the state in leading the economy, and regarding the low performance of the state owned enterprises as well. Starting in 1991 India lunched its privatization program and economic reform throughout the country. *(Megginson W. , 2005)*

2.5.3 LATIN AMERICA

Soon after the British initials on privatization, a change of ownership started to be present in Mexico and Chile, where like many other countries, privatization started with the selling the state owned enterprises (SOEs) operating in competitive markets, and later the selling moved to the SOE's in infrastructure or utility sectors. The pace of privatization was high comparing to other countries outside the OECD states, and the revenue raised was higher as well. During the 1990's the privatization revenues averaged for a 6% of GDP in the Latin American states, any by the end of the decade, more than half of all Latin American privatizations were of high value infrastructure or utility firms. From 1991 to 2001 private investment in infrastructure in Latin America totaled $360.5 billion. *(Nellis, 2003)*

2.5.4 AFRICA

However the term Privatization was not very popular between Western and South African countries, though it well existed on a small scale, according to Scholars, Nigeria was one of the most frequent sellers of state owned enterprises through initial public offering. Even though the South Africa government adopted nationalization themes, it sold several partial sales of state owned firms. *(Megginson W. , 2005)*

Privatization reached its peak in 2000 when the sum raised for governments by selling state owned firms reached $180 billion. The cumulative value of proceeds rose by privatizing governments, topped $1 trillion in the second half of 1999, and reached more than $1.5 trillion in 2003. Even though governments continued to follow privatization agendas, particularly in China, when the Chinese government offered stakes in its major oil companies; privatization slowed down due to the decline of stock markets of NASDAQ in March 2000. After the $180 billion record of 2000, privatization's proceeds dropped to $51 billion in 2001, $69.2 billion in 2002 and $46.6 billion in 2003. *(Megginson W. , 2005)* But still, this decline didn't prevent countries like, Korea, Turkey, and Morocco from taking large steps in privatization.

Privatizing speed was different in different regions. In general developed counties have raised higher revenue from privatization than developing countries. Between the years 1977 and 2001The average of privatization revenue for each developed country was $43.2 billion *(see table 3. appendix 4/4)*, while in each developing country the average was $7 billion *(see table 2, appendix 3/4).* And the proceeds of privatization of developed countries accounted for an average of 6% on GDP comparing to an average of 5% on GDP for developing countries. However Regarding the market value of privatized companies the fraction of GDP was rather similar 47.1% for developed countries and 40.06 for developing countries. Also the public offering of shares accounted for similar fraction of total proceeds 58.9% and 51.1% in developed and developing countries respectively. *(Megginson W. , 2005)*

The biggest share of privatization proceeds came from Western Europe which accounted for 53% of the world privatization proceeds, Asia and Latin America came next with 15% each, Australia 8%, Eastern Europe 5%, and with Middle East, Africa, and North America with 2% only.*(see Figure 2)* *(Megginson W. , 2005)*

Regarding the industrial sector, Telecom was the most popular sector for privatization projects, between 1990 and 2000, Telecom offerings account for 36% of all proceeds raised, followed by power 16%, financial institutions 15%, and oil and gas accounted for 10% *(see Figure 1).* This data have reflected clearly on the SOE's share on GDP in industrialized countries, when it started to decline since 1991 and reach below 5% recently. Low income countries have experienced a larger decline in SOE share of GDP from 16% in 1981 to 7% in 1995. The effect of privatization on transition economies of central and eastern European countries was huge due the size of state ownership in these economies. *(Megginson W. , 2005)*

The European and the Japanese privatization experience were the most important to push the privatization wheel to role across the globe, and by the year 1995 dozens of countries has adopted enormous privatization programs, and particularly developing countries in Latin America, Africa and South Asia.

2.6 General motives behind privatization

There has been some consensus concerning the reasons behind government's decision to adopt privatization. The present political and economic atmosphere of the country may provide strong tendencies towards privatization, also the political history of the country can play major roles also. However in this study, major seven reasons behind government's motive to privatize will be discussed.

2.6.1 Economic Development

Recent studies show that privatization and GDP are related, and according to *Colbert*, economic development is initially led by the state due to its ability to accumulate the capital in infrastructures. However the state role will decline through privatization to lead the economic development process. It is important to say that the size of the state owned enterprise in a country, and the development level of a country play a major role to determine the size or revenue that has been generated by privatization.
(Bortolotti & Siniscalco, 2004)

2.6.2 Government budget constraints

Deficit in government budget and the need to pay sovereign debts showed privatization as a magic solution to raise revenue for government instead of imposing tax increase or cuts on spending. Privatization also can relieve the governments from subsidizes to loss making SOEs. On the other hand the way of dealing with these revenues account for the success or the failure of the privatization process, as it showed in some developing or transition economies, despite that in the majority of cases privatization succeeded in making strong impacts on the economy in general. While in Europe the need to pay public finances were a major motive behind privatization, in Latin America privatization motive was mainly to attract foreign investments and capital into the country.

(Bortolotti & Siniscalco, 2004).

2.6.3 Financial Markets:

According to *Levine and Zervos(1998)* financial markets promote economic growth because of the market tendencies to favor more efficient allocation of resources, however one of the most important element of financial market is liquidity due to its ability to facilitates diversification, information, aggregation, monitoring of managers, and regulation of firms(Bortolotti, Siniscalco, 2004). Also liquidity is associated with privatization revenues in terms of “allowing a fuller extraction of a company’s market value from private investors by facilitating information aggregation”. Privatization wave peaked during high market’s performance in the 1990’s and usually it slows down with low stock prices.

(Bortolotti & Siniscalco, 2004)

2.6.4 Political majorities

Even though some left-wing parties made huge privatization plans, like the Jospin’s government in France for example, most of the privatization campaign are designed and led by conservative and by right-wing or center parties in both developed or developing countries, however it is well known that leftist governments support more size for government role, while conservative or liberal are traditionally oriented towards the market economy. Judging by numbers, right-wing’s governments raised up to $16 billion from privatization in their ruling time, while the left-wing’s government could only generate up to$ 10 billion from privatization.

(Bortolotti & Siniscalco, 2004).

2.6.5 Legal Origin

The country's law play a vital role in prompting or discouraging privatization acts, whether a country follow a civil low or a common low, affects the size and the success of privatization projects. For example an average of SOE's value added and SOE's investment as a proportion of GDP for common law countries is roughly 12%, while it is 15% for French civil law tradition country, and 12% for German civil law tradition country. In general civil law countries have a larger sector of SOE than common law countries. Also it is more difficult to lunch a privatization campaign due the need to modify the constitution of that country like the Portuguese case in 1982 and again in 1989 for example. The legal protection for investors is different between common law countries and civil law countries, and at the same time the SOE performance is different between the French civil law and the German civil law traditions. All these difference alter the result and the need for privatization.
(Bortolotti & Siniscalco, 2004)

2.6.6 Political institutions

A major similarity between countries who adopted a large scale privatization is political majority at the parliament. In most of the cases, privatization faced a strong opposition from some political parties or from labor union. These opponents could in few cases stand successfully against some privatization projects. For example in Belgium 1990, a general strike led by trade union could stop the attempts of Martens' government to privatize a large number of SOEs. A look at the British political life between 1985 and 1986 will show how the majority of the conservative parliament could push back the opposition and continue with their privatization agenda, despite a two year strike by the national union of mineworkers.
(Bortolotti & Siniscalco, 2004).

