Lessons from Bank Privatization in Mexico

Guillermo Barnes

Bank privatization in Mexico — arguably one of the most successful financial operations in recent years — has been facilitated by a strong macroeconomic stabilization program, legal and financial reform, and the adoption of clear objectives, precise rules, and transparent procedures.
This paper — a product of the Financial Policy and Systems Division, Country Economics Department — is part of a larger effort in the department to study issues in bank privatization. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Wilai Pitayatonakarn, room N9-003, extension 37664 (November 1992, 22 pages).

The recently completed privatization of Mexican commercial banks may be one of the most successful financial operations in recent years. In 13 months, the Mexican authorities were able to sell 18 banks to private groups of Mexican investors for more than US$13 billion total — more than three times book value, and with a price/earnings ratio of 14.5.

Guillermo Bames, Director General of the Development Planning Unit of the Ministry of Finance and a member of the Privatization Committee that supervised the program, sets out the preconditions, objectives, and main achievements of the privatization program. He summarizes the Mexican experience in nine lessons that may be relevant for developing countries considering similar exercises:

- The conditions suitable for privatization and the strength of the financial system are directly related to the economy’s general performance. Macroeconomic stability is essential for bank privatization to succeed.

- Bank privatization must be complemented by the structural transformation of the economy, to improve efficiency and productivity.

- Financial reform must aim to strengthen competitive economic conditions and to enhance the efficiency of the financial sector.

- Bank privatization requires a new legal framework, especially designed for private institutions.

- Legal reform should lead to structures that encourage solid, efficient financial intermediation.

- To encourage ample participation and to ensure fairness, the privatization process must be trustworthy — with clear objectives, precise rules, and transparent procedures.

- The mechanics of privatization should be consistent with the legal framework and should be based on adequate, detailed preparation.

- The proceeds of privatization should be in cash, which should be used to permanently reduce government outlays.

- Common sense rules should be followed, such as selling the small banks first, ensuring economic certainty and confidence, centralizing management of the privatization program, and ensuring honesty and transparency in the process.

The overall lesson of the Mexican experience is that bank privatization should not be rushed. Mexico waited until 1990, when inflation was less than 20 percent a year and the banks were strong (their numbers had been reduced and risky ventures restricted), while meticulous preparation set the ground rules for transparent and effective procedures.
LESSONS FROM BANK PRIVATIZATION

IN

MEXICO

Guillermo Barnes
Foreword

The recently completed privatization of Mexican commercial banks may be classified as one of the most successful financial operations of recent years. Within the span of 13 months, the Mexican authorities were able to sell 18 banks to private groups of Mexican investors for a total price of over US$13 billion.

Banks were nationalized in Mexico in 1982 in a panicky response to the dual economic shock of weakening oil prices and rising real rates of interest. During the nationalization period, the banking sector was consolidated into fewer units and was prevented from engaging in risky and speculative ventures. This avoided the accumulation of large volumes of nonperforming loans and facilitated the process of privatization. However, the smooth implementation of the privatization program was based on the promotion of macroeconomic stability, the pursuit of regulatory and structural reform and the adoption of clear objectives and credible and transparent procedures for the whole process.

Guillermo Barnes, Director General of the Development Planning Unit of the Ministry of Finance, was a member of the Privatization Committee that supervised the whole program. In this paper, he sets out the preconditions, objectives, and main achievements of the privatization program. The paper is based on two presentations made by Dr Barnes to seminars organized by the Financial Policy and Systems Division of the World Bank and by the Economic Development Institute.

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Introduction

This paper reviews briefly the Mexican experience with bank privatization. The success of bank privatization in Mexico has been facilitated by the macroeconomic stabilization policies pursued over the past few years, the relatively strong financial position of Mexican banks, and the good prospects for economic growth and expansion heralded by the closer ties with the United States and Canada under the proposed North American Free Trade Area (NAFTA).

But the effectiveness of the program has also been based on the promulgation of clear principles and objectives for the privatization program and the adoption of transparent and credible procedures. The Mexican experience is summarized in 9 lessons that may be of relevance for other developing countries contemplating similar exercises.

