Post-Privatization Assistance
When Is It Justified and How Can the World Bank Help?

Syed A. Mahmood
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INTRODUCTION

"It does not follow that whenever laissez faire falls short, government intervention is expedient; since the inevitable drawbacks of the latter may, in any particular case, be worse than the short-comings of private enterprise."

—Henry Sidgwick, British economist, 1887

For nearly a decade, the World Bank has worked with countries throughout Central and Eastern Europe (CEE), the Former Soviet Union (FSU), and the developing world to privatize state-owned enterprises. Many transition countries have moved beyond the initial stages of privatization and are now confronting obstacles that undermine the vitality of their newly privatized enterprises. Problems faced by enterprises after privatization, and the spill-over effects of those problems on the rest of the economy, have become a matter of concern. This is true not only in countries that have had substantial privatization but also in those where privatization has been slow. In the latter group, one of the factors holding back policymakers is fear of the post-privatization problems and inadequate knowledge on how to deal with them. These post-privatization problems discourage policymakers (especially in those countries that have privatized more slowly) from accelerating the pace of reform of state-owned enterprises (SOEs). This paper discusses typical post-privatization problems, the conditions under which governments can address them, and how the World Bank can help in this effort.

There is an understanding that post-privatization problems are critical and need to be addressed. But who should address these problems, and in what manner? Should governments provide post-privatization assistance? Should the World Bank be involved? There is no consensus on these issues and there is a long-standing debate regarding the World Bank's role in post-privatization assistance issues. Irrespective of the lack of consensus, the World Bank is already involved in providing post-privatization assistance. Should the assistance continue? This paper will attempt to clarify and advance the debate; to identify conditions under which post-privatization assistance may be justified; and then describe a set of lending products designed to provide such assistance.

In this paper, the author argues that lending products may be justified only under fairly restrictive conditions; in most cases, policy and regulatory reforms, not firm-level interventions, are the recommended course of action. Although this paper has an ECA focus, the analytic framework developed here could be applied to other regions.

1 This paper has benefited considerably from work by Simeon Djankov and comments by John Nellis and Bernard Drum.
DETERMINANTS OF ENTERPRISE RESTRUCTURING

There are three sets of factors that determine whether enterprises restructure and how well they restructure: signals, managerial attitudes and skills, and the enabling environment. Any one of these sets of factors cannot individually induce enterprise restructuring. For example, trade liberalization and increased competition in product markets should give strong signals that restructuring is necessary. However, effective restructuring may not follow if any one of these is true: (1) enterprises enjoy soft budget constraints (managers may prefer to spend time lobbying for government support, rather than design and implement restructuring); (2) managers do not have the right skills to restructure their enterprises; (3) managers have the incentives and skills to restructure but are limited by other factors (such as lack of financing or government restrictions on sale of assets).

Both the proponents and the opponents of publicly provided post-privatization assistance (PPA) believe that certain core policy changes, such as those establishing macroeconomic stability, private property, and hard budget constraints are necessary for restructuring. The issue is whether these are sufficient. Opponents of government-provided post-privatization assistance claim that these core policy changes are sufficient to induce restructuring, either on their own or when complemented by additional policy and regulatory reforms. Proponents of post-privatization assistance are skeptical that policy reforms would be effective, sufficient, or timely.

Deciding on PPA: Dual Criteria

Given these conflicting views, how does a government decide whether it should provide post-privatization assistance and, if so, in what manner? The framework below will help to answer this question; essentially, post-privatization assistance may be justified if both these conditions are satisfied:

- the market will not provide the required goods and services at any feasible price, and
- enterprises will make effective use of the post-privatization assistance provided.

This dual criteria—the existence of market failure and the ability to make good use of the resources—implies four possible scenarios. In only one scenario is post-privatization assistance justified (see table below).

