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The World Bank

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Report No. 18783

PERFORMANCE AUDIT REPORT

UGANDA

PUBLIC ENTERPRISE PROJECT
(CREDIT 1962-UG)

January 7, 1999

Operations Evaluation Department

Currency Equivalents (as of June 1998)

Currency Unit = Uganda Shilling

1995	US$1.00	Ush 1,000 (1995)

Abbreviations and Acronyms

DDS	Divestiture Design Study
EDP	Enterprise Development Project
GDP	Gross Domestic Product
GOU	Government of Uganda
ICR	Implementation Completion Report
IDA	International Development Association
OED	Operations Evaluation Department
PE	Public Enterprise
PEP	Public Enterprise Project
PERDS	Public Enterprise Reform and Divestiture Statute
PES	Public Enterprise Secretariat
PIES	Public Industrial Enterprise Secretariat
SARAP	Sector Administration Reform and Planning Study
SCD	Statutory Corporations Division
UDC	Uganda Development Corporation

Fiscal Year

Government:	January 1 - December 31

Director General, Operations Evaluation:	Mr. Robert Picciotto
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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

January 7, 1999

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Review: ***Public Enterprise Project (Credit 1962-UG)***

Attached is the Performance Audit Report (PAR) for the Uganda, Public Enterprise Project (PEP, Credit 1962-UG for US$15 million equivalent, approved in FY1989). The credit closed on May 31, 1995, the original closing date. A balance of US$ 2.5 million was canceled. The PAR was prepared by the Operations Evaluation Department.

The PEP was designed to strengthen the Government's capacity to sustain economic recovery by increasing productivity and output and reducing financial losses in public enterprises (PEs). The specific objectives were to (a) define and implement reforms in the sector policy and legislative framework and strengthen sector administration and enterprise management; (b) prepare and initiate an overall program of rehabilitation and rationalization for all public enterprises, integrating ongoing programs; and (c) begin to implement a program of rehabilitation, restructuring, divestiture and liquidation of selected industrial parastatals.

PEP's objectives of preparing a comprehensive sector administration and planning study and a divestiture design study and enacting the Public Enterprise Reform and Divestiture Statute were achieved. For handling PE reform under the PEP, the Government of Uganda (GOU) set up an administrative structure for managing and coordinating reform in the Ministries of Finance and Industry and Technology and the Uganda Development Corporation. The PEP also saw the completion of 18 diagnostic studies and management audits.

While the objectives of establishing a policy and legislative framework for PE reform and of reducing PE losses were relevant to the country's strategy, the assumption that PE reform would be more cost effective than divestiture was flawed. As a consequence, the PEP design lacked a central focus and provided no clear guidelines for either privatization or restructuring. Moreover the administrative structure established for implementing the PEP was cumbersome and stymied project implementation from the start. The management audits conducted under the PEP of retained parastatals were of dubious value, and progress on actual restructuring and divestiture was slow. By May 1995, when the PEP closed, only 6 PEs had been liquidated and 26 PEs had been divested, while 61 PEs remained in the portfolio. The PEP did not succeed in eliminating GOU subsidies to PEs either: in 1994, total parastatal subsidies amounted to Ush 208 billion (US$ 212 million), representing about 50 percent of total government revenues or almost 5 percent of GDP. Given the poor progress of privatization, GOU restructured the entire program in February 1995.

The PAR agrees with the ICR in rating the project's outcome as unsatisfactory, institutional development as modest, and sustainability as unlikely. Bank performance is rated unsatisfactory in view of the flaws in project design and poor supervision. The main lessons from the evaluation are: (a) effective private sector development will generally result only from completed privatizations; restructuring and efforts to turn around PE managements are usually unsuccessful; (b) the specific macroeconomic goals of privatization must be clearly articulated; (c) issues of local ownership should not delay privatization; (d) close management of complex details is necessary to complete transactions in a timely fashion without serious setbacks; and (e) when government resources are constrained by lack of expertise or private sector experience, the use of outside consultants and advisors experienced in both transactions and the regional context is imperative.

Contents

This report was prepared by Jayati Datta-Mitra (Task Manager), assisted by James W. Wolf (Consultant). The project was audited in June 1998. Brigitte Wittel and Barbara Yale provided administrative support.

Preface

1. This is a Performance Audit Report (PAR) on the Public Enterprise Project (Credit 1962-UG) for the amount of SDR 11.70 million (US$15 million equivalent). The credit was approved in November 1988 and closed in May 1995.

2. The PAR is based on the Implementation Completion Report (ICR) prepared by the Africa Region (issued April 1996), the Memorandum and Recommendation of the President and the Staff Appraisal Report for the project, the legal documents, a summary of Board discussions, project files, related economic and sector work, and discussions with Bank staff at headquarters and the Resident mission. The PAR provides further insight into the project outcome and lessons learned from the Ugandan privatization experience, the overlaps between the PEP and the follow-on Enterprise Development Project (EDP), and the resulting problems and benefits. The audit also deals, in greater detail, with the policy and technical components of a successful privatization experience.

3. An OED mission visited Uganda in June 1998 and discussed the effectiveness of IDA's assistance with staff of the Privatization Unit in the Ugandan Ministry of Finance, other public sector officials, representatives of the business community, owners of former public sector enterprises privatized under the project, managers of existing public enterprises, staff of private commercial banks and the East African Development Bank, Members of Parliament, academics, and civil society representatives. Their kind cooperation is gratefully acknowledged.

4. No comments were received from the Borrower.

Ratings and Responsibilities

Performance Ratings

	Public Enterprise Project (Credit 1962-UG)
Outcome	Unsatisfactory
Sustainability	Unlikely
Institutional Development Impact	Modest
Bank Performance	Unsatisfactory

Key Project Responsibilities

	TM	*Division Chief*	*Director*
Appraisal	Ken Newcombe	Harold E. Wackman	Callisto E. Madavo
Midterm Review	Subhash C. Dhingra	Robert E. Hindle	Callisto E. Madavo
Completion	Stefano Migliorisi	Robert E. Hindle	Francis X. Colaco

ICR was prepared by: Gerard Byam

1. Background

1.1 When the National Resistance Movement came to power in Uganda in 1986, the new government inherited 129 parastatals employing about 45,000 workers. Public industrial enterprises formed the largest part of the parastatal sector, contributing more than half the value added and about 46 percent of the workforce in Uganda's modem industrial sector.[1] However, by 1986, Uganda's public sector was in shambles following years of political instability, physical destruction, and economic decline. Public enterprises (PEs) had suffered the loss or destruction of managerial and technical staff, markets, equipment, and property and records. They had also become a significant financial burden on the Government of Uganda (GOU); net financial transfers to parastatals during 1982-86 had amounted to about US$25 million, and the Uganda Commercial Bank had lent about US$74 million in foreign exchange to PEs.[2] Reducing the financial burden of PEs was therefore an overriding concern motivating PE reform.