1. The first and perhaps most important lesson is that privatization conditions and the strength of the financial system are directly related to the general performance of the economy. The Mexican economy grew at an annual average rate of 3.8% in 1989-1991 and the rate of inflation fell from almost 200% in 1987 to 18.0% in 1991. The sustained nature of economic growth marks the end of a long period of economic crisis in Mexico and allowed a better privatization framework and a strong financial deepening.
In 1983 the country was facing a stagnant economy, severe macroeconomic instability, high inflation rates, and an increase in the public sector debt. These were partly the consequence of imbalances caused by public sector policies, increasing real international interest rates, and the collapse of oil prices in the early 1980's.

The second type of imbalances were structural inefficiencies generated, first, by an oversized public sector that owned too many state enterprises and overregulated the economy and, secondly, by protectionist trade policies that reduced foreign competition and weakened industrial competitiveness.

To solve these problems, Mexico adopted a severe adjustment program to stabilize the economy. During 1983-1987 fiscal and monetary policies were tightened with a particular emphasis on fiscal adjustment. The program’s early achievements were considerable: the primary fiscal balance, which excludes interest payments, moved from a deficit of 7.3% of GDP in 1982 to a surplus of 6% in 1991; and public expenditure was reduced sharply during the same period.

The administration of President Salinas, which took office in December 1988, continued and tuned the prior administration’s economic strategy to emphasize macroeconomic stabilization, structural reforms, and the reduction of poverty.
The stabilization strategy was based on macroeconomic programs that included tight fiscal and monetary policies, a revised wage and price control agreement between the government, business and labor, and the strengthening of the balance of payments.

Stabilization policies were designed to:

(i) Increase the public sector primary balance, which averaged a surplus of 7% of GDP in the period 1988-91.

(ii) Renegotiate Mexico’s foreign debt to reduce the problem of excessive Mexican savings transferred abroad.

(iii) Reduce domestic credit to the public sector and maintain a crawling exchange rate in order to further lower inflation.

(iv) Maintain relative prices according to demand and supply conditions, avoiding indexing and reducing inflationary expectations.

(v) Obtain economic agreements among different sectors in order to distribute evenly the social costs of adjustment.

In November 1991, the Government sent to Congress the budget for 1992. This is the first budget in recent history which shows a public sector surplus after including interest payments on domestic and foreign debt. For 1992, the public sector surplus, excluding future privatization proceeds, is estimated at 0.8% of GDP.
Fiscal balance has helped achieve a decline in the rate of inflation to less than 1 percent a month. During 1992, inflation is expected to be close to 10%. Real GDP is expected to grow at a rate of 3.5 percent.

Investment, the main source of economic growth, showed an increase of 10% in 1991. Private investment is expected to grow at an annual rate of 12% in 1992. Real expansion of savings has permitted a large accumulation of international reserves and a further increase of credit to the private sector.

The financial sector reacted according to the general performance of the economy. In 1991 the percentage of financial intermediation to GDP reached 44%. This figure was 33% in 1985. Lower inflation, economic growth and higher degree of stability increased the demand for financial assets.

2. **The second lesson is that privatization has to be complemented with a general structural transformation oriented to improve efficiency and productivity.** The financial sector reforms have to be consistent with the general structural trend of the economy.

The Mexican macroeconomic stabilization program was complemented with a profound structural reform to increase productivity and improve overall market performance. The program was based on several strategies: trade liberalization, foreign investment
INFLATION
(MONTHLY RATE)

SOURCE: Banco de México.

GDP GROWTH
(REAL GROWTH RATES)

SOURCE: INEGI.
M4 / GDP

Year's Average 26.1 25.5 26.5 26.4 27.1 27.6 28.5 32.1 35.3 39.5 45.5
End of Period 48.5
FORECAST

SOURCE: Banco de México.

DIVESTITURE
(STATE OWNED FIRMS)

STATE FIRMS 1155 1074 1049 941 737 617 412 379 280 239 227

SOURCE: SMCo.
promotion, privatization of state enterprises, deregulation, fiscal reform and financial sector reform.