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Will enterprises be able to make effective use of post-privatization assistance?</th>
</tr>
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<tbody>
<tr>
<td>Scenario A</td>
<td>YES</td>
</tr>
<tr>
<td>Scenario B</td>
<td>NO</td>
</tr>
<tr>
<td>Scenario C</td>
<td>YES</td>
</tr>
<tr>
<td>Scenario D</td>
<td>NO</td>
</tr>
</tbody>
</table>

In Scenario A, enterprises are capable of making effective use of post-privatization assistance. However such assistance is not required since the market provides the goods and services needed for restructuring, such as capital equipment, financing, and consultancy services. In Scenario B, enterprises are not capable of using post-privatization assistance effectively. However, this is a moot point because here also markets are developed and provide the goods and services required for restructuring, thus precluding any need for publicly provided PPA.
Scenarios C and D represent situations where there is market failure, i.e., markets do not provide all the goods and services required to design and implement restructuring. This would suggest a need for government provision of post-privatization assistance. However, such provision would be justified in only one of the cases, Scenario C, where the enterprises are capable of making good use of post-privatization assistance. In Scenario D, although the market failures may suggest a need for such assistance, it will not be effective as enterprises are likely to waste the resources.

To decide whether to provide post-privatization assistance, governments must identify which case best represents the situation in their country or sector. The next two sections provide guidelines for such decision-making.

Policy and Regulatory Reforms

Other than macroeconomic stability, factors that provide strong signals to enterprise managers are: strong owners capable of exercising corporate governance, competitive markets, and hard budget constraints. Both theory and empirical evidence suggest that all three elements need to be present simultaneously if the signals are to be strong.

Privatization Privatization signals the need for restructuring. It leads to a clearer definition of property rights and increases the likelihood of enhanced corporate governance by establishing owners with a long-term stake in the enterprise (Shleifer and Vishny 1994, 1997). When an enterprise requires restructuring, private owners have every incentive to signal managers to take the necessary actions. Privatization can lead away from the typical state-enterprise scenario of low efficiency, excess labor, high wages, and the accumulation of losses. For example, a study of many privatized and state-owned enterprises in seven Central and Eastern European countries found that, on average, privatized firms have higher total factor productivity growth, have reduced their labor forces by 20% more than comparable state-owned enterprises (SOEs), and have ceased to receive direct government subsidies (Pohl et al. 1997). A comprehensive study of the Russian privatization program (using data from 439 state and private manufacturing firms) also found strong evidence that private ownership has a positive impact on several measures of enterprise performance (Earle and Estrin 1997).

Such improvements in performance are not universal, however. A recent study of Georgia, based on four case studies and a survey of 92 manufacturing firms over the 1991–1997 period, found that despite privatization and an improved macroeconomic environment, enterprises suffered significant reductions in output and loss of export markets. Most of the restructuring that took place was “reactive” in nature, such as labor shedding and the exit from unprofitable markets, rather than pro-active, such as development of new markets and renovation (Djankov and Kreacic 1998). In contrast to a number of Central European examples, privatization in these Georgian firms was not associated with extensive and successful restructuring. An ongoing World Bank study of enterprise restructuring covering 960 privatized manufacturing enterprises in six transitional countries including Georgia (the others are Kazakhstan, Kyrgyz Republic, Moldova, Russia, and Ukraine) finds that the extent of restructuring varies significantly among privatized firms (Djankov 1998).

It is clear that privatization does not always lead to improved performance; even if does, it is not clear that the full potential for improvement is realized. Several factors may explain this:

- privatization does not necessarily lead to improved corporate governance;

2. Other studies that found a positive impact of privatization on enterprise efficiency include Galal et al. (1994), Megginson et al. (1994), and La Porta and López-de-Silanes (1997).
other signals are present that dilute managerial incentives to restructure;
managers lack the skills to restructure;
the enabling environment does not allow managers to carry out restructuring even if they possess the incentive and skills to do so.

INSIDER OWNERSHIP AND POOR CORPORATE GOVERNANCE In many enterprises in transitional economies, privatization has not led to new owners focussed on the long-run performance and viability of the enterprise. This is the result of the sale or transfer of large chunks of enterprise shares to insiders, especially top managers, accompanied by poor tradability of shares. Empirical studies in several countries indicate that such entrenched insider ownership has had a negative impact on enterprise restructuring. A study of Russian enterprises finds that inside owners are less likely to restructure, have more difficulty attracting outside capital, and shed less excess labor (Earle and Estrin 1997). A cross-country study based on enterprise surveys from the Czech Republic, Hungary, Poland, and Russia found that restructuring was more likely to occur when enterprises were sold to outsiders (Carlin et al. 1995) than when there was a management buy-out. Frydman et al. found that while managers who became owners performed better than SOEs, their performance was lower than new “outside” owners. They also found that the performance of worker-owned firms was difficult to distinguish from that of SOEs (Frydman et al. 1997). Studies in Georgia and Slovakia have found that when incumbent managers received free equity holdings, they usually attached little value to these and had little incentive to bring about changes in the enterprise’s traditional way of doing business. Managers have also often used the voting power associated with such share-holding to entrench themselves and prevent other share-holders from ousting them (survey findings by Simeon Djankov).