1.2 The GOU and the Bank agreed on a two-fold strategy for resuscitating the public sector: rationalizing PEs through rehabilitation, divestiture and liquidation, focusing first on public industrial concerns; and restoring the government's essential functions and processes, starting with the Ministries of Finance and Planning and Economic Development. The Bank, at GOU's request, supported the strategy through the Public Enterprises Project (PEP).

1.3 In evaluating the PEP, it is important to bear in mind that the Bank's approach to PE reform has changed substantially over the last two decades.[3] In the early 1980s, governments relied on PEs to promote industrial growth and diversification, and the Bank stepped in with projects intended to reform and restructure PEs. Thus before FY85, only 8 percent of reform measures in Bank operations aimed at PE reform focused on privatization.[4] By the mid-1980s, when the lessons of British experience on privatization first began to be recognized in the development community, privatization began to emerge as an additional instrument of Bank assistance; thus, during FY1985-89, the share of privatization measures in Bank PE operations jumped to more than 16 percent. Privatization was therefore not entirely unknown in Bank operations when the PEP was initiated. However, it was only in the 1990s that the mixed results and questionable sustainability of restructuring programs led to a new recognition of the superiority of privatization over restructuring.

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1 Public enterprises were engaged in a wide range of industrial activities: agricultural processing (such as coffee, sugar, breweries, flour, and meat packing), cement, textiles, fuel oil processing, steel fabrications.

2 While the available Ugandan GDP, budget and exchange rate data for 1982-86 may be questionable (civil conflict was still ongoing during the Obote regime), transfers to parastatals appear to have amounted to about 8 percent of government revenues.

3 See Nicolas Mathieu, *Industrial Restructuring*, A World Bank Operations Evaluation Study. Washington D.C.: World Bank, 1996.

4 See World Bank, "World Bank Assistance to Privatization in Developing countries." Operations Evaluation Department. Report No. 13273. Washington D.C.: World Bank, August 19, 1994.

1.4 Two related projects were approved in the late 1980s and early 1990s to support and implement parastatal restructuring and divestiture in Uganda. The first -- the PEP -- for which IDA approved a credit of US$15 million on November 8, 1988, focused on both restructuring and divestiture, and its stated objectives combined both technical assistance (TA) and operational goals. The second, the Enterprise Development Project (EDP), which was approved by IDA on December 3, 1991 (well before the PEP closed on May 31, 1995), had similar objectives.[5] EDP was designed to finance implementation of the comprehensive PE reform plan drawn up under the PEP, based on the premise that completing PE divestiture would take longer than the time remaining under the PEP.[6] Hence there was considerable overlap between the PEP and EDP in content and duration (the PEP closed in May 1995, as scheduled, but with US$2.7 million of the loan amount canceled). This overlap was perhaps responsible for the belief among Bank staff associated with the two operations that PEP's primary role was to provide TA to help implement the privatization objectives of the follow-up project, the EDP. Nevertheless, this audit assesses the performance of the PEP in terms of its original objectives, recognizing that the significant overlaps between the two operations complicates the task of assessment. The Ugandan PE reform program began to focus in earnest on privatization following a reorganization and restructuring of the privatization program staff by GOU in 1994-95, shortly before the PEP closed.

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[5] EDP was approved in December 1991 to improve the operating environment for all Ugandan public and private enterprises, generate a supply response, and reduce budgetary deficits. EDP provided financial support and initially built on PEP's comprehensive plans for PE reform to implement enterprise restructuring and outright divestiture.

[6] See para. 3.22 of the EDP's *Staff Appraisal Report*.

2. Project Objectives and Design

Project Objectives

2.1 The broad objective of PEP, as stated in the *Staff Appraisal Report*, was to strengthen GOU capacity to sustain economic recovery by increasing productivity and output and reducing financial losses in the PE sector. The specific objectives of the PEP were to:

(a) define and implement reforms in the sector policy and legislative framework and strengthen sector administration and enterprise management;

(b) prepare and initiate an overall program of rehabilitation and rationalization for all public sector enterprises, integrating ongoing programs; and

(c) begin to implement a program of rehabilitation, restructuring, divestiture and liquidation of selected industrial parastatal enterprises.

While PEP's broad objective was very relevant to the country's (and Bank's) strategy for economic recovery, the project's specific objectives of rehabilitation and restructuring were misplaced (see paras. 4.2-4.3).

Project Design

2.2 *Strategy.* The initial premise of the PEP was that limited government resources had to be concentrated on those sections of the economy where there was no alternative to direct government support (e.g., infrastructure and essential services) and that, in the industrial sector, key PEs had to be helped to play a critical role in economic recovery by improving capacity utilization and generating a large supply response in the short run. The starting point of the PEP strategy was the recognition that macroeconomic stabilization policy, while necessary, was just not sufficient for successful rehabilitation and reform of the PE sector. The key deficiencies in the policy, operational and institutional environment of PEs needed to be systematically addressed as part of an action program for improved public sector administration and enterprise performance. PEP's design was intended to overcome the two principal constraints facing the PE program: the perceived lack of investment capital available from local Ugandan sources, particularly given the absence of a stock market or other mechanism for pooling resources; and the relative lack of qualified managerial talent for the program, a problem exacerbated by the flight of experienced managers during the Amin regime.

