

## 1. Why Case-by-case?

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Most privatization programs outside the transition economies take a case-by-case approach. Governments move control of state enterprises to the private sector, usually one at a time, using domestic and international public offerings, trade (third-party) sales, or a combination of the two (a mixed sale). The case-by-case approach offers several advantages, allowing government to pay close attention to the policy issues surrounding privatization; structure privatizations to bring in needed foreign capital, knowledge, and market connections; and maximize the financial returns from privatization.

Many countries adopt privatization programs as part of structural reforms and to alleviate budget problems. Selling state enterprises to the private sector can substantially reduce the flow of public funds to these firms. It also can generate significant revenue for government in the form of sales proceeds and future tax revenues from the newly privatized firms.

### Global experience

The global wave of privatization started in the United Kingdom in 1979. The U.K. program is still under way, and has generated almost \$100 billion in revenue from the privatization of such major state enterprises as British Telecom (the first large British privatization), British Gas, British Airways, British Petroleum, the electricity system, the water companies, and, most recently, the railways. Even the recently elected Labor administration has embraced privatization. Other OECD and developing countries have emulated the British model of case-by-case privatization, including Argentina, Canada, Chile, France, Italy, Germany, New Zealand, and Spain.

Many Central and Eastern European countries are starting to move beyond their initial privatization programs, which focused on small-scale privatization and mass (voucher) privatization. Thus case-by-case privatization of major infrastructure and medium-size and large (strategic) enterprises is taking hold there as well. Most of the world's privatization programs have been implemented on a case-by-case basis. In general, these programs seek to increase efficiency, expose state enterprises to market discipline and best practices, promote wider share ownership and entrepreneurship, reduce government interference in the economy, strengthen competition and weaken monopolies, develop domestic capital markets, cut budget deficits, and reduce public and external debt.

### Global lessons

Considerable experience has been gained with case-by-case privatization, and consensus is emerging about the main requirements for successful programs.

### There is no "right" approach

Case-by-case privatization must be tailored to the circumstances of the country and the enterprise. Although there are a number of best practices and generally accepted privatization methods, only careful packaging, timing, and sequencing can guarantee success. The focus should be on pragmatism, flexibility, and willingness to try new solutions and methods.

### Strong political support and leadership are vital

Privatization must receive support from the highest levels of government to overcome inertia and resistance from the bureaucracy and special interests. Implementation should be the responsibility of pragmatic individuals with political clout, no vested interest in the status quo, and access to world-class technical expertise. The privatization agency should report to a senior minister.

### Investors will respond to a well-prepared transaction

Naysayers often claim that investors—both domestic and foreign—have little interest in privatization. Yet heavy oversubscription of share offerings in Britain, Latin America, and Africa (Nigeria, Senegal) have taken many by surprise. Often underestimate the informal savings and flight capital in developing and transition economies. With the right incentives, domestic and international investors are eager to buy equities. To that end, governments must avoid setting unrealistic reserve prices. Instead, market-based valuations (rather than replacement or book values) should be used.

### Transparency, fairness, and a level playing field are essential

Transparency is crucial to successful case-by-case privatization. Third-party financial advisers must carry out asset valuations to ensure that prices are realistic, fair, and consistent, as are procedures for calling for bids and evaluating offers. Moreover, governments must carefully plan and execute privatization. Publicity campaigns help make potential investors aware of investment opportunities. In trade sales the contract

terms should be included in investment bidding documents to discourage undesirable changes during contract negotiations. Finally, the privatization award process must be transparent to avoid corruption and controversy.

### Outside expertise should be sought

Specialist consultants—especially financial advisers—have a clear role to play in case-by-case privatization. Although local experts can be used, governments should not hesitate to call on the growing body of foreign privatization experts. Investment banks, consulting firms, environmental experts, accountants, and lawyers are essential players in case-by-case programs. Many privatization programs have suffered because governments, lacking qualified personnel, could not manage the process.