In the hierarchy of new private owners, the best restructurers are investors coming from outside the firm, and the worst are workers in the firm. The firm’s managers are somewhere in between; some studies indicate they are moderately to quite successful restructuring agents, while a number of others conclude that managers/owners carry out the restructuring task poorly.3

PRODUCT MARKET COMPETITION The theory is that competition in the product market should induce restructuring. Competition disciplines enterprises; it also enables them to learn from competitors and improve their performance. Empirical evidence on the impact of competition is mixed, however. A recent study of Russian manufacturing firms in the period 1992–1994 found a positive correlation between import competition and several enterprise adjustment indicators, such as labor productivity, total lay-offs and new product lines (Earle and Estrin 1997). A study of Polish industries in the period 1991–1993 found the total factor productivity (TFP) growth to be positively associated with import penetration ratios (Falk et al. 1996). A contrary finding emerged from a study of Bulgarian manufacturing firms. This study used a large panel data set covering the period 1991–1996 and found that import competition had no significant effect on productivity growth (Djankov and Hoekman 1996).

Studies on the effects of market concentration also produce contradictory results. Two of the three studies quoted above found that market structure matters. The study of Bulgarian firms found that sectors that had large number of entries, either through spin-offs from existing companies or through startups, experienced increased firm-productivity. In

3 In market economies, equity incentives to managers have been used as a device to align the interests of owners and managers, and to solve the principle-agent problem. Empirical studies in several market economies have found that, up to a point, there is a positive relationship between stock holding by top managers and corporate performance and market valuation (see survey in Shleifer and Vishny 1997).
Poland also, sectors with low concentration ratios experienced faster TFP growth. However, the study of Russian firms did not find an impact of domestic market structure on firm performance.

**Soft Budget Constraints** Why didn’t import competition induce enterprise restructuring in Bulgaria as it did in other countries? The answer seems to lie in the softness of the budget constraints that enterprises faced—successful lobbying for credits by Bulgarian enterprises diluted the impact of competition (Djankov and Hoekman 1996). When managers enjoy soft budget constraints, they often prefer to spend more time lobbying the government for support than undertaking painful restructuring measures. On the other hand, as a recent World Bank report on transitional economies states, “Enterprises subjected to financial discipline show more aggressive collection of receivables, a closer link between profitability and investment, and a reorientation of goals from output targets to profits” (World Bank 1996, p. 45).

This evidence suggests that strong corporate governance, hard budget constraints, and product market competition are complementary to each other. The absence of any one weakens signals to enterprise managers and dilutes their incentives to restructure.

Those who believe in the efficacy of policy reforms normally suggest an array of reforms to strengthen corporate governance, harden budget constraints, and intensify competition. Examples of policy reform that strengthen corporate governance include the development of capital markets, especially secondary markets, the removal of obstacles to trading of shares, and the removal of restrictions on foreign ownership. Amendments to the bankruptcy law to strengthen the position of creditors (by providing a wider range of options than just liquidation) may also provide the necessary impetus by facilitating out-of-court, creditor-led restructuring. According to this school, reforms such as these—and not pro-active government provision or financing of post-privatization assistance—is the answer to weak corporate governance. When corporate governance is weak, enterprise managers have little incentive to carry out effective restructuring, and might see no reason to go to the market to obtain the goods and services required for restructuring, even if such a market existed. In such a situation, provision of post-privatization assistance by the government may be a waste of resources because, in the absence of strong corporate governance, enterprise managers may not make efficient use of the assistance. In terms of Table 1, this is an example of Scenario B or D.

Policy steps to harden budget constraints include elimination of soft credit from the banking system or the budget, elimination of budgetary subsidies except for well-defined activities where subsidies are set in advance and not negotiable ex-post, and allowing no build-up of arrears to the government and the banking system. Measures to intensify product market competition include liberalization of trade and removal of barriers to entry in the domestic market.