2.3 GOU's strategy for restructuring the PE portfolio was to liquidate or divest enterprises that were either moribund, dormant or unprofitable and to retain those that were either profitable or might conceivably become so. The *Staff Appraisal Report* records that of 88 enterprises identified by the government (at the time of appraisal) in the portfolio of the Ministry of Industry and Technology, the Uganda Development Corporation (UDC), and other Ministries and agencies, the government was initially disposed to retain 100 percent ownership in 32 PEs, to reduce ownership to no more than 51 percent in 34 and to completely divest or liquidate 22 PEs.[7] These PE numbers, however, changed every year as enterprises were split up, dissolved or even acquired during the PE reform process. Such changes make it difficult to compare lists of PEs and to gauge progress toward divestiture goals.

2.4 *Lending Instrument.* While Bank staff supervising PEP may have considered the project to be a technical assistance credit (see para. 1.4), this audit's view is that it cannot be considered to be a pure technical assistance operation as two of the project's objectives went beyond capacity building and called for the actual implementation of the sector policy and legislative reform program and of the program of restructuring and divestiture of selected industrial PEs. Moreover, insofar as technical assistance was an objective, this audit suggests, given the uncertain economic, technical and political conditions of the times, that a specifically "process"-oriented approach to technical assistance would have been more appropriate for the PEP, building in the neceassary flexibility and opportunities for stocktaking, learning, and possibly, for redesigning the project.

2.5 *Institutional Framework.* PEP provided for the preparation of a comprehensive Sector Administrative Reform and Planning Study (SARAP) and a Divestiture Design Study (DDS). These studies were to formulate GOU policy for government participation in commercially oriented enterprises; define institutional arrangements for efficient GOU administration of the PE sector; identify needed reforms in existing legal, wage and salary policies; and prepare a program of actions for rehabilitating, divesting and liquidating PEs.

2.6 The PEP identified the Statutory Corporations Division (SCD) in the Ministry of Finance as the focal point for managing the PEP and the SARAP, DDS and other diagnostic studies, for designing and implementing uniform accounting and reporting standards for PEs, and for monitoring and controlling their financial and operating performance. The Minister of Finance was to chair a Divestiture Implementation Committee to oversee and approve divestiture decisions during the implementation phase of the divestiture program.

2.7 PEP provided technical assistance to the Public Industrial Enterprise Secretariat (PIES) in the Ministry of Industry and Technology to assist in designing and implementing the restructuring and divestiture program for industrial parastatals. Specifically, PIES was to identify the most commercially promising industrial enterprises through management audits performed by outside consultants. To support these enterprises, PEP provided for management and technical assistance contracts, advisory services, full-time and short-term technical consultants, and equipment.

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[7] Over 40 PEs were left out of consideration because they were either defunct or of less importance. Moreover, PEs in the transportation and utilities sectors were initially not included under the PEP.

2.8 UDC, which was primarily responsible for promoting industrial sector development, also served as a holding company, responsible for overall daily management of the PE portfolio. UDC was initially responsible for 35 enterprises, but high priority was attached to reducing UDC's role as a holding company.[8] The PEP envisaged that half the UDC portfolio would be fully or partly divested and one-third would be liquidated. UDC was to be responsible for assisting the management audits of companies that were candidates for rehabilitation, overseeing their rehabilitation and overall performance improvements, and supervising the liquidation and divestiture arrangements for companies in its portfolio.

2.9 *Monitoring and Evaluation.* To ensure monitoring and evaluation of the project, PEP required SCD, PIES and UDC to submit, to IDA, quarterly reports on implementation progress and expenditure. The three GOU agencies were also to prepare work programs for each calendar year for review and discussion with IDA.

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[8] Thirty-five companies were shown to be under UDC supervision at the time of PEP appraisal. However, of these, 4 were effectively outside UDC jurisdiction, 9 were wound up or never went into production, another 2 were dormant. Hence there were only 20 real companies in the UDC portfolio.

3. Implementation

Institutional development

3.1 *The Policy and Legal Framework.* PEP's first objective--to define a comprehensive program of PE sector reform -- was achieved. Both the SARAP and DDS were completed in 1990 and used to formulate GOU policy for PE reform and an action plan for rehabilitation and divestiture. The policy for PE reform set out guidelines for divestiture and the basic principles for restructuring those PEs which were retained in the public sector. Among these restructuring policies, the most important was the introduction of a hard budget constraint.

3.2 In the area of legal reform, the institutional framework, policies and principles guiding the reform and divestiture program were codified in the Public Enterprise Reform and Divestiture Statute (PERDS), passed by Parliament in October 1993. The statute classified all PEs into five categories -- depending on whether PEs would be fully owned, majority owned, or minority owned by GOU; fully owned privately; or liquidated (see annex B, table 1).

3.3 *Administration and management of PEs.* The PEP's objective was to define and strengthen the roles of SCD and PIES and reduce the role of UDC as a holding company for industrial PEs. However, as the ICR points out, overall management of the PE sector remained weak throughout the life of the project, and the administrative structure grossly cumbersome (see para. 4.7).

3.4 Although SCD successfully managed the preparation and implementation of the SARAP, DDS, and other diagnostic studies, its substantive role in designing and implementing PE performance monitoring and controls and reviewing and approving requests for budgetary support to PEs was never clarified; procedures for allocating budgetary support to PEs were never well defined; and the division (severely understaffed to begin with) was never adequately strengthened during the project. In 1991, the Public Enterprise Reform and Divestiture Secretariat was created to coordinate the program and effectively usurped the role of SCD. This new body consisted of a coordinator and two secretariats: the Public Enterprise Secretariat (PES) became the focal point for developing and implementing PE reform policies and programs, and the Divestiture Secretariat (DS) became the focal point for the defining and implementing the divestiture program. Notwithstanding these changes, by end-January 1991, the five diagnostic studies required under the PEP Credit Agreement had also been completed (Bank of Uganda, Uganda Commercial Bank, the Banking Sector, Uganda Airlines, and SARAP).

3.5 PEP financed a UNIDO contract to strengthen PIES. By December 1990, PIES had supervised the completion of 8 management audits (including audits of two major companies: Lake Victoria Bottling and Nile Breweries). However, the effectiveness of PIES was impaired by the overlaps in its responsibilities with PES.[9]

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[9] The ICR also subscribes to this view. However, Bank staff supervising PEP point out that the roles of SCD (later PES), PIES and DS were well defined: PES was responsible for managing the reform program, PIES for designing and implementing the restructuring of industrial PEs, and DS for divestiture.