2.6.7 Efficiency

Most scholars agree that privatization promote efficiency inside firms. And on the other hand there is increasing evidence that many SOEs are loss-makers rather than revenue generators. According to a study by the World Bank, state owned firms in developing countries accounted for one-quarter to one-half of all outstanding domestic debt and for a substantial portion of foreign policy. This inefficiency can be related for many reasons including:

- Mismanagement, corruption, patronage and padded payrolls.
- Inefficient operations, maintenance and service delivery.
- Involvement in highly capital-intensive operations or investments with long payback periods.
- Constraints on pricing policies by governments.
- Overly restrictive government controls on the finances of SOEs.
- Failure of central governments to provide promised subsidies in timely manner.
- Government requirement that SOEs should take over failed privately owned businesses.

(Prokopenko, 1995)

2.7 How to privatize

Privatization is not a step; it is a long process and requires an effortless study and preparation before making a final decision to privatize. Giving the importance of existing enterprises for economic activity inside the economy, the method of selling SOE and converting them into a private enterprise is vital. However according to Megginson, it is required from the government before selling a state owned enterprise to:

- Decide whether to restructure the state owned enterprise before sale.

- Find an acceptable and transparent method to value the company and to ask suitable price for it.

- Decide whether or not to regulate a newly privatized company after it has been divested.
  (Megginson, 2005)

While *Gibbon (1997)* pointed out the steps that are required by a government developing a divestment programs:

- Setting up a structure for privatization, including legislation, if necessary.

- Providing adequate performance records for the SOE which being sold (generating believable accounting data).

- Developing any necessary new regulatory structures.

- Determining the appropriate post-sale relationship between the firm and the government.
  (Parker & Saal, 2003)

Based on that information the following steps are crucial in order to continue with a successful privatization plans:

2.7.1 Choosing the right sector

Usually privatizations plans face a strong opposition from different segments, starting by politicians, bureaucrats within the government, and workers and managers of the state owned enterprises, which makes it vital for any government adapting privatization policy to choose very carefully the sector which the government intends to privatize. When a certain government takes a step toward privatization, this government is risking losing power or producing major problems to the economic reform which the government wanted to implement in the first place.

However different segments, shows different levels of oppositions, the current state of the economy play a critical part also. According to a study on privatization in Poland, Hungary, and Czech Republic by *Borsnstein (1999)*, retail trade, consumer service and housing industries operate in sectors that are partly privatized in most of the countries, which makes it relatively easy for this sectors to be fully privatized. Agriculture is more difficult to privatize than the previous sector, while light industry usually need a substantial restructuring in addition to small capital investment due to its full state owned status. Starting by heavy industry, followed by banking, electricity and telecommunications, privatization become a very difficult task, due to the strategic importance of these sectors and because of the need of these sectors for foreign direct investment and for more and new regulations before it is privatized.
(Megginson W. , 2005).

2.7.2 Passing a privatization law

However implementing effective regulations in developing or transition economies is a very difficult mission, simply because these countries suffer mostly from a poorly functioning legal systems, and they face a high opportunity cost of losing experienced employees and staff. But still, this regulatory mission is not an easy task at all even for advanced economies in the world. Once the decision on the sector for privatization has been made, a new law or legislation is needed to legalize the selling process. In many cases when privatizing a national or strategic industry (oil and gas production, surface transportation) a change in the constitution of the country is needed. In most of the cases, a new legislation is made with each new privatization project, and eventually after many projects, an overall law for privatization will be made as a frame to all privatization processes in the country

(Megginson W. , 2005)
(Seven, 2002)

2.7.3 Create an Administrative body

Due the fact that privatization process is large and complex, a new administrative agency will be created. This agency contain all the staff and skilled personnel who responsible on the process of the privatization from the very beginning. Some countries have given this responsibility to the Ministry of Finance or the Ministry for Industry while in most of the transition economies the case was creating a new ministry responsible over privatizations decisions and process. However in some examples a relatively small organization or agency with a significant authority and with a limited life span will be created to lead the privatizations process. The implementation of privatization also should be decentralized to banks, financial institutions or management consulting firms, or to the managers of the state's enterprises themselves, with appropriate supervision by the national privatization agency.
(Prokopenko, 1995)

2.7.4 Commercialization of the state owned enterprise

The next step in the privatization process is commercialization. Commercialization means the change of the objectives and the culture of the state owned firm. The new objective of the enterprise should be maximizing profit, and new operating private sector policies should be implemented. In another words, it is a change in the firm's culture. However this is one of the most difficult tasks to be done. Many studies showed how difficult it is, to insert a new profit-oriented value into a work force of public-sector employees, or to implement new systems of accounting, information processing, supply-chain management, and human resource management policies into the daily operating rhythms of state owned firms. For example the accounting system that is used in most of the transition economies is entirely different from the international accounting standards that are used in most non-transition countries.
(Megginson W. , 2005)

2.7.5 Trade- off between state's objectives and valuing the SOE

Normally governments are multi-objectives organizations, but when it comes to privatization, government objectives might carry a contradictions tendency, which makes it very critical step for any government to trade-off between objectives like:

- Speed of sale versus revenue maximization and transparency.
- Revenue maximization versus favoring citizens and ensuring domestic ownership.
- Promoting economic efficiency versus preserving the SOE's employment levels and maximizing political benefits for the government.
- Promoting development of the national stock market versus divesting state assets rapidly and completely.
 (Megginson W. , 2005)

After selecting the objectives of the privatization process the government will face a very problematic difficult task, and that is valuing the asset it plans to sell. for example in most cases the current economic or financial state of state owned firm is not very tempting, but at the same time it carry a huge potential for profit making if the firm is running under private ownership. So the question would be: On which basis the state owned enterprise should be valued? Is it on its current state, or is it on its potential for the future? However there are four basic methods for valuing a non-traded company for sales, these methods are:

1. The earning capitalization approach, which is also known as the P/E ratio method.
2. The discounted cash flow method.
3. The market entry method (or determine the Tobin's Q value for the company).
4. The comparable-firm approach. *(Megginson W. , 2005)*

2.7.6 Choosing the sale's methods:

- **Restitution:**

The first method is called Restitution, which can be performed by giving back specific property or land to its original owner or to the legal heirs of that owner. This property has been taken by the government from the original owner at some point back in time, due to political or economic reasons during that period. This method is primarily related to the political or the economic history of the country, and that is why it has been used mostly in Eastern European countries and it is rarely used outside that region. For example in Bulgaria restitution has covered 64.2% of all the houses, plots and yards that were claimed. The value of the returned property to their owner via restitution has reach 10.3 billion Levs, about 2% of GDP. *(Drobniak,2008)*(Iatridis,o.a.,1998)