Proponents of post-privatization assistance argue that, under certain conditions, these steps may not be effective or sufficient. For example, some question the efficacy of trade liberalization in promoting import competition in some countries. In many central and eastern European countries, the geographic proximity to Western Europe has led to considerable competition from imported goods and services following trade liberalization. But the potential for trade liberalization to promote competition in the ex-Soviet Union countries is somewhat more limited. Their markets are less contestable given their peripheral location (history and geography do matter). Hence, the disciplining effect of trade liberalization on enterprises will be relatively less, and one would have to rely more on other elements of policy and institutional change to induce enterprise restructuring.
Managerial Incentives and Skills

Transitional economies have few people with the skills to manage firms in a market economy. This is particularly true for the former Soviet Union; the old system did not encourage the development of market economy skills and attitudes in managers. First, managers lacked self-initiative and entrepreneurial spirit; in fact, they were discouraged from taking matters in their own hands except in day-to-day technical areas. Second, they were not trained to be responsible for the quality of production because all production was centrally distributed. Third, the vertical managerial structure eliminated the room for teamwork. Finally, the emphasis was always put on the supply side, or, how much the firm could produce, not how much could be sold. This explains why, in Moldovan enterprises (Kreacie 1996), managers do not shed labor and divest underutilized machinery; they believe that these factors of production make it possible to produce more, even though the final product market has collapsed. Under state ownership, the major criterion for selection of top managers was their ability to lobby politicians for subsidies and other forms of assistance, rather than their strategic leadership qualities.

Some argue that equity incentives to existing managers will not be very effective in inducing enterprise restructuring in transitional economies; what is required is the infusion of new human capital, including changes in top managers (Rosen 1992). A study for the Czech Republic provides evidence for this hypothesis (Claessens and Djankov 1998). The study, covering a cross-section of 706 Czech firms over the 1993–1997 period, looked at the effects of management changes and the use of equity incentives on firm performance and market valuation. The study found that several measures of enterprise performance are positively related to the entry of new managers, particularly if those managers were selected by private owners rather than the government. Equity holdings by the managers, on the other hand, appear to have no effect on corporate performance.

A study of 452 privatized Russian shops found that privatization led to the selection of more efficient managers and that the presence of both new owners and new managers enhanced the possibility of restructuring. This same study found that equity incentives for old managers did not make much difference (Barberis et al. 1996). Another study found that Slovak firms with changes in top management performed better than firms that retained old managers (Djankov and Pohl 1997). There is also evidence that management changes in individual firms may have spill-over effects. In some small former Soviet Union countries, where top management turnover is uncommon, even the few changes in top management may have a positive effect on enterprise restructuring by signaling to other managers that their jobs depend on performance. This could induce incumbent managers to take restructuring measures in order to ensure their positions.

These findings suggest that if there is a supply of new managers with appropriate skills, privatization is likely to lead to better enterprise restructuring. However, this is a resource many transitional economies lack. In Slovakia, for example, the study found that although all general managers were removed from office in 1990–1992, many managers retained a position in another firm (in some instances also as new owners) by 1996, even though they had not acquired any new skills (Djankov and Pohl 1997).

The situation is worse in many FSU countries. These countries did not experience an exodus of young people, as in other parts of the region (1956 for Hungary or 1968 for Czechoslovakia), some of whom are now returning as skilled managers with work experience in Western firms. In Georgia, for example, there are few trained managers that have worked or studied abroad. To make matters worse, many managers of Russian origin left Georgia during the 1992–1994 civil war, shrinking the pool of human capital. In Moldova, the ambitious and enterprising young
people were encouraged to join the central administration or party apparatus in Moscow; the best students also enrolled in Moscow universities. Following independence, a few of them returned to Moldova but the majority stayed back in Russia.

It has thus been suggested that, in small FSU countries such as Georgia and Moldova, which lack a large pool of potential new managers, the payoff to manager training may be quite high. Empirical evidence from Moldova supports this view. A recent study of 192 Moldovan enterprises shows significant returns from manager training (Djankov et al. 1997). Surveys have found that training in marketing and sales is considered first priority by most managers with accounting training; secondly, the experience of working in firms abroad has been cited as very useful for managers (Djankov 1998).

The Enabling Environment

Even when managers have the incentive and skills to carry out restructuring, they may be constrained by the environment in which their enterprises operate. Some of the factors that constrain enterprise restructuring, especially in the transitional economies, are discussed below.

