

## 7. Hiring financial and other advisers

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In the context of case-by-case privatization, financial advisers are investment bankers or merchant bankers that sell and advise on the sale of firms. The government may use a single financial adviser or a consortium of financial and other advisers. A foreign and a domestic adviser should be used if the government wants to attract both domestic and foreign investors.

### Selecting financial advisers

Governments need financial advisers in case-by-case privatizations to value enterprises, advise on the timing and method of sale, and contact potential buyers. Advisers will suggest the price (usually within a range) that the government could receive for the enterprise. Advisers may provide several valuations based on different sales methods—for example, whether sale is through a stock flotation or a trade sale. Advisers will also suggest sales options. This advice will cover such issues as whether the company is salable, whether it should be sold now or later, and what sorts of sales choices are feasible, and at what cost.

Once the government has decided when and how to privatize, it will require a financial adviser (sales con-agent) to undertake the sale. The sales agent will help design the sales plan and will undertake the sale in cooperation with government officials. If a privatization takes the form of an initial public offering, a syndicate of investment banks or merchant banks will be formed to sell the enterprise's shares. The government must appoint a firm as the lead manager for the syndicate to manage the sale process. If a privatization takes the form of a trade sale, the sales agent will be responsible for preparing the sale documents, contacting potential buyers, and enticing interested parties to bid for the company.

If privatization involves a small enterprise that is unlikely to attract much international interest, accounting firms and financial consultants may suffice as financial advisers. But if the enterprise is larger or has an international dimension, valuation should be done by an investment bank or merchant bank. This is because valuation requires market awareness as well as technical skills. Unless the financial adviser is involved in buying and selling companies in the same sector as the privatization candidate, the results of the valuation may not reflect what the market is willing to pay for the assets. Furthermore, an investment bank is more likely to provide the government with timely market information on the corporate strategy of potential buyers. Accounting firms, by contrast, may not have a corporate relationship with potential buyers.

For the same reason, many analysts believe that valuation mandates should be combined with placement mandates—making the investment bank charged with valuing assets responsible for also identifying potential buyers. This approach guarantees that valuation reports are grounded in market reality. Others believe that valuation mandates and placement mandates should be dissociated because of the potential conflict of interest between the two tasks. Indeed, the investment bank charged with placing assets may want the sale price to be low to facilitate its task. Thus it may be tempted to undervalue the assets. Still, this argument ignores the fact that in most cases the structure of the placement mandate is such that the higher is the sale price, the higher is the bank's compensation. Thus conflicts can be avoided by properly structuring the compensation of financial advisers and ensuring that it is in their interest to maximize proceeds.

### Selecting other advisers

Other professional advisers are also needed during privatization. Lawyers are required to manage due diligence activities, advise the government on the legal aspects of the privatization, draft and negotiate sales contracts and draw up confidentiality agreements. Accountants and auditors may be needed to undertake audits prior to sale. Technical experts with specialized industry skill and knowledge may be required as well. The government may find it convenient to tender for these advisers as a single consortium or may prefer to hire them separately.

### Should the same financial adviser be used for both phases of privatization?

The literature on privatization often questions whether the same financial adviser that helped the government during the early stages of privatization should undertake the sale of the enterprise. The argument against using the same adviser is that there is an inherent conflict of interest in advising on whether and how to privatize an enterprise and helping with the sale of that enterprise. The best advisory firms, however, are often reluctant to participate in the first phase if they cannot participate in the second, which is usually more profitable.

One way to manage this issue is to tender for advice for both phases but not to restrict the winner of the first from participating in or winning the second. Alternatively, the adviser could be hired for both phases, but the government could be allowed to exit after the first phase if it is not happy with the adviser's performance.

### Foreign advisers

Governments in transition and developing economies should probably use both domestic and foreign advisers. Foreign financial advisers are essential if the government expects participation by foreign investors or injections of foreign capital, or if it plans to sell shares on international markets. These advisers should work with domestic advisers, who should address more local issues.

### Tenders for financial advisers

Governments should hire financial advisers through a competitive bidding process. But given the specialized nature of financial advice, officials may want to develop a "short list" of firms that have the experience and marketing capacity needed for privatization. As a rule the list should include at least 10 companies to avoid too few bidders if companies combine to bid or if several are uninterested. Interested firms should submit written proposals against broad terms of reference drawn up by the government. Interviews with key officials of the best firms should follow.