- **Voucher:**

The second and the most controversial method is the mass privatization or the voucher method, which has been used mostly by the transition economies of eastern and central Europe. This method is preformed simply by giving citizen voucher which can be used to claim stakes at a state owned enterprise. These vouchers are giving for free or at minimal rates. *(Drobniak, 2008).* The voucher method has been used mostly in countries with a history of communism, where most if not all state owned enterprises were in bad shape, and a need for quick change to market economy was critical. And that makes sense why this method has been used in specific region, where countries in that region have some similarities in political background, despite large differences of the details and the time frame of the mass privatization programs used in each country. Even though the voucher method succeeded in privatizing a large segment of the country's SOE, it produced many impediment and problem for the whole privatization program and mostly it brought negative results. These results were due numerous reasons:

- The emergence of the new owners or the insiders who were mostly the mangers or the employees of the divested state owned firm. These new owners gained massive controls over the divested enterprise and provided them with less incentive to restructure it.

- The short inflow of cash to both the firm and the government.
- The intervention tendencies of the government into some important or strategic SOEs.
- The massive control of the banking sector by the government, despite a large privatization campaign in other sectors of the economy.
  (Megginson W. , 2005)

- **Asset's Sale:**

The third method is selling the state property for cash, and it takes two main forms. The first form is direct trade sales (trade sales) of state property to a certain investor or for a certain corporation, and this form is usually used for a relatively small state's assets. Even though 40% of privatization in developed countries and 47.3% of privatization in developing countries was done by using trade sales, the revenue of these privatizations was much lower than the revenue generated from share issue privatization (SIP). Direct sale is considered tempting for foreign investors, and it allows the government to ensure that the strategic SOEs are between domestic hands, and it provides the government with the opportunity to term the sales in order to reach social or political objectives. However this form is still unable to provide large sales proceeds for the state, also direct sale has a negative impact on the national stock market, and due to its complexity and non-transparency, direct sales are an easy target for corruption. The second form of state property's sale called share issue privatization SIP which can provide large sums of cash for the government and it is usually used for big state owned enterprises. SIP is usually done by selling the state for its property through a public share offering. Even though this form of sales considered costly and require a lot of time, it can generates huge sums of money for government and it provide the government with an opportunity to term the sales to reach social and political objectives as well. However an important feature for SIP is transparency.
(Megginson W. , 2005)

2.8 Privatization in developing regions

Between 1988 and 1995 privatization revenue in developing countries topped $132 billion, with more than 3800 transfers of control from public to private hands. The revenue from selling state owned enterprises increased from $20.6 billion in 1988 to reach over $21 billion in 1995, with the exception of the year 1992 when the revenue peaked over $26 billion. Mexico, Argentina, Brazil, Malaysia, Hungary, China and India were the highest developing country privatization revenues between 1988 and 1995. The number of developing countries adopting privatizations plans has increased from 14 in 1988 to 60 countries in 1995. Latin America contributed for most of the total revenue earned with 51%, followed by East Asia 21%, and Europe and Central Asia 18%. *(Organization, 1998)*

The following section will provide some statistics on some majore privaizing developing counties around the world.

2.8.1 Latin America:

Ranked as the Fourth in the world in terms of number of privatization transaction and third in terms of revenue, Latin America witness 424 sales transaction in 13 years period with revenue's worth over $109 Billion. Brazil, Argentina and Mexico stand for most these transactions and revenues. These three countries stand for 75% of total revenue and 53% of transaction. 45% of the revenue came from utilities, energy, industry and credit. The average percentage of stock sold is 58%. The predominant sale's method in Latin America is direct asset sale.

(Bortolotti & Siniscalco, 2004)

2.8.2 Africa (Sub-Saharan):

Sub-Saharan Africa is ranked the last in the world in terms of revenue and Second last in terms of transaction. 143 privatization programs had been conducted since 1986 with revenue's worth 7.3 billion, which account for 0.6% of the world's total only. South Africa and Nigeria stand for 56% of total revenue and 34% of total transactions. Between 1988 and 1992 the predominant method of sale was public offering, while after 1996 the predominant method of sale was direct asset sale. Almost 50% of the transactions were in agriculture and industry sector. The average percentage of stock sold is 55% *(Bortolotti & Siniscalco, 2004)*

2.8.3 North Africa and Middle East (MENA):

Privatization in MENA is practiced on a small scale, with 149 transactions generated 13 billion. Egypt and Israel stand for 69% of total transactions and 49% of total revenue. 32% of total deals in MENA were in the financial sector. Public offering and direct asset sales are the predominant methods in the region. *(Bortolotti & Siniscalco, 2004)*

2.8.4 Asia

From 1985 to 2001, 448 transactions have taken place in Asia with a revue's worth $296 Billion. Telecommunication generated the most revenue while transportation account for the most deals. The average percentage or shares sold is 42% *(Bortolotti & Siniscalco, 2004)* Revenues raised from South Asian economies between 1991 and 2005 totaled 24 billion, out of which Bangladesh contributed 132 million, Sri Lanka 878 Million, and Pakistan 7,4 billion. *(Roland, 2008)*

3 EMPIRICAL PART

The empirical part of this study will be divided into two parts. The first part is an interview with an expert. The interviewee will be discussing and answering a set of 15 questions regarding privatization prerequisites, methods and review the privatization experience in developing countries. The expert is Mr. Arto Honkaniemi, a Senior Financial Counselor at the Ownership Steering Department at the Prime Minister's Office. The interview has taken place at Mr, Honkaniemi's office at the Ownership Steering Department and it lasted for more than one hour.

The second part will be referring to three major international studies on the performance of newly privatized firm. These studies have measured the performance of firms by measuring the change in certain variables after divestiture. The main data used for these studies are the annual reports and the sales prospectus of the newly privatized firms. These measured variables are; profitability, efficiency, capital investment, employment, output, leverage, and dividend. The studies have been conducted over 107 firms in 25 countries, 13 of these countries are ranging between little-income and middle-income developing countries. However the author of this research will focus on the finding regarding firms operating in developing countries.

3.1 The interview

Who is Arto Honkaniemi?