Residual Government Controls Many privatized enterprises are subject to a wide array of government restrictions (including those imposed by local governments), which constrain managers' ability to implement restructuring. These include restrictions on exports, requirements to maintain the existing line of business, restrictions on sales of assets, entry of new businesses, transfer of social assets to municipalities, and the hiring and firing of workers. Even where outright restrictions are not in place, government policies may effectively restrict managerial discretion. For example, high taxes on the proceeds of asset sales may discourage enterprises from selling assets.

Unpredictable and Poorly Administered Government Policies Deficiencies in tax policies and tax administration have been cited in enterprise surveys as a major constraint on restructuring. Frequently changing tax rates, arbitrary interpretations of tax rules and excessive visits by tax authorities are the factors commonly cited as creating uncertainty, raising the cost of doing business and discouraging restructuring. In general, poorly enforced and constantly changing rules and regulations are cited as major constraints.

Lack of Information Another set of constraints on restructuring is the lack of legal and economic information, including market studies and company diagnostics. Inadequate knowledge of existing laws and their interpretation prevents enterprises from implementing appropriate restructuring decisions and has often made them vulnerable to the whims of government officials. Market studies may be viewed as investments in an "informational infrastructure," which serves all investors, domestic and foreign, and may thus qualify as public goods. The lack of information, the prohibitively high cost of obtaining it, or the asymmetric nature of information available to different market participants, is the most frequently cited "market failure" in this problem set.

Lack of Support Institutions In many countries, support institutions such as the consulting, accounting, and auditing industries are underdeveloped and usually just serve larger clients with the ability to pay. In many countries, smaller clients, like SMEs, find it difficult to pay and/or have access to this information; some larger firms also encounter such problems.

Lack of Financing Lack of financing is a major aspect of the enabling environment that prevents enterprise managers from carrying out restructuring even if they had the incentives and skills to do so.
Banks often do not have the capacity to manage restructuring risk. This results in excessive risk-averse behavior, which leads to inadequate supplies of credit to credit-worthy enterprises. Lending is mostly to a few well-known clients, and credit decisions are often based on the quality of collateral, rather than project quality. The financing problems are exacerbated in some countries by a poor supply of foreign investment. This means that enterprises are not only deprived of financing but also of technical know-how. Another reason why bank financing to enterprises may be limited is the high yields of government T-bills encourage banks to invest in these assets rather than in riskier loans to enterprises.
SHOULD GOVERNMENTS PROVIDE OR FINANCE POST-PRIVATIZATION ASSISTANCE?

It is important to understand that altering a few core policy areas to promote corporate governance, harden budget constraints, and liberalize and remove barriers to trade can only induce so much restructuring. However, this does not establish a rationale for government-provided post-privatization assistance.

In many countries, statistics do not offer a complete picture of enterprise sector operations. Enterprises sometimes hesitate to divulge information or they underplay increases in revenues or profits for fear of attracting the attention of tax authorities. In other words, existing statistics may paint an overly pessimistic picture and exaggerate the need for government intervention to induce restructuring. Hence, one of the first things a government needs to do is to rigorously analyze what is going on in the enterprise sector and verify if there is indeed a lack of restructuring.

Scope for Further Policy Changes

Once it is established that restructuring is indeed inadequate, the government needs to assess whether the problem can be resolved through further policy, legal, and regulatory reforms. These additional reforms may enhance the effectiveness of previous reforms which, by themselves, may not have been enough to induce sufficient response from the enterprise sector. Examples of such “second-order” reforms are:

- If lack of credit is a constraint, measures to revise laws to establish collateral or remove biases against foreign investment may be appropriate;
- If generous returns to risk-free government securities are crowding out private borrowers, policy measures to reduce yields on T-bills and make the T-bill market more competitive (so that intermediation fees on T-bills are low and not a major source of income for banks) may be appropriate;
- If obstacles to liquidation hold up enterprise reform, improvements in the legal framework

4 It must be noted that these are illustrative examples of policy, legal, or regulatory measures that may address particular constraints. These do not represent the full range of policy, legal, or regulatory options, nor do they present the best response to these constraints in all circumstances.