3.6 PEP also provided technical assistance to UDC to enable it to liquidate, merge or divest the companies in its portfolio. By 1995, this objective must have been substantially achieved as only 4 PEs remained in its portfolio by April 1996. However, it is unclear whether this achievement was at all related to the quality of technical assistance provided under the project. Interviewees indicated that the UDC portfolio was substantially transferred to the Ministry of Finance to reduce the monitoring fees charged by UDC and improve the quality of portfolio management.

Restructuring and Divestiture

3.7 Although the President's office was strongly committed to privatization and the DDS called for an "immediate and bold" move to show the world that Uganda was serious about private investment and foreign direct investment, progress on divestiture and PE reform was slow from the start. Bank staff accepted the reluctance of the line ministries to transfer the larger and more important PEs to private investors. In 1988 Bank staff accepted that "in the present circumstances of Uganda some form of planning and guidance of the economy will be inevitable."[10] The Bank thus acquiesced in assisting GOU to retain enterprises for "development objectives" and other "national reasons". In fact the supervision records suggest that Bank staff ignored the suggestions advanced by certain PEP consultants that a more transactions-oriented approach be followed with less emphasis on restructuring and support of unprofitable PEs. While understandable in the context of the historical experience with privatization (see para. 1.3), this shift in emphasis delayed the achievement of Uganda's privatization objectives.

3.8 In the first 18 months of PEP operations, the PEP staff worked on only five enterprises. During that time none of these were transferred to the private sector. The Borrower's effort was spent classifying enterprises and on legal and policy issues related to the return of formerly privately-owned enterprises to their original owners under the Departed Asians Property Custodian Board (DACB). Restructuring and reform efforts consisted largely of "caretaking" of the enterprises, with a significant amount of staff time spent dealing with the poor financial condition of the PEs and related labor and employment issues.

3.9 In December 1994, the Office of the President of Uganda called for a major reorganization and revitalization of the entire privatization program. The program and staffing changes were suspended for 6 months while personnel were recruited or promoted from within the program. A new Minister of State for Finance (Privatization) was appointed, and the Divestiture and Reform Implementation Committee (formerly the Divestiture Implementation Committee) was reorganized to focus on the divestiture of parastatals. New policies on transparency, objectivity, and the use of tenders focused on bid price were also put in place. This reorganization affected both the ongoing PEP and EDP programs. Shortly after the reorganization, the PEP was closed (May 1995) to avoid the continuing overlap with the ongoing EDP project.

[10] Divestiture Design Study.

4. Assessment of Outcome, Institutional Development and Sustainability

Project Outcome

4.1 Uganda brought three distinct advantages to the privatization program: a political will to privatize and divest public enterprises (led by the Office of the President); a number of working PEs in a range of industries; and sufficient financial assistance from the Bank (through the PEP) to attract qualified outside assistance. Nevertheless, the overall performance and outcome of the PEP was unsatisfactory. This assessment agrees with the ICR's assessment of project outcome (see annex C) and with its observation that the assessment of project outcome is complicated by PEP's overlap with EDP. The shortfalls in project preparation and implementation identified in the ICR are detailed below (paras. 4.5-4.7).

4.2 *Relevance of Objectives.* The PEP's major objectives were to foster economic recovery through effective and efficient PEs, to stop their operating losses, and to reduce the high level of government subsidies to them. Rehabilitation and reform of the most commercially promising and economically sound PEs became the government's primary goals because of the assumption that the lack of local capital and foreign investor interest would made actual divestiture difficult.

4.3 While the objective of reducing PE losses and government subsidies was relevant, the assumption that reform would be more cost effective than divestiture was essentially flawed. Without private sector management and incentives, rehabilitation (of both profitable and potentially profitable PEs) merely prolonged the history of enterprise losses. It was only after several years of continued government support of the loss-making PEs that GOU became impatient with the program's emphasis on enterprise restructuring.

4.4 *Project Design.* The overall PEP design lacked a central focus and provided no clear guidance to the Borrower for either restructuring or divestiture. The Bank appears to have expected that a broadly outlined privatization policy could be implemented quickly and easily by the Borrower. There was little recognition either that a "process" approach to project design would have been more appropriate given the country's relatively unsettled institutional environment in the late 1980s.[11] Moreover, little importance was attached to gaining support for privatization from line ministry bureaucracies or individual PE managers.

4.5 When designing the PEP, the Bank does not appear to have considered the broader macro-economic or sectoral impact of privatization. The selection of enterprises to be restructured took little account of the economic impact of the selected PEs on specific sectors or of the relative benefits to be gained from restructuring or divesting alternative PEs. The audit agrees with the ICR's observation that the selection of PEs for divestiture was arbitrary, bid and evaluation criteria were undefined, and no clear policies guided the reinvestment of divestiture proceeds in the parastatal sector. In fact, the absence of information on parastatals resulted in numerous disputes on the legal ownership of PEs following the completion of divestiture (see

[11] However, the ICR is of the view that the flexibility built into the PEP's design allowed the project to finance relevant and timely studies.

annex D, box 1). Moreover, the Bank's approach to PEs was to "rehabilitate first, not expecting any unemployment to result."[12] The ICR points out (and the audit agrees) that a clear strategy for addressing employee retrenchment, GOU assumption of parastatal debt, and the broadening of share ownership should have been an essential component of a public information campaign.

4.6 The failures of the PEP can also be characterized by the caution that the devil is in the details. The DDS and SARAP offered few specific guidelines on technical approaches to privatization or enterprise reform. Individual consultants were left to recommend any of a wide range of privatization approaches, including management contracts, public sales of shares, creation of a stock market, use of "turn around management" teams, and public tenders. The credit's strategy and design also overlooked critical policy sequencing issues. The result was a "case by case" approach to privatization, resulting in delays and duplicative preparatory work by consultants.

4.7 Finally, the institutional arrangements set in place for implementing PEP and for effecting inter-ministerial coordination, particularly between the Ministries of Finance and of Industry and Technology were so complex as to stymie project implementation from the start. The ICR rightly points to the absence of centralized responsibility for ownership and supervision of PEs.