"Mr. Arto Honkaniemi, M.Sc. (Econ.), B.Sc. Econ., LL.M. has been the Industrial Counsellor of Ministry of Trade and Industry, Finland since 1998. Mr. Honkaniemi serves as Senior Financial Counsellor at Ownership Steering Department of the Prime Minister's Office, Finland. He has held several positions at Yrityspankki Skop Oy in both Finland and Luxemburg from 1989 to 1998, Senior Legal Counsel for PerusyhtymÃ¤ Oy from 1976 to 1989 and Company Lawyer at Arila Oy from 1974 to 1975. Mr. Honkaniemi also served as General Manager at KiinteistÃ Oy Casa Academica from 1971 to 1974. He served as the Chairman of the Board of Directors of Finnish Export Credit PLC from 2003 to 2004. Mr. Honkaniemi has been Director at Metso Paper, Inc. since 2008, and Alko Oyj since 2007. He serves as a Board Member of Patria Oyj and Alko Inc. He served as a Director of Kemira Growhow Oyj from 2004 to October 22, 2007, Outokumpu Oyj from 1999 to 2006 and Partek Corp. from 1998 to 2002. He served as a Director of Metso Corp., since April 2, 2008. He served as a Director of Metso Minerals Oy since 2008. Mr. Honkaniemi served as Member of the

Board of Directors of Destia Oy from 2008 to 2009 and Solidium Oy since 2004. Mr. Honkaniemi also holds Master of Laws and Master of Science (Economics and Business Administration)"

(Bloomberg BusinessWeek)

What is the Ownership Steering Department?

"Duties relating to state ownership steering are handled in the Ownership Steering Department in the Prime Minister's Office. The department is responsible for state ownership policy, the ownership steering of state-owned companies under the Prime Minister's Office, expansion of ownership base, branch reorganizations, share investments, coordination of ministries' ownership steering procedures and interministerial cooperation." (Ownership Steering Prime Minister Office)

3.1.1 Discussion

It is important to note at the beginning, that each country has its own circumstances, these circumstances could be economical, political, or cultural, and they will have a big influence on the motives behind privatization, methods used, and the impact of the privatization on the economy. So it is quite difficult to draw a guidelines or method of privatization that would apply for all countries. Before privatizing a state owned enterprise in a certain country, a look at the history of the state owned enterprises in that country should be considered, in order to find the reasons behind the existence of such enterprises in the first place, and why these enterprises are owned by the state. Each country had its own economic and political circumstances that contributed to the creation for these public firms. Before start any privatizing plans, the economy should be divided into sectors, and the company that will be chosen for privatization should be the one which is seen as the most feasible for such a project. For example, a state owned company which is already competing with private enterprises could be considered as a natural candidate for privatization, but on the other hand if the company is operating in a strategic sector, like energy, maybe it is not considered as the best choice for privatizing. The criteria for choosing the firm or the sector to be privatized, is depending on the state motives or objectives behind privatization, and it is very important to choose a company that would flourish and perform much better under private ownership. The ultimate goal for the state behind privatization should be to improve the sector or the company which is going to sell. There has been some bad example for privatization in Africa during the 90's, where a number of privatization projects have taken place in Africa, after being recommended by the World Bank's experts, and the results were negative due picking the wrong company or the wrong industry for privatization, or due having the wrong motive to privatize. The state should choose the right policy before privatizing, is it going to start a mass privatization program, or is it going to privatize partially, and decide whether it will adapt a long term privatizing program or whether it is going to privatize by taking each firm on its own. Also the state should decide on a policy to remedy some of the possible side effects of privatization, like for example laid off employees. Concerning the developing countries, there have been some common reasons behind the failure of the privatization plans, like political interference, corruption, and picking up the wrong company or sector for privatizing, where the chosen firm or sector was not in a sufficient shape to be able to function well or prosper under private ownership. When a company is going to be privatized, certain actions or steps should be taken:

- The firm should preferably have a corporate form under the general low of corporate form that is applied in the country like limited liability company

- The company should probably capitalized in order to survive in a less advantages economic circumstances,

- It should have a well-equipped board of director with no political interference, professional management, and optimal personnel.

And in order to reach a proper privatization results, major prerequisites for privatization should be exist:

1. Majority of political support to the privatization plans.

2. Absence of government interference.

3. A transparent and public ownership policy of the state, regarding the state owned firms.

4. The company which is going to be privatized should be well-chosen, and prepared in order to sustained under private ownership.

5. The transaction to the private ownership should be transparent and no corrupt.

6. The new ownership of the enterprise should be proper and honest.

7. A common companies' law that all firms can follows, should be existed or legislated.

8. A creation of ownership or privatization department, which works as a transparent public state organization, with the proper legal framework that should be applied for both public and private companies.

3.2 Multinational studies:

"Major study by Megginson, Nash and van Randenborgh (MNR henceforth) compares the pre- and postprivatization financial and operating performance of 61 firms from 18 countries (12 industrialized (OECD) and 6 developing (non-OECD)), and 32 industries over the 1961-1990 period.

"Boubakri and Cosset (1998) consider a large set of newly privatized firms (79)

headquartered in 21 developing countries that experience full or partial privatization over the period 1980 to 1992. Their sample covers a wide range of DCs in terms of development level and capital market sizes."

"D'Souza and Megginson (1999) compared the pre- and post-privatization financial and operating performance of 85 companies in 28 countries and 21 industries that were privatized through public share offerings for the period from 1990 through 1996. Out of

these 85 companies, 58 of the firms are from 15 industrialized countries and 27 from 13 developing countries.

(Boubakri & Cosset, 1999)

3.2.1 The financial and operating performance of newly privatized firms: An international empirical analysis

By Megginson, William L., Robert C. Nash and Matthias van Randerborgh, l994

Magginson, Nash and Randerborgh led a study which compared the performance of 61 privatized companies from 18 countries, before and after privatization, and also between 32 industries, 6 of the sampled countries are listed as developing and 12 listed as developed countries. These companies have been privatized through a public share issue only. The variables which observed in this study are: Profitability, Efficiency, Capital investment, Output, Employment, Leverage, and Payout. The study is using Wilcoxon signed-Rank test as a principal method of testing the significant changes in the variables. And also the study is using a proportion test to determine whether the proportion P of firms experiencing changes in a given direction is greater than would be expected by chance (typically P=0). The finding of the test is divided between the results of the complete 61 firms' sample, and the results of the subsamples which are: privatization of firms in competitive versus noncompetitive industries, full versus partial privatization, and privatization involving firms headquartered in developed (OECD) versus less developed countries. However the focus will be on the results regarding privatization impacts in firms operating in developing countries.

- **Profitability:**

The profitability has been measured with three ratios, return on sales ROS, return on assets ROA, and return on equity ROE. According to ROS and ROA and ROS profitability increased significantly after privatization with the ROS is the strongest. The mean increased in ROS 2.49 percentage points (1. 40 points) after privatization, and 69.1% of all firms tested have experienced an increase in the profit margin after privatization. The statistics for this test are all significant at the 1% level. The ROS is also improved for the firms operating in both OECD and developing countries. (At the 5 or 1 percent level)

- **Efficiency:**

The efficiency will be measured by employing inflation-adjusted sales per employee (SALEFF) and net income per employee (NIEFF). For the full sample sales per employee went from a median of 95.6% before privatization to 106.2 after privatization. The net income per employee increased by a mean of 25.1 percentage points (17.7 percentage points). Both SALEFF and NIEFF increased in 85.7% and 69.7% of all firms respectively, and both increases are significant at 1 and 5 percent levels respectively. However the efficiency measured by SALEFF and NIEFF ratios, increased insignificantly in developing countries

- **Capital Investment Spending:**

Using the capital expenditures divide by total assets CETA shows an increase in capital investment relative to sales by 5.21 percentage points (1.59 percentage points) and 67.4% of all cases increased CESA after privatization. The Wilcoxon and proportion test statistics (2.35 and 2.44) are significant at the 5 percent level. On the other hand the CETA measure is insignificant to both Wilcoxon and proportion tests. When it comes to developing countries, the study was not able to draw a strong conclusion due the low number of observation for CESA in developing countries; however the study showed that Capital investment spending does not decrease in developing countries.