BOX 1

A Checklist of Issues

Before a government decides to provide post-privatization assistance, they should check that certain conditions have been satisfied. The following is a partial checklist of such conditions:

- Does a potential client base exist that will use the post-privatization services?
- Is there an identified group of enterprises that can take full advantage of the benefits of post-privatization, including the demonstration effect on other enterprises?
- Do enterprises have the capacity to implement post-privatization assistance?
- Will the post-privatization assistance unit be immune from political influences and will resources be allocated according to efficiency rather than political criteria?
- Will it be possible to close down the post-privatization unit after its work is done, or will there be pressures to make this a permanent agency?
for collateral, bankruptcy, and liquidation of large SOEs may be appropriate so that their assets can be freed up for use by smaller enterprises;

- If policy uncertainty is discouraging enterprise restructuring, making policy formulation more transparent and consistent, widely publicizing changes in policies, rules, and regulations and reducing the scope for discretionary interpretation of rules may be appropriate;

- If inadequate corporate governance is an issue, legal and regulatory changes that allow the establishment of intermediaries such as “privatization investment funds (PIFs)” may be appropriate;

- If asymmetric information is a constraint, public disclosure of policy or regulatory measures would be appropriate.

**Institutional PPA**

Proponents of post-privatization assistance argue that additional policy, legal, or regulatory reforms are not often sufficient or expedient to have the desired effects. They argue for more pro-active measures that build institutions in the public or private sectors. For example:

- *If lack of credit is a problem, institutional development (such as improving the risk-management capacity of banks, developing financial institutions that can attract foreign capital and build up the infrastructure for collateral registration and repossession), may be required to complement the policy, legal, and regulatory changes;*

- *Measures to improve the legal framework for collateral and bankruptcy may need to be balanced by measures to improve judicial administration such as training and equipment for courts, notaries and bankruptcy administration;*

- *If intermediaries, such as privatization investment funds (PIFs) are considered necessary to improve corporate governance, policies or laws that allow the establishment and operation of such funds may not be sufficient; these might need to be balanced by the institutional development of the PIFs;*

- *Policy or regulatory changes that call for better disclosure of enterprise information, especially financial statements, may not be effective in the absence of a developed accounting and auditing profession; hence, such policy/regulatory measures need to be complemented by institutional development that strengthens a country’s accounting and auditing professions;*

- *Even if enterprises have all the incentive to seek out consultancy services, they may be handicapped if the consultancy industry itself is not developed; hence, an argument may exist for institutional support to help develop a country’s consultancy industry.*

It is not strictly correct to call this list “institutional post-privatization assistance” measures because they impact all kinds of enterprises, privatized or newly formed in the private sector. However, in many countries, these might address some of the most important constraints impeding performance of privatized enterprises and hence may qualify as post-privatization assistance measures. Indeed, according to many who do not support the idea of firm-level interventions by government, these are the only acceptable forms of post-privatization assistance.
Government Failures in Providing Firm-level Assistance

If it is clear that inadequate enterprise response to policy, legal, and regulatory reforms cannot be addressed by institutional development initiatives, a case might exist for providing firm-level assistance, such as credit lines, subsidized provision of business advisory services, and managerial training. However, before deciding to provide such assistance, governments should heed the caution by Sidgwick more than a century ago (see page 1) and carefully weigh the costs of potential “government failure” against that of market failure. Government failure will reduce effectiveness of any resources devoted to firm-level assistance, and may even compromise other efforts at reforming enterprises. In order to be assured that government failures will not be a problem, governments need to address the following issues:

Government capacity to administer the assistance program Does the government have the capacity to administer firm-level assistance programs? Do they have the skills required to choose the right enterprises to be supported, help them develop restructuring plans, and identify the right consultants? Governments in most countries are overstretched—they often do not have the administrative or technical capacity for the basic functions they should be discharging, such as law enforcement, health care, and education. Can they afford to divert scarce resources to manage an assistance program? Even if they could, do they have a comparative advantage in helping private enterprises adapt to the market? If government does not have the capacity to provide assistance on its own, it may provide only financing and delegate the service delivery to other agents, such as banks (e.g., in the case of credit lines) or special agencies created to deliver privatization assistance and managed by private consultants. Would such an agency be able to carry out their activities independently without government interference?

Enterprise capacity and incentives Effective use of post-privatization assistance depends on whether the recipients of assistance have the capacity and incentives to properly use them. The pertinent questions are:

- Do the enterprises have incentives to be efficient? That is do they operate under hard budget constraints, are subject to competition, and have adequate corporate governance?
- Do they have the skills to absorb the assistance?
- Are there restrictions on managerial discretion, that will prevent them from implementing the plans?