4.8 To be fair, this evaluation of PEP outcomes needs to take account of best practices existing at the time. The Bank's privatization experience in other regions at that time may not have adequately prepared staff for the complexity and level of detail involved in a successful privatization program.[13] Nevertheless, it has to be recognized that the fundamental premise of the program -- that enterprise reform initiated by the public sector can match the economic improvements to be gained by a quick transfer to the private sector -- was fatally flawed. But even allowing for the disparity in best practice standards between the late 1980s and now, the project's performance in meeting its own objective, to "begin to implement a program of ....divestiture," was below par (see para. 4.10).[14]

4.9 *Efficacy.* The PEP's objective of setting out the institutional rules of the game for eventual reform and privatization was achieved: the SARAP and DDS were completed, and PERDS was enacted. In addition, the PEP saw the completion of 18 diagnostic studies and management audits, although the audits were of questionable value. Overall sector administration and management of PEs remained weak and uncoordinated throughout the life of the project, with the division of responsibilities between SCD (later PES) and PIES remaining undefined.[15]

4.10 Moreover, progress on the divestiture and rehabilitation objectives was not satisfactory. Fewer than 10 enterprises were privatized during the first five years following the inception of PEP. Though the pace of privatization picked up from 1994/95 (see annex B, table 2), the record indicates that, by May 1995, at the time the PEP credit closed, only 6 PEs had been liquidated or

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[12] In fact a "Redundancy Account" for systematically paying redundant workers was organized only under the EDP.

[13] See Kikeri, Sunita, John Nellis, and Mary Shirley, *Privatization: The Lessons of Experience*, A World Bank publication. Washington D.C.: World Bank, 1992, page 35.

[14] Bank staff associated with the PEP point out that once EDP was approved, it was assumed that PEP's divestiture objectives were to be met by EDP.

[15] Footnote 9 provides an alternative view.

struck off the register, 26 PEs had been divested, and 61 PEs remained to be disposed of.[16] PIES's failure to tender tranches of PEs grouped by industrial sector meant that a great opportunity was lost to significantly speed divestiture.

4.11 Finally, PEP did not succeed in eliminating GOU subsidies to PEs. In 1994, total subsidies to parastatals amounted to Ush 208 billion (about US $ 212 million), representing about 50 percent of total government revenues or almost 5 percent of GDP.[17]

4.12 *Efficiency.* Low efficiency of the PEP is evident from the fact that only 26 enterprises were divested by May 1995, while 61 remained to be disposed of (see annex B, table 2); moreover, a 1994 evaluation report noted that the time taken to complete a divestiture -- 759 days -- was very high. No indicators were developed by the PEP for judging reform efforts, despite the fact that, at appraisal, project goals had been set for the number of PEs to be divested and reformed. Moreover, several PE managers and the Privatization Unit staff indicated that the diagnostic studies and management audits were of relatively little help to either government officials or parastatals managements. Further, by any measure (total value of bids, average bid value, average number of bids per PE advertised), bids were declining substantially.

Institutional Development Impact

4.13 A significant positive achievement was the adoption of PERDS in September of 1993. Precise and brief, PERDS has given the Borrower a strong legal framework for its ongoing privatization under EDP.

4.14 Training programs carried out by the Borrower under PEP also had a positive institutional impact on the units involved in Ugandan privatization. Although staff left during reorganizations, several of the key staff with significant training have stayed with the privatization program for nearly a decade. Training was of both sufficient quantity and quality to have a positive impact on GOU's ability to assume ownership of the program. Still, it is important to note that, because privatization programs always come to an end, the long-term benefits of training to GOU institutions will be limited.

4.15 The audit's rating of modest institutional development impact substantially agrees with the ICR's rating of partial impact (see annex C); however, the ICR does not discuss this rating in any detail.

Project Sustainability

4.16 It is unlikely that the project as originally designed and implemented was sustainable. In the case of PEP, sustainability refers to the long term success of any actual divestitures, as well as continuation of the management reforms effected within the PEs. As discussed elsewhere, the initial objectives of the program were improperly focused on restructuring rather than on

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[16] By the end of December 1997, seventy-eight enterprises had been privatized and an additional 2 were privatized soon thereafter. Most of the privatized enterprises operate in the manufacturing, agriculture, finance, tourism, and trading sectors. Those 39 public enterprises remaining to be privatized as of July 1998 include some of the largest public enterprises, for example, in transportation and communications.

[17] The subsidy level was equivalent to roughly five times the expenditure on health and double the public sector wage and salary bill. The total includes all PEs (including those in transport and utilities, not included under PEP).

divesting parastatals, and too little attention was paid to the complex details of privatization techniques. As a result only a modest degree of divestiture was accomplished under PEP. Moreover, despite the Government's intention of imposing a hard budget constraint on public enterprises, there was little dent in the financial burden shouldered by GOU on account of PEs (see para. 4.11 and footnote 12).

4.17 By 1993-94, the possibility of the collapse of the project, and a reversal of any benefits gained, had become very real. With only 11 enterprises shifted to the private sector (see annex B, table 2), there was little demonstration effect visible to GOU leaders or the public. The overlap of PEP and EDP contributed significantly to the program's lack of focus and ineffectiveness. The fact that the GOU halted the program in 1994-95 for a major overhaul of the privatization program and a reorganization of the staff and the implementing unit is clear evidence of the Borrower's recognition of the lack of sustainability of the PEP. Since the program was reorganized, there has been much greater ownership of program objectives at all levels, and the pace of privatization has picked up and been maintained to date.

4.18 The audit's rating of unlikely sustainability agrees with the ICR's (see annex C). The ICR bases its judgments on the project's poor institutional arrangements, insufficient attention paid to broadening local ownership of the program (below the level of the Office of the President), misplaced emphasis on restructuring (relative to divestiture or liquidation), lack of success in reducing subsidies, and poor performance on divestiture. The audit agrees with all these judgments.