Today Mexico is an open and competitive economy. Trade liberalization policies evolved from a system based on import perr and quantitative restrictions to a general system based on tariffs. As a result, resources have been reallocated to highly competitive sectors and protection rents have been eliminated. Companies based in Mexico have access to international raw materials at competitive prices. This has allowed them to become internationally competitive and has fostered non-oil exports.

Foreign investment plays an important role in Mexico as it complements domestic capital. To promote foreign investment, regulations were revised, and administrative procedures for approving foreign investment projects were simplified. Foreign investment is encouraged since it complements domestic investment with new technology, efficient market strategies and modern management. Foreign investment also enhances Mexican export capacity and provides domestic employment.

Privatization plays an important role in the overall economic strategy. Mexico wants a strong and efficient public sector based on law and justice, not on the ownership of public enterprises. The public sector will maintain ownership and control only of those strategic sectors as defined by the Mexican Constitution. The privatization policy has several objectives: to increase aggregate economic efficiency and productivity; to promote private
investment and technological change; to reduce pressure on the public budget; and to make available public resources to increase infrastructure and social investments.

From 1155 firms owned by the government in 1982, including 18 commercial banks, Mexico still maintains ownership of 23 public enterprises in 1992. In terms of value the cumulative sales have reached approximately 13 billion dollars (6% of GDP) up to 1991. These resources have allowed for better economic conditions in the country.

Deregulation is another important element of the economic strategy. The basic objective is to create rules that promote business and entrepreneurial activity. As long as an economy remains overregulated, it increases the cost of doing business. The Mexican goal is to liberalize the economy and improve resource allocation and efficiency. This policy has helped curb down domestic price increases through greater competition. More generally, it has contributed to the establishment of a competitive market incentive structure for the private sector.

The fiscal reform objective is to increase the efficiency and equity of the tax structure. On the one hand, tax rates have been reduced to a maximum level of 35%, which is considered an internationally competitive standard. On the other hand, the tax base has been expanded by including sectors which were traditionally excluded. Tax evasion also has been reduced.
Lower rates and a broader base tend to increase the equity of the system. Tax revenues have increased as a percentage of GDP. These policies have fostered the fiscal performance and the primary public sector surpluses observed in the past years.

3. The third lesson concerns directly the financial sector. The reforms have to achieve an improvement of competitive economic conditions and enhance the overall efficiency of the financial system. The liberalization has to include operational and legal reforms.

In 1988, Mexico deregulated interest rates by eliminating controls of rates and maturities on all traditional bank instruments. Restrictions on loans to the private sector were also eliminated and lending at below market interest rates to the public sector was discontinued.

Financial reforms included changes in the reserve requirement system. Reserve requirements on deposits in pesos were initially replaced by a 30 percent liquidity ratio, which was recently reduced to zero. Foreign exchange deposits maintain a 15% reserve requirement. Today, Government instruments held to satisfy a voluntary liquidity ratio earn market interest rates and are fully tradeable.

To enhance the operating efficiency of banks and their ability to respond to changing market conditions, bank management was given more flexibility via the creation of boards of
directors with the power to oversee all operating and investment decisions faced by management.

In December 1989, to further financial liberalization and strengthen banks and other institutions involved in credit and stock market operations, Congress approved wide-ranging institutional reforms. The measures were intended to increase competition and reduce forced market segmentation by expanding the scope of permissible activities for different types of institutions. They also allowed a greater degree of integration in the delivery of financial services.

The reforms also eliminated government regulation of insurance premiums and policies, and deregulated and simplified the operation of mutual funds. Additionally, restrictions governing foreign investment in financial institutions were relaxed.

In summary, modernization of the Mexican financial system was based on the liberalization of instruments and institutions and was complemented with better government supervision of financial institutions.