If enterprises do not have the right incentives and skills to make good use of post-privatization assistance, the resources will not only be wasted but the program may generate moral hazards. For example, if lack of good governance, disclosure, and transparency are the real reasons some enterprises are not getting credit, the provision of subsidized credit will give the wrong signals; the subsidized credit will reduce incentives to introduce good governance, encourage firms to spend more time on lobbying for post-privatization assistance rather than on efficiency-enhancing measures, and generally dilute the effect of reforms.

The costs of the program Will the costs of the program justify the benefits? The costs to be considered are not only the supervision costs and cost of the
subsidies; they are also any contingent liabilities for
the government, such as those arising from govern-
ment-guaranteed credit lines. Choosing enterprises
with a strong demonstration effect could be one way
of making the program cost-effective; another way
could be to choose programs that offer services to
groups, rather than individual firms. A related issue is
whether there will be adequate demand for the ser-
dvices, especially if enterprises are asked to bear part
of the costs.

PPA Projects: Possible Models

It is clear that the apparent absence of restructuring
in privatized firms should not immediately lead a gov-
ernment to provide firm-level post-privatization assis-
tance. Such assistance could be seen as a “measure of
last resort” to be provided only when other options,
such as policy, legal, and regulatory reforms and institu-
tional development have been exhausted. The fol-
lowing description of possible “models” of post-priva-
tization assistance should thus be evaluated with the
above caveat in mind. These models are based on
actual post-privatization assistance projects, including
those supported by the World Bank Group. The mod-
els are not mutually exclusive; various combinations
are possible and have, in fact, been tried in many pro-
jcts.

Model 1 (Help Desk, Initial Diagnosis and
Immediate Action Plans) In this model, the post-
privatization assistance unit (PPA) provides a narrow
range of services including help desks and initial diag-
nosis of enterprise conditions. The diagnosis may
include financial audits (to establish a reliable set of
economic and financial data), and social and environ-
mental audits (to establish the degree and severity of
both social obligations and environmental liabilities).
The initial diagnosis may indicate the need for more
in-depth work, such as drawing up restructuring
plans or business plans, establishing or improving dif-
ferent systems such as MIS, quality control systems,
marketing departments, etc. Such work will be car-
rried out by consultants (expatriate and/or local) who
will be hired by the enterprise from the market. The
PPA unit itself will not provide or finance these ser-
dvices but may help enterprises locate and select the
consultants and draft terms of reference for them.

In a variation of this model, the PPA unit would
help enterprises prepare immediate action plans but
not long-term restructuring plans or business plans.
The PPA unit may provide this service in-house or
contract outside consultants to do the job. In terms of
financing these services, the PPA unit may pay 100% of
the costs of all consultants, in-house or external or
it may share the costs with the enterprise.

An example of this model is Consulta, a post-priva-
tization assistance unit in Lithuania, supported by
the World Bank (through the Lithuania: Enterprise
and Financial Sector Assistance Project) and EC-
Phare. Consulta funded a portion of consultants' fees
for follow-up assistance (80% of foreign consulting
costs and 60% of local consultant costs). Having ful-
filled its original mandate, Consulta is now in the
process of being privatized.

Model 2 (Model 1 plus subsidization of long-term
consultancy/advisory services) Model 2 provides
all of the services of Model 1 plus subsidization of the
long-run consultancy/advisory services. Per Model 1,
the initial diagnosis of an enterprise may suggest the
need for more in-depth work. These may include
drawing up restructuring or business plans, establish-
ing/improving operational systems, such as manage-
ment information systems, accounting systems, qual-
ity control systems, marketing infrastructures, etc.

There are two possible variations of this model.
In one variant, all or most of the consultancy will be
provided in-house by the PPA unit. Expatriate and
some of the local consultants will be housed in the
PPA unit along with the full-time staff of the unit.
Teams will be formed to work on the enterprises. The
PPA unit may subsidize all the costs of the consultants, at least those who are in-house, or may require the enterprises to share the costs.

In the other variant, no consultants will be housed in the PPA unit, except perhaps some technical advisors. The PPA staff will procure consultancy services from the outside. As in the first variant, there is likely to be a cost-sharing arrangement with the enterprises. The difference between Model 2 and Model 1 is that in Model 2, the unit will procure the services for the enterprises.