5. Bank and Borrower Performance

Bank Performance

5.1 The Bank's strategy under PEP was flawed. While the studies financed under the project were relevant to Uganda's overall reform program, the flaws in the strategy were the misplaced emphasis on restructuring as opposed to divestiture; the failure to evaluate the extent of support for privatization that existed in civil society and within the GOU bureaucracy (despite the fact that the risks posed by the lack of consensus had been recognized in the Memorandum of the President); and the complexity of the institutional arrangements that were devised to deal with the sharing of project responsibilities between the Ministries of Finance and Industry and Technology. This audit therefore concludes that Bank performance at identification, preparation and appraisal were unsatisfactory. This assessment agrees with the ICR's rating of Bank performance (see annex C).[18]

5.2 Project supervision by the Bank was also unsatisfactory. The audit agrees with the ICR that "weak (Bank) project management led to a blurring of the distinction between project amanagement and supervision," and the consequent "undermining of local ownership of the program." Supervision missions (5 were fielded in 6 years) were quick to suggest steps to improve project administration. Bank missions confined their attention to personnel and budget issues and did not push GOU to confront critical decisions regarding the fundamental purpose of the program.[19] Given the steep learning curves that both the GOU and the Bank were on, a more radical review of project objectives in 1990 (about midway into the project) might have been warranted. Moreover, the Bank appears to have mistaken legitimate concerns (raised by the Borrower) about the bureaucratic complexity of the program for lack of commitment to the goals of privatization.[20]

5.3 The Bank's assistance in consultant selection was also poor. A number of resident and short-term consultants had broad backgrounds in government administration and reform of parastatals, but did not have significant private sector experience. An inherent conflict existed between the culture and expertise of Bank staff and the need for experienced deal-makers with private sector experience in Africa. Consultants also tended to lack either transactions experience or familiarity with the African context.

5.4 While the overall budget was adequate, particular tasks were under-resourced. According to both Bank and Borrower staff, the Bank's procurement procedures and level of compensation in Africa were not able to attract the best qualified privatization consultants. Lack of experienced personnel led to unnecessary policy conflicts within GOU (e.g., closure of recently privatized enterprises for failure to pay back taxes owed prior to privatization), and specific errors in negotiations (see annex D, box 1).

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18 The ICR, which is in agreement with the audit on all these issues, emphasizes that the Bank shared responsibility with the Borrower for weaknesses in project design.

19 However, the Bank's broader policy dialogue with GOU may have contributed to the turnaround of the privatization program in 1995.

20 The Bank responded constructively only toward the end of the project, during the restructuring of EDP -- indeed in the last two years Bank staff have taken extraordinary steps to improve overall project supervision of EDP.

5.5 An important result of the failure to obtain advisors with private sector experience was that both the Bank and the Borrower failed to grasp that for PEs with a record of sustained financial losses, attempts to impose a hard budget constraint are not sufficient. Stronger medicine is needed -- a clear focus on what it takes to induce such enterprises to grow, change , and adapt, and to maintain, if not improve, market share; to do this requires private sector management and incentives. The Bank's attempts at restructuring and reform missed this essential point, resulting in the continuing loss of market value in the remaining PEs (see annex D box 2).

Borrower Performance

5.6 Borrower performance during the PEP is rated unsatisfactory: poor project preparation and implementation overwhelmed GOU's record of adequate covenant compliance.[21] This assessment differs from that in the ICR, which rates Borrower performance as satisfactory based on its judgment that project preparation by GOU was satisfactory (see annex C). The audit assesses project preparation as unsatisfactory given the complex institutional arrangements that were set up to handle privatization and the Borrower's failure to ensure commitment to privatization goals not merely at the highest levels of government but at all levels of GOU and PE management.

5.7 The audit and the ICR agree in their assessment of project implementation by the Borrower. Though covenant compliance by the Borrower was satisfactory, overall project implementation was poor and there was a lack of coordination between PIES, PES, and UDC. While political will in favor of privatization was clearly present in the upper echelons of GOU, bureaucratic confusion and poor communication in the trenches slowed the process of implementation. However, there was one redeeming feature of the Borrower's implementation record -- the Borrower's strong management of public and community relations, based on a creative program for communicating with local government agencies and the public in rural areas.

[21] However, the performance of the Borrower during the life of the overall privatization program improved considerably with the actions taken by GOU in 1994/95 to restructure the whole program and its institutional framework. The Borrower assumed clear ownership of the program at that time, and quality personnel were promoted to take charge of the successor program under EDP. Nonetheless some concerns remain. Management of the privatization process still continues to face serious problems today, as the work pace has intensified under EDP; good managers have been overstretched; and few incentives have been offered to increase the number of qualified Ugandan staff. The quality of experienced foreign advisers willing to reside permanently in Kampala has been limited. A more creative plan for incentives for foreign assistance (such as use of success fees or rotating short-term consultants) may alleviate some of these problems. Moreover, the Borrower needs to move from crisis control to building an effective management structure.

6. Lessons Learned

6.1 Two broad themes emerge from the experience of the Uganda PEP: only completed privatization transactions can contribute to effective private sector development, and the choice of privatization methods will determine the Government's ability to complete those transactions. Following are the lessons that emerge from these themes.

6.2 *Effective private sector development*[22] *will generally result only from completed privatization- -deals done.* Restructuring, reform, and efforts at "turning around" management of industrial PE's proved to be relatively ineffective in Uganda. An emphasis on restructuring, as opposed to divestiture, also fed the natural inclination of Government managers to retain enterprises within their portfolios and support continuing losses. The choice of privatization methods should be decided by a single objective: to move operating control of PEs quickly to the private sector.

6.3 *The specific goals of the privatization program must be clearly articulated.* Setting goals requires the balancing of government interests, e.g., foreign direct investment vs. local ownership; increased output and efficiency vs. labor redundancy; restitution of former claims vs. a speedy process, etc.[23] These and other macroeconomic considerations such as food security, energy needs, and unemployment should determine the priorities for PE divestiture.

6.4 *Lack of consensus on local ownership of assets should not delay privatization.* Uganda has avoided the delays inherent in voucher and coupon programs and has moved quickly to restore the former private sector owners of some key manufacturing enterprises. Recognizing the need for quick and early outside investment, GOU has not waited for the stock market to become fully operative to attract strategic investors, but at the same time has retained significant stock shares in some key enterprises for public flotation in the future. This balance of local and foreign ownership has given GOU the political will necessary to move forward with a positive program.

6.5 *Close management of complex details will be necessary to complete transactions in a timely fashion without serious setbacks.*[24] Implementing privatization is neither easy nor simple. Methodologies are complex, and negotiations with investors -- which are inevitable in any large program -- are messy.