4. Privatization of commercial banks in Mexico required a new legal framework, specially designed for private institutions. This principle provides the fourth lesson: privatization of banks can be carried out only after having a solid and well defined legal structure.
In 1990, the Government launched two major initiatives to allow the privatization of commercial banks and to establish the framework for the formation of integrated financial groups, envisaged as the main organizational structure of financial markets. On May 2, 1990, President Salinas submitted a bill to Congress to amend Articles 28 and 123 of the Constitution, permitting full private ownership of commercial banks.

The new Credit Institutions Law, enacted in July 1990, allows commercial banks to be majority owned and controlled by the private sector. To ensure Mexican control of banks, four classes of bank shares are provided for: "A" shares which have to be at least 51 percent of the ordinary capital, can only be held by Mexican individuals and are related to the strategic control of the bank; "B" shares that can be up to 49% of the ordinary capital depending on the number of "C" shares issued and can be held by Mexican individuals, Mexican corporations, and mutual funds; "C" shares that can be up to 30% of the ordinary capital and can be held by Mexican individuals, Mexican corporations and foreign investors; and "L" shares which represent the additional capital and can be issued in an amount up to 30% of the ordinary capital - these shares can be held by the same investors as "C" shares, but have limited voting rights.

The law regulates banking and establishes the terms under which the State exercises supervision and control over the banking system. Prior to nationalization, the financial system was dominated by a few large banks with strong links to major industrial groups. The new regulatory provisions are intended to limit the concentration of credit risk, ensure
the separation of interests between banking, industry and commerce, and avoid conflicts of interest in the management of banks. Strong emphasis is placed on prudential regulation and supervision of banks. A comprehensive system for classifying loans according to their inherent risk was implemented with a requirement to create specific reserves for loan losses on nonperforming loans. In 1991 Mexican banks were obliged to constitute over a two-year period general reserves for up to 1% of the average balance of their loan portfolio.

5. The fifth lesson is that legal reforms should lead to structures that encourage solid and efficient financial intermediation.

Mexico adopted a financial legislation which opens the possibility of establishing a system of "universal banking". The law pertaining to Financial Groups regulates and permits the formation, under a common structure, of groups of companies performing different financial functions such as banking, insurance, brokerage and other services. It ends the traditional separation of banking from other types of financial activities, and in particular, allows banks and brokerage houses to come under the control of a single holding company.

But in order to limit the concentration of risk, ensure the adequacy of capital, prevent the pyramidation of capital and prevent conflicts of interests within the groups, the legislation restricts the presence of more than one type of intermediary within a single financial group, and prohibits members from investing in each other's or the holding company's stock.
6. The sixth lesson is related to the special characteristics of the privatization process. In order to encourage ample participation and assure fairness, the process must be trustworthy. Clear and precise rules for the entire privatization process are essential for this purpose.

The privatization of the banking system was initiated with a Presidential decree and had the following objectives:

- Create a more efficient and competitive financial system.
- Guarantee diversified participation and ownership of banks to promote investment in the financial sector and guard against ownership concentration.
- Ensure high ethical standards and competence of bank management and obtain adequate capitalization levels.
- Ensure Mexican control of banks, but without the exclusion of foreign involvement.
- Promote decentralization and regional participation in the banking institutions.
- Obtain a fair price for the institutions in accordance with valuations based on homogeneous and objective criteria.
- Achieve a balanced financial system.
- Promote fair and healthy financial and banking practices.
To oversee the whole process and bring it to fruition, a Bank Privatization Committee was formed by Presidential decree and made responsible for the entire process. The Committee included government officials from all areas related to financial activity. The main responsibilities assigned to this group were the following:

- establish criteria and general policies for the process;
- formulate a specific strategy for the sale of each bank;
- assure transparency of the process with periodic communications to the public at large;
- hire external advisers as needed; and
- benefit from international experiences in banking privatization.

7. The mechanics of the privatization process should be consistent with the legal framework and specific guidelines of the banking system. The seventh lesson is that adequate preparation of the mechanics of privatization should be made before starting the process.