- **Output:**

The real sales increased for both Wilcoxon and proportion tests after privatization significantly, the change is significant at the 1 percent level for both measures. The median increased in real sales from an average level before privatization to real sales after privatization is 24.14 percentage points (19.02 points), before privatization the average of sales level were 89.9 percent (89.0 percent). And 75.4 % of firm tasted showed an increase, including companies in developing countries.

- **Employment:**

The most surprising results were concerning employment, where it increased by a median of 2.346 employee (276 employees) after privatization. The Wilcoxon test is not significant at conventional levels, but the proportion test is significant at the 10 percent level. The employment levels increased in 64.1% of all firms.

- **Leverage:**

Using a total leverage measure, total debt to total assets LEV, and a long term debt to equity LEV2 the results showed a significant decline in leverage for both ratios. In LEV the median declines in 2.43 percentage points (2.34 percentage points) and in LEV2 52.88 percentage points (16.68 points). At least 70% of all firms decreased their leverage ratios after privatization. The leverage measured by LEV declined significantly in developing countries.

- **Dividends:**

Whether it is measured as a total dividend payments divided by net income PAYOUT or dividends divided by sales DIVSAL, an increase is shown after privatization. The median of PAYOUT increased 23.31 percent (20.09 percent) of profits to 45.87 percent (37.58 percent) after privatization and the mean increase in payout of 22.55 percentage points (12.48 points) is significant at the 1 percent level. The payout increased in 70% of all firms tested. On the other hand the measure of DIVSAL showed that the mean increased in dividends as a fraction of sales, 1.72 percentage points (1.21 points) is significant at the 0,001 percent level, and fully 89.7 % of all firms increased DIVSAL after privatization. DIVSAL increased significantly also in developing countries and the rest of the subsamples after privatization

- **Conclusions:**

Privatization resulted in the following impacts on firms: a significant increase in profitability, output per employee (adjusted for inflation), capital spending and total employment, dividend payout, and a decrease in leverage. These results were unchanged when compared industrialized and developing countries privatization. However the improvement of privatization was greater on companies which experienced a 50% or greater turnover in directors than companies with less dramatic change in director after privatization.

(Magginson, Nash, & Randenborgh, 1994)

3.2.2 The financial and operating performance of newly privatized firms: evidence from developing countries.

Boubakri, Narjess and Jean-Claude Cosset, 1998

This study was conducted on a sample of 79 newly privatize firms in 21 developing countries, the developing countries mentioned in these studies are different in their level of development and capital market size. The sample of firms selected includes low income economies like Bangladesh and Pakistan, lower middle income economies like Chile, Thailand, and upper middle income economies like Argentina and Malaysia. The firms selected have been privatized through public share issues and through direct sale to another company. The variables that have been used in this test are: profitability, efficiency, capital investment, output, employment, leverage, dividend policy. The two tailed Wilcoxon-signed rank test will be used in testing the significant changes in the variables in addition to a proportion test to determine whether the proportion P of firms experiencing a change in a given direction is greater than what ought be expected by chance, typically testing whether P=0.5. In addition to the full sample there will be a measure for subsamples of: Total privatization versus partial privatization, firms operating in a competitive environment versus firms operating in noncompetitive environment, control privatization versus revenue privatization, upper middle income countries versus lower middle income countries.

- **Profitability:**

The profitability will be measured by return on sales ROS, return on assets ROA and return on equity ROE ratios. The return on sale mean went from 4.93 percent (4.60

percent) before privatization to 10.98 percent (7.99 percent) after privatization. This significant increase at 1 percent level is achieved by 63% of the sample firms.

- **Efficiency**:

The efficiency will be measured by sales efficiency (real sales per employee) and net income efficiency (net income per employee) ratios. The sale efficiency ratio mean increased for raw at one percent level and market adjusted at 5 percent level after privatization, and this increase is achieved by 80% and 75% of firms respectively.

- **Capital investment:**

Measuring the capital investment will be by employing two ratios, the first is capital expenditures divided by sales CESA and capital expenditures divided by total assets CETA. The test resulted in an increase in both of the ratios after privatization, both for raw and market adjusted data. Capital expenditures ratio increased on average from 10.52 percent (0.93 percent) to 23.75 percent (3.62 percent). This increase is achieved by 62 percent of the unadjusted firms and 64% or the market adjusted firms.

- **Output:**

An increase in the output has been documented in both unadjusted (at the 1 percent level) and market-adjusted firms (5 percent level) for 76% and 64% of tested firms respectively.

- **Employment:**

Employment increased significantly at the 10 percent level according to the unadjusted results, while when we adjust the employees for market effects, employment increased significantly at 5 percent level. The market adjusted increase in employment is on average 139(601) employees for 58 percent (67 percent) of the sample firms.

- **Leverage:**

The measuring ratios will be total debt to total assets and long term debt to equity ratio. The increase is significant at the 5 percent level in debt to assets ratio and in the long term debt to equity ratio for the unadjusted data. The median decline in the total debt to total assets was 5.08 percentage points (1.62 percentage point) and in the long term debt to equity ratio was 44.15 percentage points (5.74 percentage points). 63% and 65% of all firms experienced such a decrease.

- **Dividend payout:**

Both dividend to sales ratio and dividend payout (dividend payments divided by net income) have increased for unadjusted data and for market adjusted data. The median of unadjusted dividend to sales ratio increased from 2.84 percent (0.89 percent) before privatization to 5.28 percent (3.05 percent) after privatization. 76% and 68% of the full sample distributed more dividends as proportion of their sales using unadjusted and market adjusted data respectively.

- **Conclusion:**

After comparing the pre-privatization to post-privatization data, this study concluded that privatization succeeded in influencing the full sample. Both unadjusted and market-adjusted results showed significant increases in profitability, operating efficiency, capital investment spending, output (adjusted for inflation), total employment and dividends. And the results showed a significant decrease in leverage for the unadjusted leverage ratios. The subsamples showed a similar results as well, where a strong performance improvement has been documented for all the subsamples; however the improvement of performance were stronger in the middle income developing countries than low income developing countries.