6.6 *The use of outside consultants and advisors is imperative, when government resources are constrained by lack of expertise or private sector experience.* Government executives managing a large privatization program are usually unfamiliar with cross-border investments, financial analysis, negotiations or deal structuring. Deficiencies cannot generally be made up by short-term training in privatization techniques --consultants experienced both in transactions and the regional context are necessary.

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22 Measured by firm outputs, tax receipts, foreign direct investment, levels of local enterpreneurship, etc.

23 See Annex E for a discussion of the issues involved in privatization policies.

24 See Annex F for a more detailed list of lessons on privatization procedures.

Basic Data Sheet

PUBLIC ENTERPRISE PROJECT (CREDIT 1962-UG)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	19.3	14.2	73.6
Loan amount	15.0	12.5	83.4
Cofinancing	---	---	---
Cancellation	---	2.5	---
Date physical components completed	05/31/95	05/31/95	n.a.
Economic rate of return	n.a.	n.a.	n.a.

Note: "n.a." means "not applicable".

Cumulative Estimated and Actual Disbursements

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Appraisal estimate (US$M)	0.30	2.25	4.35	7.35	10.20	12.60	15.00
Actual (US$M)	0.53	3.69	6.97	8.02	9.84	11.48	12.52
Actual as % of appraisal	176.67	164.00	160.23	109.11	96.47	91.11	83.46
Date of final disbursement: August 15, 1997							

Project Dates

	Original	*Actual*
Initiating memorandum	n.a	03/27/88
Negotiations	09/88	09/20-23/98
Letters of Development Policy	not applicable	not applicable
Board approval	10/30/88	11/08/88
Signing	n.a.	12/02/88
Effectiveness	01/89	05/11/89
Closing date	05/31/95	05/31/95

Note: "n.a." means "not available".

Staff Inputs (staff weeks)

	Total
Preappraisal	10.6
Appraisal	12.4
Negotiations	7.7a
Supervision	127.2
Other	6.9b
Total	164.8

a) Spans period from negotiations to Board approval
b) Refers to completion activities

Mission Data

	Date (month/year)	No. of persons	Weeks in Field	Specializations represented	Performance Rating		Types of problems
					Implied Status	Devlop. Status	
Identification/Preparation	02/12/88 to 03/03/88	2	2.7				
Appraisal	05/05/88 to 05/16/88	3	1.2	Public Sector Management Specialist			
Supervision	10/22/89 to 11/14/89	2	2	Public Sector Management Specialist Senior Operations Officer	HS	HS	Lack of a Divestiture Implementation Committee and the delayed start up at UDC and MOIT
	11/21/90 to 12/07/90	2	3.4	Senior Industrial Specialist Public Enterprise Reform Specialist	S	HS	Problems encountered in integrating the UNIDO-implemented component (strengthening of PIES in the Ministry of Industry) with the other two components of PEP. (PES, in the Ministry of Finance; and UDC, in the Ministry of Industry)
	04/03-23/91	1	2.7	Public Enterprise Reform Specialist	S	S	Coordination and program approval mechanism have not operated (in a regular manner and oversight function requires more attention). Insufficient local funding of the project has had a negative impact on the ability of the agencies to carry out their task during the first month of 1991
	12/08/91 to 12/20/91	1	.7	PE Reform	S	HS	Insufficient Local Funding

	Date (month/year)	*No. of persons*	*Weeks in Field*	*Specializations represented*	*Performance Rating*		*Types of problems*
	06/04/93 to 06/16/93	5	2.9	Industrial Specialist	U	U	There has been substantial slippage in achieving agreed target (no liquidation, only three parastatals privatized, delay in PE reform), and backtracking in some cases. PERD has been without a substantial coordinator for 10 months. With the unclear responsibility for the project implementation, consequent to the PM becoming the Chairman of DRIC (formerly the Dirctive Implementation Committee) the project has been stalled. A Task Force, set up by the Ministry of Finance (MOFEP), suggested some changes to the project. There also appeared to be dilution of earlier political consensus on privatization/PE reform.

Other Project Data

Borrower/Executive Agency

FOLLOW-ON OPERATION Operation	Credit no.	Year of Approval	Amount (US$million)	Board date	Status	Purpose
Enterprise Development	2315-UG	1991	65.6	12/3/91	Ongoing Restructured in February 1995.	To improve the operating environment and generate a supply response for all enterprises

Annex B:

Table 1: Uganda Public Enterprises as Classified by the Privatization Law (PERD Statute)

Class	Description	1993	1997(a)
I	GOU retain 100 percent ownership	10	12
II	GOU retain majority ownership	17	7
III	GOU retain minority ownership	20	0
IV	PEs to be fully divested	43	78
V	PE s to be liquidated	17	17
Total		107	114

(a) PERD was amended May 16, 1997 to reflect the changes in targets for privatization
Source: Privatization Unit, Uganda Ministry of Finance

Table 2: Uganda: Number of Privatized Companies, 1988-1998

	Sold	Liquidated	Struck off register (a)	Total
1988 to 1992/93	3			3
1992/93	4			4
1993/94	4	1	5	10
1994/95	15			15
1995/96	19		1	20
1996/97	16	2	3	21
1997/98 (b)	20			20
Total	81	3	9	93

(a) PE s struck off register includes companies ceasing operations or facing lengthy legal impediments to divestiture.
(b) Anticipated.
Source: Privatization Unit, Uganda Ministry of Finance

Annex C:

PAR and ICR Ratings

	PAR	*ICR*
Outcome	Unsatisfactory	Unsatisfactory
Sustainability	Unlikely	Unlikely
Institutional Development	Modest	Partial
Bank Performance	Unsatisfactory	Unsatisfactory
Borrower Performance	Unsatisfactory	Satisfactory

Box 1

Case Study, Lake Victoria Bottling Company

The case of Lake Victoria Bottling Company, which after its privatization was engaged in a long legal dispute with minority shareholders, illustrates the difficulties which arise when quality advisory services are not provided. The original bottling company was nationalized in 1972. In 1986 the Government attempted to return it to the previous owners, but no one claimed ownership. In 1992, when the company was singled out as one of the first ones to be privatized, the government owned 98 percent, and 2 percent of the shares were owned by the public. The company was sold in 1992 for US$3.2 million, with the investor assuming liabilities of US$2.6 million. The most difficult and time-consuming matter in the privatization process was related to compensating the minority shareholders; this negotiation was only concluded in 1997, at significant cost to the GOU. An appropriate legal review at the time of the proposed sale would have identified the minority shareholders rights and formulated alternative approaches.