The Mexican bank privatization process consisted of four main stages. The first, preparatory actions, included: qualification and selection of the bidders by the Committee; writing each bank’s sale prospectus; and announcing the auction and its rules.
The selection of bidding groups aimed to ensure that potential investors were experienced and of high moral standing and were able to make a positive contribution to the future growth of the banks. Only approved groups were allowed to participate in the auctions for each bank. More than 44 groups were approved and they presented in total 133 solicitations to acquire a bank. Each bidding group consisted of a core group that was allowed to invest in "A" shares. No foreign investors were included in the bidding groups, although after the completion of the privatization process, foreign investors were invited to participate in the ownership of different banks.

During the first stage, several valuations were prepared for all banks. Each bank had an accounting valuation prepared following standard criteria. In addition, two independent financial valuations were made for each bank with the assistance of external advisers of international prestige. Obtaining objective valuations of banks is always a difficult exercise because of the information problems involved in assessing the performance of commercial and industrial loans. However, unlike the current situation in most developing countries, Mexican banks were fortunate in that at the time of the privatization process they had relatively low volumes of nonperforming loans. To some extent, this was the result of the past imposition of heavy reserve and investment requirements on banks that forced them to allocate a disproportionate amount of their resources to government bonds. In addition, during the nationalization period, banks were encouraged to consolidate their operations and to build adequate reserves against loan losses. The number of banks was reduced from 60 at
the time of nationalization to 18, of which 6 were nationwide institutions, 7 were multiregional banks and 5 were regional banks.

Once the auction was announced, the second stage began. It consisted of the due diligence process carried out by each bidder. Qualified bidders had access to the process if they made a deposit and signed a letter of confidentiality, relating to all information obtained.

It is important to point out that equal access was given to all bidders to information, bank visits and management interviews. The committee supervised the due diligence activities during the whole process.

The auction itself was the third step of the process. After the due diligence process was completed, qualified bidders presented their bids. Fairness was guaranteed by the presentation of all bids at the same time in the presence of public notaries. The Committee reviewed the bids and selected a winner based on the highest price offered, provided that this price was higher than the valuations determined previously by the Committee. In case of a tie, the following items were considered to award the bank: business plan, capitalization plan and the regional presence of the bidders. All winning bids were those with the highest price offered.

The final stage in the process was the sale itself. The sale was decided by the spending-financing commission of the federal government, following the privatization
committee's recommendation. The government transferred its shares to the winning group once the group had paid the total value offered.

Thirteen months after initiating the selling process, control of all 18 banks has been sold for US$ 13.5 billion. The prices that have been achieved are a result of the state of the banking system and of each individual bank. In all cases, the prices have been higher than the valuations obtained by the external advisors. The weighted average price-earnings ratio amounted to 14.5. In the U.S. and Europe an average of comparative bank acquisitions in the last five years reached a price-earnings ratio of 14. The weighted price-book value ratio was 3.08 versus an international average of 2.2. The price range that has been obtained reflects the health of the banking system, the modern legal framework, and positive expectations on the future performance of the Mexican economy.

In addition to the quantitative results mentioned above, other important objectives have been obtained. In particular, a diversified ownership of the capital stock of the banks has been achieved. More than 130,000 private investors, including employees through special trusts, have participated in the process, while no individual investor has more than 10% of the stock of any bank.

Additionally, the regional presence of the banks has been strengthened. The new bank owners come from all states in the country. They will link the banks with their local economies and customers.
Bank Privatization in Mexico