(Boubakri, o.a., 1998)

3.2.3 The financial and operating performance of privatized Firms during the 90's

Juliet D'Souza and William L. Megginson

This is a study of 85 newly privatized firms from 28 countries and 21 industries, where 58 of these firms are from 15 industrialized countries, while the rest of 27 firms are from 13 developing countries. These firms have been privatized through public share offering between1990-1996. The variables tested in this study are the same of previous studies, which are: profitability, efficiency, capital investment, output, employment, leverage, and dividend payout. The Wilcoxon signed-rank test will be used as the principal method of testing a significant changes in the variables, also another proportion test will be used to determine whether the proportion P of firms experiencing changes in a given direction is greater than would be expected by change (typically testing whether P=0). In addition to the full sample a number of subsample will be tested, these subsamples are: firms from competitive versus firms from noncompetitive industries, control privatization versus revenue privatization. Firms from developed versus firms from developing countries, firms with less than 50% post-privatization change in the firm's board of directors versus firms with a 50% or greater change in board of directors, and firms which change their CEO after privatization VS firms that do not.

- **Profitability:**

Measured by ROS and ROA ratios, profitability increased significantly after privatization for the full sample. The mean increase in ROS after privatization is 3.0 percentage points (3.0 points), from 14 to 17 percent of sales, this result apply for 71% of all firms. Wilcoxon test showed that ROS, ROA increased significantly at the 1 percent level after privatization, while the change in ROE is insignificant. However when it comes to less industrial countries, the profitability increased insignificantly according to both the Wilcoxon test and the proportion test.

- **Efficiency:**

The measuring ratios for efficiency will be the inflation-adjusted sales per employee SALEFF and net income per employee NIEFF. According to both measures the median increased significantly for all the sample firms. Sales per employee increased from a median of 102 percent (87 percent) before privatization to a median of 123 percent (116 percent) after. While net income per employee went from a median of 62 percent (71 percent) before to 132 percent (137 percent) after privatization. SALEFF and NIEFF increased in 79 and 76 % of all cases, both significant at the one percent level respectively. Efficiency improved after privatization in firms operating in developing countries as well, with all changes significant at the 1 percent level.

- **Capital investment:**

Investment intensity will be measured by CESA (capital expenditures divided by sales) and CETA (capital expenditures divided by total assets), and according to both measures, no significant decrease in spending has been found, and these including all subsamples except firm in industrialized countries.

- **Output:**

Changes in output will be calculated by comparing the average inflation-adjusted sales level before and after privatization. The median increased in real sales from the average level during three years prior to divestiture to the average level afterwards is 176 percentage points (111 points) and 88% of the full sample firms, showed an increase in real sales. A significant increase in real sales is experienced for all the subsample groups.

- **Employment:**

Employment change will be calculated by examining the average employment levels for 3 years period before and 3 years period after divesture. The Wilcoxon test showed an insignificant median decrease in employment of 805 employees (770 employees) after privatization. The proportion test statistics showed a significant decline at the 5 percent level, with 64% of firms experienced declining employment levels. The significant difference between subsamples is that privatized firms from industrialized country reduce employment more than do firms from non- industrialized countries.

- **Leverage:**

Measured by total debt to total assets, a significant decline in leverage is documented for the full sample of privatized companies. The median decline in total debt to total asset is 6.0 percentage points (8.0 percentage points) with 67% of all firms experienced a decrease in leverage. The leverage decline is experienced in the subsample of developing countries as well.

- **Dividend payout:**

Measured as cash dividends divided by sales revenue DIVSAL, the median dividend payment increased from 1.5 percent (0 percent) of sales before divestiture to 4 percent (2 percent) afterwards, and the median increased in payments of 2.5 percent (2 percent) is significant at the 1 percent level. DIVSAL increased in 79% of all cases. The dividends improved via the subsamples as well.

- **Conclusion:**

The study documented a significant increase in the mean and median level of profitability, sales, efficiency and dividend after privatization. Also the study documented a significant decrease in mean and median leverage ratio, insignificant decreases in the mean and median employment level, and insignificant decrease in mean and median capital investment ratios. However the subsample of unindustrialized countries resulted in a significant increase in output, efficiency and dividend, with a significant decline in leverage, but the increase in profitability was insignificant in firms operating in unindustrialized countries.

(D’Souza & Megginson, 1999)

4 FINDINGS AND CONCLUSION

The findings of this study are presented in two parts. The conclusion of the interview with an expert will be answering the first part of the research questions of this study; while the findings of the three major international studies regarding privatization impacts over firms, will be answering the second part of the research questions of this study.

As the interview with Mr. Honkaniemi suggested, a certain conditions should be existed in order to insure the success of the privatization, these conditions are:

1. Political support.
2. No government interference.
3. Transparency of the policy toward SOEs, like the motives behind privatization, and the reasons behind choosing a certain company or sector.
4. Proper prepare for the divested SOE in order to sustain in the future.
5. Transparency of the selling method.
6. A trusted and well-chosen buyer for the SOE.
7. A common company's law that could be followed.
8. A separate independent department that can be responsible over the transaction and over privatization in general.

Regarding the preparation of the divested SOE, these important steps should be taken:

1. A provision of corporate form to the divested SOE.
2. A proper capitalization for the divested SOE.
3. A provision of well-equipped management with no political interference, and with optimal personnel.

These finding answers the first part of this research's questions, "what are the general steps that can be taken or the conditions that should be available in order to insure the success of privatization?"

The three major studies that have been chosen as a reference for this thesis showed that privatization have a general positive impact on firms' performance in developing countries. The samples of the previous three studies examined 107 companies from 25 countries, 13 countries from low-income and middle-income economies and 12 from upper-income economies, and all of the studies measured the impact of privatization on the firm performance by commuting the change in mean of certain variables after divesture, these variables are profitability, efficiency, capital investment, employment, leverage and dividend. However the privatization impacts on firms are generally positive and improved the firms' performance, and these findings answers the second part of our research's questions, "what are the impacts of privatization on firms in developing countries?"

In the First study conducted by Megginson, Nash, and Randerborgh, Profitability, output, and Dividends increased significantly for the privatized firms in developing countries, and at the same time, Leverage declined significantly for firms operating in developing countries. However the increase in efficiency is insignificant for privatized firms operating in developing countries. In the second study conducted by Boubakri and Cosset, Profitability, output, employment, and dividends increased significantly for all newly privatized firms in developing countries. However the efficiency increased significantly for upper middle income developing countries only. In the third study led by D'Souza and Megginson, profitability, efficiency, output, and dividend increase significantly for privatized firms operating in developing countries, while capital investments increased insignificantly and leverage declined significantly. The surprising result of the last study is that employment rate declined after privatization. However the decline is insignificant, and this due the fact that one third of D'Souza, Megginson firms' sample are from regulated utilities (electricity and telecommunication firms).