Box 2

Case Study, Uganda Coffee Marketing Board (UCMB)

Prior to the implementation of economic sector reforms, the Uganda Coffee Marketing Board retained monopoly authority for all foreign sales of Ugandan coffee. The UCMB operated a processing plant (sorting, washing and grading of raw beans) with capacity to process the entire national coffee output (approx. 240 million kgs/year). With market liberalization reforms in 1991 the monopoly authority was repealed, and the UCMB was made available for privatization. In 1991-92 the UCMB was corporatized, with regulatory authority (standards, crop improvements and some research) retained by the GOU. Machinery and assets with an estimated value of approximately US$36 million were then available for privatization. After several failed attempts at tendering and negotiations, UCMB was still on the list for privatization in mid-1998. By then UCMB's share of coffee processing had dropped to less than 6% of the total market, as private sector competitors had grown up. The market value of the enterprise fell accordingly. The Borrower believes that any earlier sale attempt would have been blocked by public resentment due to the perception of UCMB's strategic value as the "nation's processor" of coffee.

Lessons Learned: Privatization Policies

The PEP and EDP projects together have arrived at a relatively efficient policy for privatization. Some of these specific policy issues, which must be addressed in designing a privatization program, include:

(i) Objectives of Parastatal Reform and Privatization. Objectives of the reform and privatization program must be both clear and detailed. Broad economic impact should be considered. Tradeoffs will be required between increasing foreign direct investment, encouraging local ownership and entrepreneurship, mitigating labor dislocation and increasing efficiency. PEP and its design documents left the selection of such key objectives to the consultants to individual enterprise privatizations. This flaw has been remedied under EDP.

(ii) Valuations. Valuations of government-owned enterprises and assets should be set very low, if at all. The demand for high valuations is a practical political problem for local Government officials, as well as a straw-man for slowing the privatization process to achieve other political objectives.

(iii) Restitution. Restitution to previous owners and claim-holders must be addressed at the outset. Return of previously owned properties to Ugandan Asians has been a major component of the GOU's Program.

(iv) Land Reform. Land reform is a serious issue in Uganda, due to the overlapping complexity of earlier tribal claims, treaties, and later confiscation of property by the Amin regime. PEP did not address these issues in its conception or design.

(v) Labor Issues. Labor issues, fairness for workers with longer histories, options for equity participation and treatment of displaced workers must be addressed. Early supervision of the program by the Bank appears to have ignored this issue.

(vi) Sectoral Impact and Sequencing. Sequencing of industrial sectors (including agriculture and food processing as a separate sector) must be addressed in planning privatization. **This was noticeably absent from the DDS and follow-on planning efforts.**

(vii) Timing and Expectations. Completing smaller, less sensitive transactions early in the process should not be taken as a failure to address the important issues. Early experience helps train staff, work through systems and procedures, and refine the legal issues both in legislation and in the courts. Larger industrial PEs, infrastructure projects and major monopolies can be better handled following this preliminary experience. **In this respect EDP is now reaping the benefits of the earlier efforts under PEP to privatize industrial PEs.**

(viii) Public Support and Transparency. A strong public information program is important to supporting the political will to privatize. This program in Uganda was important with the public and influencers of public opinion, including MPs and other political leadership.

(ix) Donor Program Coordination. There is a strong need to coordinate with other donor agencies, particularly on sectoral reform and in setting divestiture targets. **The lack of sectoral planning and the absence of a coordinated planning process hampered GOU, particularly in the agri-business sector.**

Lessons Learned: Privatization Procedures

Uganda's "trial and error" development of privatization has refined a set of workable procedures primarily using international and local tenders, as well as public auctions for smaller objects.

The Borrower considers the entire offer of a prospective investor, looking to factors such as business plan, labor employment, and future investments, as well as purchase price. While there are valid arguments that such a subjective review may invite bad behaviors, GOU has taken steps to avoid direct conflicts of interest. Under EDP the Privatization Unit has developed a plan for "second round" or "best and final" bidding from a pool of short-listed bidders. This permits the Divestiture and Restructuring Implementation Committee (formerly the Divestiture Implementation Committee) and GOU to screen investors on such issues as employment or financial stability, while ensuring that the final choice is made on clear and objective standards.

Specific technical components of a successful privatization program will include:

i) Use of public tenders seeking competitive bids from prospective investors. **This has been the centerpiece of the GOU privatization program.**

ii) Standardized tender conditions, with flexibility to pre-qualify bidders where considerations such as business plans are important.

iii) Standardized purchase and sale contracts, drafted in advance by the Borrower and made transparent to prospective investors as well as public. **Lack of standardized contracts led to early GOU failures in both negotiations and investor performance.**

iv) Detailed privatization procedures, including rules for tendering, qualification of bidders, and priorities for judging bids.

v) Where possible, offering of a majority (greater than 50%) of the voting shares. Ideally, the Borrower should seek to divest 100% of the shares or assets.

vi) A program to seek a strategic investor, defined as a buyer with previous experience in the relevant industrial sector and specific market niche. Such a strategic partner brings capital, management experience and access to wider markets.

vii) Broadest possible international advertising of the tender, where foreign interest may be present. Similarly, the widest local publicity and advertising promotes a transparent process.

viii) Strongly enforceable bid bonds (irrevocable and cashable on first sight). **The EDP program continues to rely on the use of performance bids in 1998.**

ix) Strong enforcement mechanisms incorporated into contracts with investors.

x) Use of larger investment banks only in cases requiring assistance with issues of industry regulation or complex financial assessment of the enterprise (e.g., utilities, financial sector institutions).

xi) Regular use of outside consultants for assistance with legal issues, preparation of due diligence memoranda, and contract negotiations.

xii) Minimal preparation of information by the Government; leaving due diligence to the prospective investors.

xiii) No advance restructuring of operations or assets, except in rare cases of proven positive return on the Borrower's investment in the costs of reform and continued operation of the parastatal.