### Related structural reforms should keep pace with privatization

Governments should implement privatization programs within a framework of mutually reinforcing economic reforms, including macroeconomic stabilization, trade liberalization, financial sector reform, public sector reform, and regulatory reform. If other reforms lag, privatization will be unsustainable and unable to restructure the economy.

### Pre-privatization restructuring should be brief and defensive

Pre-privatization restructuring should be limited to balance sheet and organizational changes such as closures, workforce reductions, and transfers of social services. Technology changes, capital investment, and major purchases should be left to the new owners, not to government officials.

### Privatization programs should attract foreign investment

Governments compete fiercely for foreign investment in privatized assets. To attract investment, foreign investors should be treated the same as domestic investors. Without a conscious, consistent, and aggressive policy to attract foreign investors, privatization programs may fail to generate sufficient revenue or could discourage investors who could provide market access, new technology, and management expertise. The state must assure investors that it will not use its political power, residual shares, or golden share in a way that jeopardizes the company's ability to maximize profits and efficiency.

### Privatization in tranches or through a mixed sale can help maximize government receipts

Emerging markets may be unable to absorb large packages of shares all at once. In such cases share sales should be broken into tranches and sold over time following a pre-announced schedule. Mixed sales can boost domestic and foreign demand and improve corporate governance by introducing a strong, controlling shareholder.

### Governments should minimize the conditions attached to privatization

Elaborate conditions for sale will detract from the value and attractiveness of an enterprise and may undermine the deal. Governments should fix regulations, price controls, subsidies, and other problem areas before the sale.

### Governments should not adhere to an artificially fixed timetable

Although constant pressure is needed for case-by-case privatization to proceed, unrealistic time constraints serve little purpose. One useful approach is to sequence several sales according to market conditions. Moreover, governments should bear in mind that not all transactions will be successful, and that it might be necessary to reject all bids and start the bidding process anew or change the method of divestiture.

### Public information campaigns are crucial

Most successful privatization programs have placed a heavy emphasis on educating the public and advertising expected sales. Special efforts to inform institutional investors have encouraged them to participate in many privatizations.

### Private monopolies may be worse than public monopolies

Before privatizing natural monopolies, governments should restructure the industry to promote competition, accompanied by clear regulations and credible enforcement.

### The desire to maximize sale proceeds should be balanced with other priorities

Although the privatization agency has a duty to sell state assets for their fair market value, it must balance its desire to maximize sale proceeds with other priorities, such as broadening share ownership, deepening domestic capital markets, and promoting competition.

### Privatization laws can be helpful but are not always essential

Countries with a civil law tradition tend to approach privatization by preparing a general privatization law. Such laws define the rules of the privatization program and establish and empower the institutions charged with executing it. Canada and the United Kingdom—and countries with a common law tradition—privatize without a privatization law, using specific legislation only where required. Countries with weaker institutions and law enforcement, however, may not be able to ensure the transparency of privatization. Such countries should draft a privatization law that clearly defines privatization procedures.

Privatization laws offer both advantages and disadvantages. When carefully drafted, they strengthen the state's capacity to carry out structural reforms. They also help make more transparent the transfer of state property to the private sector. Once ratified, however, a law cannot easily be changed. If procedures need to be revised in response to market conditions, an amended law or new regulations may be required.

### Care should be taken in crafting a list of strategic industries

In selecting companies for privatization, many countries have drafted a positive list (containing enterprises that can be privatized) or a negative list (containing enterprises that cannot be privatized, because they are deemed strategic). A positive list is useful because it has the full power of the law behind it. Companies are committed to privatization within the deadline for the program, and can be privatized at any time by the institution in charge of executing the transfers. Such arrangements make it harder—though not impossible—for enterprise managers to stall privatization.

Although a negative list may provide more options for privatization, care should be taken in preparing such a list. As many countries have learned, private ownership does not necessarily imply a loss of state control over enterprises. Thus many state enterprises that were once deemed strategic—oil and gas companies, telecommunications firms, other utilities—are being privatized. Many governments have chosen not to have a positive or a negative list, preferring to privatize state enterprises without restriction, as and when market conditions appear favorable.