As a conclusion of the three previous studies, and as the interview with Mr. Honkaniemi suggested, Privatization is not an easy process, it require multiple conditions, and it takes many steps to implement it, and to ensure its success. Privatization requires well planning, reconstruction of the public firm that is going to be privatized, a non-corrupt government, and an appropriate political atmosphere. And at the same time, the state should provide the legal and administrative frame for privatization. On the other hand, privatization had major positive impacts over firms' performance in developing countries. Privatization could improve profitability, output, and dividends for all the firms operating in developing countries, and at the same time privatization could decrease the leverage for all the firms in developing countries as well. Regarding efficiency measured by ROS (return on sale), ROA (return on asset), and ROE (return on equity), the increase in the performance was insignificant. Privatization succeeded in improving the employment rate significantly for two of the previous studies. Another crucial point to be added to our conclusion is that both, the development stage of the country, and the type of privatized sector in the industry, have a vital role in deciding the size of impacts of privatization over firms' performance in general.

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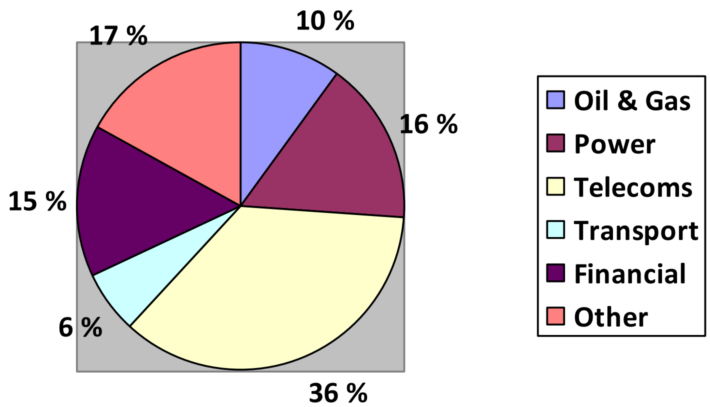

Figure 1 Sectoral Breakdown of privatization Proceed

Source: (W. Megginson)

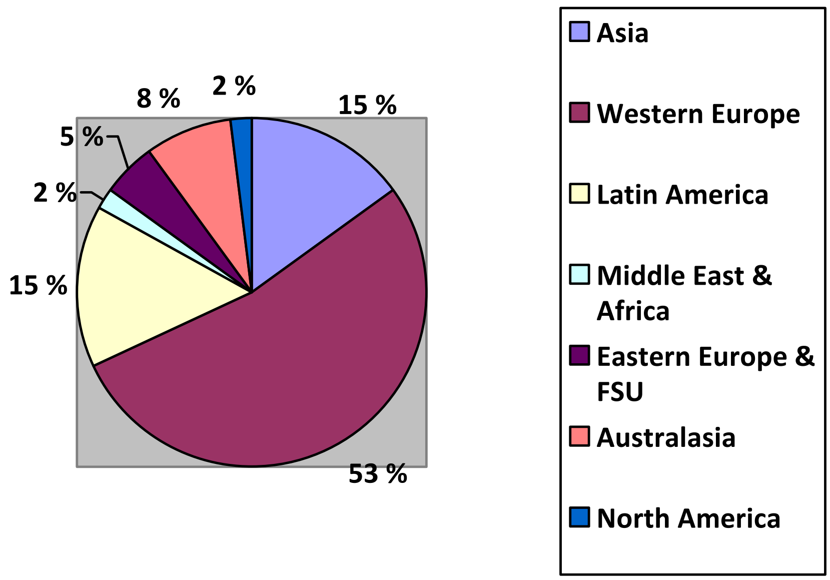

Figure 2 Geographic Breakdown of Privatization Proceeds

Source: (W. Megginson)

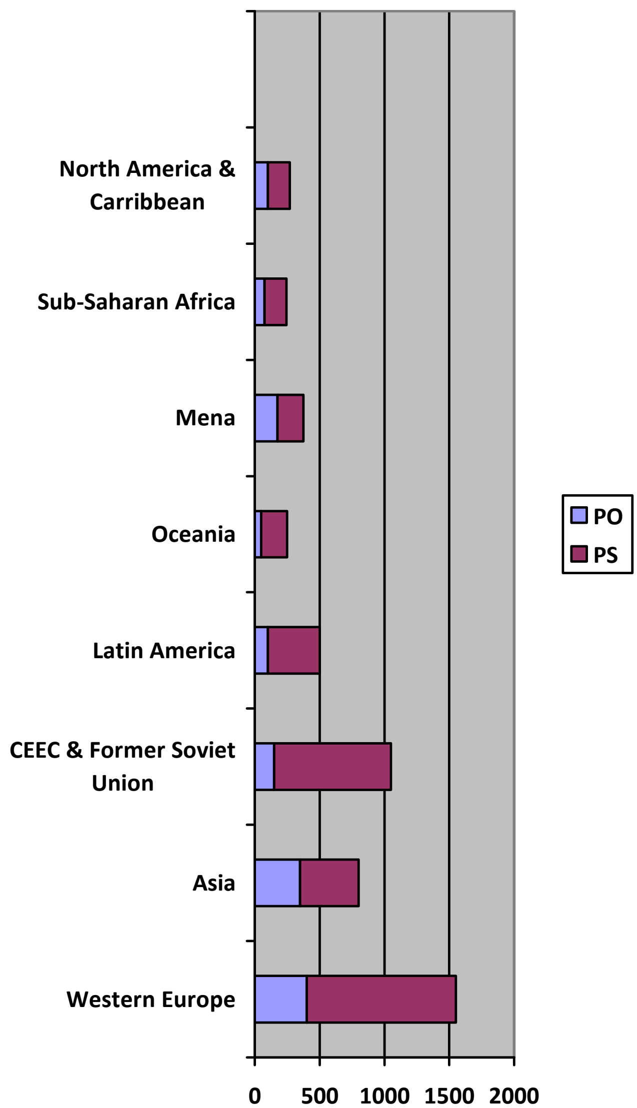

Figure 3 Privatization around the world by transactions (1977-2001)

Source : (Bortolotti and Siniscalco)

APPENDIX 1/4

1. What could be considered as major reasons for a government to privatize?
2. What are the most important prerequisites for privatization, in order to be successful?
3. What are the major steps that governments should take before starting its privatization plans, in order to achieve the maximum result?
4. How do governments privatize? And what methods are commonly used?
5. What do you think is the best and most efficient privatizing method? Why?
6. Do you recommend any specific privatizing method for all countries, especially developing countries?
7. Do you recommend privatization as a way for economic development in developing countries? Why?
8. What do you think of privatization impacts in some developing countries in Asia, Africa or Latin America?
9. There have been some disastrous results after privatization plans in some countries, what do you think were the major reasons behind that results?
10. What do you think a developing or emerging economy should do as major steps before starting its privatization projects?
11. What sector or industry should be privatized first? Why?
12. Do you recommend privatization for some strategic industries, like power for example?
13. Do you think a major reform or restructure for state owned enterprises could replace privatization as a solution for inefficiency?
14. How important is the political factors behind privatization?