An example of this model is the Polish Business Advisory Service (PBAS) established by the IFC and co-sponsored by the EBRD. Between 1991 and 1996, the PBAS provided finance and advisory services. It prepared business plans, investment proposals, and market strategies, and gave operational support and training to management. PBAS has now completed its projected five-year program; its consultant training program will be maintained under a new Polish foundation (created to serve the small and medium enterprises sector) and its field offices will be privatized.

**Model 3 (Building up local consulting industry)** In Model 3, the primary goal is to build a local consulting industry. Model 3 is an example of institutional PPA, which should be distinguished from enterprise-specific PPA (although this includes enterprise-level support also).

Selected individual consultants as well as consulting firms will be grouped (perhaps according to specialization) and matched with long and short-term expatriate consultants who will act as mentors. During an apprenticeship period, these teams of local consultants will receive formal instruction as well as on-the-job training from the mentors as they develop business plans and provide implementation assistance to enterprises. The group will also develop standard approaches that can be used in other enterprises.

An example of this model is USAID's Local Consultancy Capacity Building Project in Moldova, which uses enterprise cases as a training ground for local consultants.

**Model 4 (Training of enterprise managers)** Model 4 trains enterprise managers. This training could be split between pre-placement training and on-the-job training. Pre-placement training will impart some basic skills and test the suitability of managers for further training. Managers will get basic exposure to foreign languages required for business, learn basic computer skills and management training. Hundreds of managers could be given such training.

On-the-job training would take place abroad. Managers who satisfy certain criteria, such as successfully completing the pre-placement training, will work in a foreign enterprise (or enterprises) for periods of up to six months to be exposed to western enterprise and managerial behavior. Enterprises will pay 100% of the costs of pre-placement training and share the costs of the foreign on-the-job training.

An example of this model is the World Bank's Second Private Sector Development Project for Moldova, which envisions training of up to 2000 managers over the life of the project.

**Model 5 (Arranging finance)** In Model 5, the PPA unit helps enterprises obtain financing for investment and working capital. It may also help enterprises prepare business plans and investment proposals, do financial review, and help search for partners. Enterprise-specific teams may be formed, which consist of industry specialists (possibly expatriate), local consultants, and full-time staff of the PPA unit. Enterprises will pay fees, some up-front and others on delivery of the expected output, including success fees if financing is successfully arranged.

An example of this model is the Polish Business Advisory Service (PBAS) described in Model 2.

**Model 6 (Line of Credit)** In Model 6, a line of credit funded by multiple donors as well as the host
government would be used to restructure privatized enterprises. The line of credit would be channeled through an Apex unit to participating financial institutions that would provide sub-loans to eligible enterprises. Eligibility criteria would be determined for both participating financial institutions as well as the enterprises receiving loans.

An example of this is the World Bank’s Enterprise and Financial Sector Assistance Project for Lithuania.
CONCLUSION

This paper raises several questions about the use of post-privatization assistance to address issues of restructuring in transition economies. Many countries in these regions currently face obstacles that undermine the vitality of their newly privatized enterprises; in addition, the spill-over effect could potentially threaten their economies as a whole. Although there is a consensus about the severity of the problem, the debate over post-privatization assistance as a solution is still in process.

The determinants of enterprise restructuring depend on the existence of these three variables:

- *policy and regulatory reform*,
- *managerial incentives and skills*, and
- *the enabling environment*.

The interplay between the variables determines whether enterprises restructure effectively. It is this same interplay that underlies the debate on the value of post-privatization assistance. Opponents of post-privatization assistance argue that policy reforms to strengthen corporate governance, harden budget constraints, and intensify competition should be sufficient. Proponents of post-privatization assistance agree that policy changes are crucial and necessary, but disagree that those policy changes would be sufficient to catalyze and maintain restructuring changes in their economies.

Governments are cautioned to carefully analyze the condition of their economies to assess whether post-privatization assistance is absolutely necessary for growth and whether the PPA resources would be effectively utilized. Post-privatization assistance should be viewed as a “last resort” and provided only when other options such as policy reforms and institutional development have been exhausted. If post-privatization assistance is deemed appropriate, this paper offers six different models supported by the World Bank. These models have been successfully used in different parts of the ECA region.
REFERENCES


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