

Firm in Transition

Topic 4
Privatization

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Stylized Facts

Problems of massive privatization

Based on Boycko, Schleifer, Vishny

Means of Large privatization:

- Mass privatization
 - Design of a special scheme - how??
- Conventional way
 - Sales
 - Auctions
 - Public offerings
 - Investment tenders
 - Direct sale (non-competitive methods)

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**Mass privatization:
Alternative to Classical Method**

- Features
 - * Allocation of assets to population is free
 - * High fraction of national economy is covered
 - * Require less preparation => Fast method
- Forms
 - * Grant shares to insiders
 - workers
 - managers
 - * Distribution of vouchers to whole population
 - * Direct allocation

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**Mass privatization:
Alternative to Classical Method**

- Objectives
 - * Be private
 - No political control
 - No subsidies
 - * Efficient users
 - Should be new owners
 - * Corporate governance
 - control and monitor managers
 - restructuring
 - * Fast transfer
 - * Added later: Institutional setup
 - legal system and framework

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Mass privatization

- Political feasibility
 - Populist program
 - To get wide support
 - Reducing efficiency
 - Trade efficiency for support

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Auctions

- Auctions
 - Most efficient
 - Bidders cannot raise capital?
 - High value users can make alliance with:
 - Bank
 - foreign partner
 - Governance would be achieved

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Mass privatization

- All stakes in state hands
- Private wealth is low
 - Chile, Mexico, UK
 - Private wealth
 - a few hundreds of firms only
- Low wealth =>
 - Low proceedings because of low price
 - But this is not problem
 - Proceedings ARE NOT the (main) objective
 - Uneven distribution of wealth favoring “old guys”
 - Large segment has to benefit
 - scheme such that wealth is not limiting

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Efficiency

- Speed
 - Sales are slow
 - Sales can be manipulated...
- Incumbent have to be taken into account
 - Low influence
 - CZ, SK, HU
 - High influence
 - FSU
- Dispersed ownership
 - politicized governance of firms

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Voucher Schemes

Similarities

- Mutual funds
- Allow managers to acquire stake
- Stimulate investments by outsiders
 - CZ: Outsiders can make proposals
 - SU: Investment tenders - indirect way via tradable vouchers - this allows to get large blocks
- PL: Direct allocation to funds
 - Problem: Lobbying for subsidies
 - Advantage: Corporate governance, legal framework

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Design of Voucher Schemes

- Denomination
 - Points
 - Currency
- Points
 - Clearly not currency, less money-like
 - Control of M supply
 - Risk of high discount in trading
- Currency
 - like security, clear promise of give-away
 - stronger commitment to irreversibility
 - Compare CZ and SK
 - Technical benefits

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Design of Voucher Scheme -cont.

- Tradability
 - Tradable
 - Non-tradable
- Non-tradability
 - Vouchers are MECHANISM, not securities
 - Speculative excess of vouchers
 - High discounting
- Tradability
 - Cash right-away
 - improve opportunities of large investors
 - development of financial markets

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Voucher Exchange

- How to exchange vouchers for shares?
 - Voucher auctions
- Auctions are
 - + efficient
 - + produce market valuation
 - + No bureaucrats to assign value
 - No corruption or price manipulation
 - + Less corruption in general
 - + **Choice which shares to select**
 - Everybody can select

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Voucher Auctions

- Requirements
 - Simple
 - Millions of people can take part in
 - Everybody should succeed in getting shares
 - Small investors do not end up paying more than institutional investors
- Centralized Auction Advantage (CZ)
 - + All shares gone
 - + no room for lobbying & price manipulation
 - + efficiency of auction

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Auction Design

- Real Auctions
 - # of shares at maximum price
- Problems
 - Small investors do not know how to value
- Solution
 - just divide (shares) equally among bidders
 - Extremely simple
 - always get something
 - pay the same price
 - Drawback: extremely noisy price

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Privatization - Practical Issues

- Poland
 - Lipton & Sachs, Winiiecki
- New, fast, method is needed, taking into account:
- workers
 - population
 - banks
 - pension funds
 - mutual funds
 - Political problems
 - Only public sales used
 - Limited size of mass privatization (400 firms)
 - through financial intermediaries
 - Every citizen got the same portfolio

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Privatization - Practical Issues

- East Germany
 - Collin & Mayer
- Treuhand:
- break large enterprises
 - smaller units are easier to sell
 - initial labor adjustment
 - mergers & acquisitions were used
 - liquidation & bankruptcy to protect creditors
- Advantage
- Presence of West Germany...

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Full Portfolio of Privatization Strategies

- Restitution
 - Small scale
 - Auctions - whole enterprise or rent
 - Large scale - Mass
 - voucher scheme
 - direct sale ^F
 - auctions ^F
 - investment tenders ^F
 - Free transfer
 - municipalities
 - public institutions
- (F) = Foreign investors participation
Joint-ventures, take-over, (newly established enterprise)

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Conclusions

Later, in the discussion on the success of the reform...

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