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

For nearly a decade, the World Bank has worked with countries throughout Central and Eastern Europe, the Former Soviet Union (FSU) and the developing world to privatize state-owned enterprises. Many transition economies have moved beyond the initial stages of privatization and are now confronting obstacles that undermine their newly privatized enterprises. These post-privatization problems discourage policymakers, especially in those countries that have privatized more slowly, from accelerating the reform of state-owned enterprises (SOEs). In this newsletter, we discuss typical post-privatization problems, the conditions under which governments can address them, and how the World Bank can help in this effort.

The Determinants of Success in Enterprise Restructuring

Privatization is often a catalyst for enterprise restructuring. It leads to a clearer definition of property rights and increases the likelihood of improved corporate governance by establishing owners with a long-term stake in the company. Several empirical studies have confirmed that privatized enterprises are more likely to restructure (or take other steps to improve performance) than enterprises that remain in the public sector. However, such improvements in performance are not universal. There are several factors that can influence the effect of privatization on restructuring:

Ownership. Several studies have found that when insiders (e.g., management) control the newly privatized enterprises they often do not restructure, and performance does not improve. Further, equity incentives do not appear to induce entrenched managers to restructure.

Product Market Competition. The theory is that competition in the marketplace is likely to induce restructuring (allowing managers to learn from competitors and forcing them to make tough decisions). However, the empirical evidence is mixed.

Hard Budget Constraints. When managers face hard budget constraints, they are forced to execute painful restructuring measures or close down. When budget constraints are soft, managers often find it easier to lobby the government for subsidies than to make difficult choices.

Poor Managerial Skills. The lack of managerial skills has limited the enterprise restructuring in many transition economies. This appears to be especially true in the FSU where the old system was not conducive to the development of market skills and attitudes. In small FSU countries, such as Moldova and Georgia, there is apparently a serious lack of potential new managers.
The Enabling Environment

It is important to note that even when skilled managers have all of the correct incentives, they might be constrained by the environment in which they operate. These are some of the environmental factors that might prevent managers from restructuring:

Residual Government Controls Many privatized enterprises are subject to a wide array of government restrictions, including restrictions on exports, the hiring and firing of workers, and the sales of assets.

Unpredictable and poorly administered government policies Frequently changing tax rates, arbitrary enforcement of tax rules, and harassment by tax authorities raise the cost of doing business and discourage restructuring. In general, managers complain more about inconsistent enforcement and changing rules and regulations than they do about high tax rates.

Lack of Information Inadequate legal and economic information prevents enterprises from restructuring and leaves them at the mercy of government officials.

Lack of Support Institutions Support institutions (e.g., consulting, accounting and auditing firms) are often underdeveloped. Small and medium enterprises (SMEs), in particular, find it difficult to gain access to these institutions.

Lack of Financing Capital market failures often make it difficult for enterprise managers to gain access to the funds that they need to restructure. This can be exacerbated by a poor supply of foreign investment and high yields on government T-bills that crowd out private investment.

Despite the complexity of the issues, both the proponents and the opponents of publicly-provided post-privatization assistance agree 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 alone are sufficient.
Post-Privatization Assistance

When the conditions that justify post-privatization assistance are satisfied, governments may decide on the particular type of post-privatization assistance that is most appropriate. The following is a description of various methods based on actual post-privatization assistance (PPA) projects supported by the World Bank. The models are not mutually exclusive; various combinations are possible and have been implemented.

**Model 1** In this model, the PPA unit provides a narrow range of services including help desks and an initial diagnosis of enterprise conditions. The diagnosis may include financial audits (to establish a reliable set of economic and financial data), and social and environmental audits (to establish degree and severity of both social obligations and environmental liabilities). In a variation of this model, the PPA unit would help enterprises prepare immediate action plans, but not long-term business plans; the PPA unit may provide this service in-house or they may cover some portion of the costs and contract outside consultants to do the work.

**Model 2** In addition to the services mentioned in Model 1, the PPA unit may subsidize long-run consultancy or advisory services including restructuring, business plans, or implementing operational systems (e.g., management information systems or accounting systems). The consultancy could be provided either in-house by the PPA unit or procured from outside.

**Model 3** In this third model, selected individual consultants as well as consulting firms will be 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 and on-the-job training as they work together to develop business plans and provide implementation assistance to enterprises.

**Model 4** This model involves pre-placement training or on-the-job training for enterprise managers. Pre-placement training will teach some basic business skills and test the suitability of managers for further training. Managers who satisfy certain criteria could also be exposed to western enterprise and managerial behavior in on-the-job training in Western firms. Enterprises could pay the full cost of pre-placement training and share the cost of the foreign, on-the-job training.

**Model 5** In this model, the PPA unit helps enterprises obtain finance for investment and working capital. Enterprise-specific teams may be formed, consisting of industry specialists, local consultants, and full-time staff of the PPA unit. In this model, the finance is obtained from commercial sources.

**Model 6** Lines of credit could be channeled through an Apex unit to participating financial institutions that provide sub-loans. Eligibility criteria will be determined for both participating financial institutions as well as enterprises receiving loans. Lines of credit could be funded by multiple donors and the host government, and used to restructure privatized enterprises.

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Conclusion

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 the fear of the post-privatization problems and how to deal with them. Thus, 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? 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.

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