15. Some states sold their full or majority stakes in SOEs, while others decided to keep most of the stakes, which solution would be more suitable for developing countries?

APPENDIX 2/4

Company	*Country*	*Date*	*$ Millions*	*Fraction Sold (%)*	*Times Offer Subscribed*	*First Day Return (%)*	*# Shareholders Created, mln*
Volkswagen	*Germany*	*Mar 1961*	*315*	*60%*	*2*	*103,3%*	*-*
British Petroleum	*UK*	*Jun 1977*	*972*	*17*	*4,7*	*22,7*	*-*
British Aerospace	*UK*	*Feb 1981*	*339*	*51,6*	*3,5*	*14,0*	*-*
British Telecommu-nications	*UK*	*Nov 1984*	*4,673*	*50,2*	*9,7*	*86,0*	*2,25*
British Gas	*UK*	*Dec 1986*	*8,012*	*100*	*4,0*	*23,0*	*-*
Banque Paribas	*France*	*Jan 1987*	*2,740*	*100*	*40,0*	*18,5*	*3,81*
Nippon Telegraph	*Japan*	*Feb 1987*	*15,097*	*12,5*	*6*	*55,0*	*-*
British Petroleum	*UK*	*Oct 1978*	*12,430*	*31,4*	*<1,0*	*-21,5*	*-*
Nippon Telegraph	*Japan*	*Nov 1987*	*40,260*	*12,5*	*-*	*3,1*	*-*
Conrail	*U.S.A*	*Mar 1989*	*1,650*	*85*	*>1*	*10,3*	*-*
Telefonos de Chile (ADR)	*Chile*	*Sep 1990*	*89*	*-*	*>1*	*7,4*	*-*
Telefonos de Mexico	*Mexico*	*May 1991*	*2,170*	*14,8*	*>1*	*0*	*-*
Deutsche Telekom	*Germany*	*Nov 1996*	*13,300*	*26*	*5*	*19*	*2+*
French Telecom	*France*	*Oct 1997*	*7,080*	*23*	*3*	*15,0*	*3,91*
ENELl	*Italy*	*Nov 1999*	*18,900*	*34,5*	*Heavily*	*0*	*3,8*
PetroChina	*China*	*Apr 2000*	*2,3890*	*10*	*-*	*-4,7*	*-*
Statoil	*Norway*	*Jun 2001*	*2,900*	*20*	*-*	*0*	*-*

Bank of China	*China*	*Jul 2002*	*2,800*	*-*	*-*	*-4,7*	*-*
Saudi Telecom	*Saudi Arabia*	*Jan 2003*	*3,700*	*30*	*-*	*-*	*-*

Table 1 Historically Significant Share Issue Privatization 1961-2003

Source: (W. Megginson)

APPENDIX 3/4

Country	***Deals***	***Revenue***	***Rev/GDP***	***Stock***	***PO/Deals***
Argentina	*77*	*3.2485,16*	*0.11*	*0.78*	*0.17*
Uruguay	*2*	*38.08*	*0*	*0.77*	*0*
Chile	*24*	*3.195.35*	*0.04*	*0.7*	*0.38*
Malaysia	*33*	*6.622.95*	*0.06*	*0.67*	*0.33*
Brazil	*76*	*33113.27*	*0.04*	*0.68*	*0.22*
South Africa	*14*	*2.987,70*	*0*	*0.59*	*0.21*
Mexico	*67*	*22.055,61*	*0.06*	*0.84*	*0.07*
Venezuela	*45*	*11.156,06*	*0.14*	*0.82*	*0.09*
Turkey	*28*	*5.636,27*	*0.03*	*0.69*	*0.18*
Thailand	*24*	*5.275,78*	*0.03*	*0.54*	*0.63*
Peru	*66*	*5.265,56*	*0.09*	*0.86*	*0.05*
Colombia	*16*	*4.423,53*	*0.05*	*0.55*	*0.19*

Jordan	*3*	*590.46*	*0.07*	*0.36*	*0*
Ecuador	*1*	*44.76*	*0*	*0.67*	*0*
Egypt	*64*	*2.007,02*	*0.03*	*0.37*	*0.8*
Philippines	*16*	*312.83*	*0.02*	*0.61*	*0.06*
Indonesia	*16*	*312.83*	*0.02*	*0.61*	*0.06*
Zimbabwe	*6*	*71.63*	*0.01*	*0.56*	*0.83*
Pakistan	*14*	*2.205,00*	*0.03*	*0.71*	*0.07*
India	*25*	*2.283,01*	*0*	*0.43*	*0.44*
Kenya	*14*	*109.41*	*0.01*	*0.56*	*0.43*
Nigeria	*20*	*10.478,17*	*0.33*	*0.42*	*0.95*
Average	***29***	***7.089,02***	***0.05***	***0.61***	***0.31***

Table 2 Privatization in some developing countries (1977-2001)

Source: World Bank Development Indicator (Bortolotti and Siniscalco)

APPENDIX 4/4

Table 3 Privatization in Developed countries (1977-2001)

Source: World BANK Development Indicator (Bortolotti and Siniscalco)

Country	***Deals***	***Revenue***	***Rev/GDP***	***Stock***	***PO/Deals***
Switzerland	*6*	*7,014.30*	*0,02*	*0,54*	*0,50*
Japan	*17*	*187,708.40*	*0,03*	*0,15*	*1,00*
Denmark	*7*	*3,533.31*	*0,02*	*0,66*	*0,71*
Norway	*29*	*7,979.26*	*0,05*	*0,64*	*0,45*
Austria	*47*	*9,597.65*	*0,04*	*0,65*	*0,57*
Germany	*151*	*77,752.34*	*0,03*	*0,79*	*0,13*
Finland	*55*	*18,404.17*	*0,11*	*0,59*	*0,40*
U.S.A	*38*	*12,519.94*	*0,00*	*0,97*	*,034*
Sweden	*51*	*18,970.51*	*0,07*	*0,77*	*0,22*
Netherlands	*28*	*18,763.94*	*0,04*	*0,59*	*0,39*
Belgium	*15*	*6,657.09*	*0,02*	*0,53*	*0,20*
France	*97*	*58,633.64*	*0,03*	*0,68*	*0,55*
Singapore	*25*	*3,308.30*	*0,03*	*0,54*	*0,64*
Ireland	*14*	*5,811.79*	*0,06*	*0,64*	*0,29*
Hong Kong	*19*	*11,187.14*	*0,07*	*0,49*	*0,47*
Australia	*131*	*58,054.89*	*0,13*	*0,93*	*0,07*
Canada	*57*	*11,439.49*	*0,02*	*0,81*	*0,32*
UK	*215*	*133,635.28*	*0,10*	*0,91*	*0,33*
Italy	*113*	*98,275.28*	*0,08*	*0,63*	*0,38*
Spain	*88*	*48,626.92*	*0,08*	*0,63*	*0,38*
New Zealand	*42*	*7,697.39*	*0,11*	*0,88*	*0,10*