<table>
<thead>
<tr>
<th>Bank</th>
<th>Date of Auction</th>
<th>Sale Price</th>
<th>% Sold</th>
<th>Book Value</th>
<th>P/Book Value</th>
<th>Profits (%)</th>
<th>% Profits</th>
<th>Expected Profits</th>
<th>P/Expected Profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>MERCANTIL</td>
<td>Jun-07-91</td>
<td>$611.20</td>
<td>77.19%</td>
<td>$297.6</td>
<td>2.66 x</td>
<td>12.73 x</td>
<td>$69.3</td>
<td>11.43 x</td>
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<td>BANPAIS</td>
<td>Jun-14-91</td>
<td>$544.99</td>
<td>100.00%</td>
<td>$180.1</td>
<td>3.03 x</td>
<td>17.73 x</td>
<td>$24.6</td>
<td>22.15 x</td>
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<td>CREDI</td>
<td>Jun-21-91</td>
<td>$748.29</td>
<td>66.70%</td>
<td>$329.9</td>
<td>3.40 x</td>
<td>21.87 x</td>
<td>$41.7</td>
<td>26.90 x</td>
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<tr>
<td>CONFIA</td>
<td>Ago-02-91</td>
<td>$892.26</td>
<td>78.68%</td>
<td>$304.0</td>
<td>3.73 x</td>
<td>13.52 x</td>
<td>$108.6</td>
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<td>BANORIE</td>
<td>Ago-09-91</td>
<td>$223.22</td>
<td>66.00%</td>
<td>$83.7</td>
<td>4.04 x</td>
<td>23.65 x</td>
<td>$18.4</td>
<td>18.38 x</td>
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<td>BANCRESER</td>
<td>Ago-16-91</td>
<td>$425.13</td>
<td>100.00%</td>
<td>$163.5</td>
<td>2.60 x</td>
<td>50.48 x</td>
<td>$48.6</td>
<td>8.75 x</td>
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<td>BANAMEX</td>
<td>Ago-23-91</td>
<td>$9,766.98</td>
<td>70.72%</td>
<td>$5,242.1</td>
<td>2.62 x</td>
<td>11.18 x</td>
<td>$4,264.1</td>
<td>10.90 x</td>
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<tr>
<td>BANOCOR</td>
<td>Oct-25-91</td>
<td>$8,564.21</td>
<td>56.00%</td>
<td>$5,111.8</td>
<td>2.99 x</td>
<td>15.67 x</td>
<td>$4,104.1</td>
<td>13.85 x</td>
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<td>BCII</td>
<td>Nov-08-91</td>
<td>$878.36</td>
<td>100.00%</td>
<td>$328.4</td>
<td>2.67 x</td>
<td>23.31 x</td>
<td>$35.60</td>
<td>24.67 x</td>
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<tr>
<td>SERFIN</td>
<td>Ene-24-92</td>
<td>$2,827.74</td>
<td>51.00%</td>
<td>$2,061.00</td>
<td>2.69 x</td>
<td>14.77 x</td>
<td>$491.00</td>
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<td>COMEREX</td>
<td>Feb-07-92</td>
<td>$2,706.01</td>
<td>66.54%</td>
<td>$1,089.24</td>
<td>3.73 x</td>
<td>20.61 x</td>
<td>$235.00</td>
<td>17.31 x</td>
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<td>SOMEK</td>
<td>Feb-28-92</td>
<td>$1,876.53</td>
<td>81.62%</td>
<td>$695.57</td>
<td>3.31 x</td>
<td>21.25 x</td>
<td>$150.00</td>
<td>15.33 x</td>
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<td>ATLANTICO</td>
<td>Mar-27-92</td>
<td>$1,469.16</td>
<td>68.48%</td>
<td>$402.70</td>
<td>5.33 x</td>
<td>17.95 x</td>
<td>$228.00</td>
<td>9.41 x</td>
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<tr>
<td>PROMEX</td>
<td>Abr-03-92</td>
<td>$1,074.47</td>
<td>66.00%</td>
<td>$383.09</td>
<td>4.25 x</td>
<td>16.53 x</td>
<td>$115.80</td>
<td>13.16 x</td>
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<tr>
<td>BANORTE</td>
<td>Abr-10-92</td>
<td>$1,137.81</td>
<td>66.03%</td>
<td>$436.25</td>
<td>3.95 x</td>
<td>11.27 x</td>
<td>$174.80</td>
<td>11.26 x</td>
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<tr>
<td>BANORTE</td>
<td>Jun-12-92</td>
<td>$1,775.78</td>
<td>66.00%</td>
<td>$633.08</td>
<td>4.25 x</td>
<td>12.62 x</td>
<td>$230.40</td>
<td>11.68 x</td>
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<tr>
<td>INTERNACIONAL</td>
<td>Jun-26-92</td>
<td>$1,486.92</td>
<td>51.00%</td>
<td>$987.05</td>
<td>2.95 x</td>
<td>N.A.</td>
<td>$236.70</td>
<td>12.32 x</td>
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<tr>
<td>BANCEN</td>
<td>Jul-03-92</td>
<td>$869.38</td>
<td>66.31%</td>
<td>$281.70</td>
<td>4.65 x</td>
<td>10.85 x</td>
<td>$120.00</td>
<td>10.93 x</td>
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<tr>
<td>SISTEMA</td>
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<td>$37,856.45</td>
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<td>$19,010.76</td>
<td>$3,697.71</td>
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<td>$4,696.75</td>
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</tbody>
</table>

Maximum: 5.33
Minimum: 2.60
Average: 3.49
Standard Deviation: 0.78
Weighted Average: 3.08

Figures in billion pesos
a) In April 1991.
b) In June 1991.
c) In July 1991.
d) In September 1991.
e) In December 1991.
g) In February 1992.
h) In March 1992.
j) In April 1991. The profits for 1990 were much higher at 41 billion pesos, yielding a price/earnings ratio of 13.3.
k) In June 1991. Profits include revaluation gains on fixed assets.
l) Estimation based on annualizing profits accumulated up to the date of sale. In the case of Cerfin, Comerex, some, Internacional and Bancen expected profits were obtained from the Annual Operating Plans.
m) Unconsolidated.

Source: CS First Boston
8. The eighth principle is that sales have to be in cash and privatization revenues have to be used on permanent welfare improvements.

Privatization should be an irreversible process that intends to transfer the ownership of assets from the government to the private sector on a once and for all basis. Selling for cash is a transparent way of cutting the relation between the firms and the government, prevent future unpaid balances, or granting some type of government credit to finance the purchase of the firms.

Once the sale is completed one has to decide the destiny of the transitory revenues of the sale, in order to have a permanent impact on public finances. Prudence suggests that once and for all revenues should not be used to finance current spending. These resources should be used to reduce government outlays on a permanent basis. In the Mexican case the stock of internal debt as a percentage of GDP was reduced from 24.4% in December 1990 to 17% in December 1991, using privatization proceeds. This is expected to decline further to 13% in 1992. A smaller public debt reduces government outlays on interest payments and allows a transfer of government outlays to social programs.

9. The last lesson is that one has to follow common sense rules to have a successful privatization experience. Some of these rules are:
9.1 Start privatizing small firms first. There are several reasons to be prudent about the timing and the sequence of any privatization process. Learning the technical facts involved takes time and it is important to minimize risks. Mistakes made selling a small firm are not as important as those privatizing a large bank, the telephone company or a major airline.

9.2 Ensure economic certainty and confidence through macroeconomic stabilization and market-friendly regulatory and structural reform. These conditions allow public sector firms to be sold at higher prices. The timing and planning of the strategy requires both a stabilization program and a privatization scheme.

9.3 Centralize the management of the whole process. In practice this means having a single responsible office which would preside over the firm's board and the general manager, would establish the proper strategy, would deal with all potential buyers, and would supervise all legal requirements.

9.4 Ensure honesty and transparency in the whole process. Credibility has to be gained and people have to know that everything is done according to the law and honestly. Detailed information has to be given to the mass media, which include characteristics of the buyer, forms of payment, etc. Congress and the General Comptroller must be briefed on a continuous basis.
Conclusion

In conclusion, it can be claimed that the bank privatization process in Mexico has achieved all its short term objectives and has also laid the foundations for the pursuit of the longer term objectives.

Among the former, the privatization process has succeeded in ensuring Mexican control of banks with diversified ownership and regional participation. It has also obtained high but fair prices for all the banks. As regards, longer term objectives, bank privatization has laid the foundations, in conjunction with the reform of bank and financial regulation, for creating an efficient and competitive, but balanced, financial system, enhancing operating efficiency and ethical standards, and developing fair and healthy banking and financial practices.
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