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MID-TERM EVALUATION OF THE USAID FUNDED ZAMBIA PRIVATIZATION PROJECT

Final Report

U.S. Agency for International Development

Prepared for: USAID/Zambia

Prepared by: SRI International, Inc.

Sponsored by: Private Enterprise Development Support Project III
Contract No. PCE-0026-Q-00-3031-00
Delivery Order No. 23
Prime Contractor: Coopers & Lybrand, LLP

March 1996

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PREFACE

The purpose of this document is to provide a mid-term evaluation of the USAID funded Zambia Privatization Support Project. The overall intent is that this evaluation will provide USAID, ZPA, and CFED with an objective and rational basis for making decisions about future privatization program and project priorities.

The evaluation project was undertaken by Peter Boone of SRI and Peter Carr, Consultant to SRI under this project. The authors would like to thank USAID/Zambia, ZPA, CFED, and all other individuals, companies and government officials in Zambia who contributed to this report. The findings and recommendations, however, as well as any errors and omissions, are solely the responsibility of the evaluation team.

EXECUTIVE SUMMARY

PRINCIPAL FINDINGS

Following a slow start in 1993-94, not uncommon for privatization programs of this kind, the Privatization Support Project is now on track to achieve (and exceed) all of the substantial goals and objectives set forth in the Project Paper and Contractor Agreement. The GRZ, USAID, the ZPA, CFED, and the major sub-contractors should all be credited with very strong performance to date. This highly favorable overall performance is particularly noteworthy, given the serious initial constraints the project faced including: ZPA and CFED personnel turnover at the senior levels, political constraints (ZIMCO), the initial ZPA Board indecisiveness, and serious overall logistical constraints - telephone, fax, other operational support problems.

If the project maintains current momentum, the evaluation team believes it could become one of USAID's most successful private sector initiatives in Africa in recent years and the ZPA privatization program could serve as a model for the African continent.

Transactions Progress

As of end-September 1995, 31 companies had been privatized (sales agreements concluded) under the ZPA program compared with overall life-of-project target of 50-75. From the start of the CFED contract (February 1994) through end of September 1995, sales agreements have been concluded for 22 companies compared with a target of 50 for the life of CFED's contract. In addition, six companies were dissolved or liquidated between 1993 and September 1995. As of October 1995, privatization sales had raised some $26 million in proceeds for GRZ.

Given the current pace of privatization, the evaluation team believes the ZPA is on course to exceed the target set in the Project Paper of privatizing 50-75 companies during the life of the project. These forecasts for transactions to be completed are based on the following:

- The large numbers of companies in the "transaction pipeline" (68 companies had started, but not yet concluded, negotiations in October 1995);

- ZPA staff have improved and tightened procedures considerably over the past two years (valuation, advertising, board submissions and approvals, negotiations);

- Training and skills development in negotiations have improved the quality of negotiations and as a result, negotiations time is dropping (from 2 months - 2 years to as little as 1 day);

- Overall momentum for privatization has been built and there are no major barriers in sight for privatizing the remaining 145 or so companies in ZPA's divestiture sequence plan.

Marketing and Promotion

The ZPA marketing and promotion activities undertaken, with significant input from the CFED team, have correctly focused on a two pronged approach:

- General Investment Promotion (country); and
- Individual Company Marketing.

Although the original budget is considered highly inadequate, the following achievements were recorded:

1. Country marketing:

- A special supplement in Fortune Magazine: 750 enquiries
- Zambia survey in the Financial Times
- Advertisements in Business Strategy International
- A ZPA marketing brochure
- Government Ministers, ZPA executives and advisors attended the following international investment promotion conferences:

- Sub-Saharan Investment Opportunities Conference (London)
- World Economic Forum (Johannesburg)
- Southern Africa Investment Summit (Johannesburg)
- Southern Africa Development Corporation (Johannesburg)
- Made in the USA Trade and Investment Forum (Johannesburg)
- Emerging Markets CEO Round Table (New York)

- Thirty Investor Group Presentations
- Organization of Investment Opportunities Conference (Lusaka) sponsored by Financial Times for 1996

2. **Company-Specific Marketing Activities**:

- Print advertising for over 75 companies in local, regional, and international markets
- Country-wide marketing campaign for Chilanga Cement flotation
- Over 100 company marketing profiles
- Visits to investors
- Direct mail campaign
- Successful solicitation of funds ($350,000) from the World Bank for advertisements costs

It is the opinion of the evaluation team that the marketing and promotional activities have been professional, cost-effective and have generated direct buyer interest

Public Awareness/Education

ZPA's public awareness program has been a key factor in "selling the privatization program" to Zambian citizens. Informing the public about privatization objectives and strategies was particularly crucial during the early stages of the privatization program. The following activities contributed substantially to the success of the privatization public awareness campaign:

- World Bank-funded radio programs;
- Information brochures in seven regional languages and English;
- ZPA marketing brochure has been widely distributed;

- A two-phase television, radio, and print media advertising campaign;
- Essay competition;
- Public forums on privatization; and
- Other public awareness educational tools such as radio and television talk shows.

Training/Institutional Development

There has been significant interaction and on the job skills transfer between the CFED advisors and Zambian counterparts at the ZPA. The evaluation team considers that "on-the-job" training has been an important contribution of the CFED contractor team. This on-the-job training has related to the entire "transactions chain" including:

- valuation methodologies and assessments;
- cash-flow analysis and NPV;
- business plans development and assessments;
- advertising and promotion of companies;
- ZPA Board submissions and presentations;
- scoring and ranking of bids; and
- transactions negotiations.

In terms of more formal training the following activities have taken place under the project:

- Negotiations skills workshop training by Ostrer and Associates -- highly effective in teaching directly applicable negotiating skills that resulted in faster negotiations with clearer objectives.

- CFED training program -- sharpened privatization and transactions skills of ZPA staff.

Key ZPA staff and other Zambian officials directly involved in privatization also benefited from third country training under the Privatization Support Project including:

- International Law Institute: courses in legal aspects of privatization and capital markets development

KEY FACTORS IN PROJECT SUCCESS TO DATE

It is the assessment of the evaluation team that there are a number of factors which have been key in project success to date. Many of these factors have acted as "turning points" in the successful implementation of the privatization program. Without some of these issues resolved, the project would not have been so successful and or could have even stalled as a complete failure. The principal success "drivers" to date include:

Support for Privatization Process

✔ Strong support for privatization at the highest political level including the Minister of Finance and the Minister of Commerce and Industry.

✔ Unwavering support of privatization from key donors such as USAID, World Bank, and other donors.

✔ Liquidation of ZIMCO, the holding company for many of the parastatals. Until its liquidation, it was emerging as an obstacle to the privatization process. USAID and the World Bank played a key role in convincing the government to liquidate ZIMCO, and also to proceed with other key steps such as the ZCCM privatization.

Institutional Factors

✔ Recruitment of top level Chief Executive, following a world-wide search.

✔ Strong commitment and technical strength of CFED advisors, who have been willing to assist local staff, but also have been ready to "roll up their sleeves" to get the job done.

✔ Highly effective training course in negotiations skills delivered by Ostrer and Associates to a solid cadre of independent negotiators. The approach taken emphasizes greater flexibility through a "total value package technique," and negotiating time has been reduced substantially as a result of the training course.

Legal/Regulatory Framework

✔ Sufficient legal framework for privatization (Privatization Act).

✔ Centralized, independent privatization agency and Board of Directors with significant decision making authority.

✔ Transparent divestiture process (valuation as benchmark for price, competitive bidding, clear scoring criteria and ranking process, independent negotiators, public announcement of winning bid and reasons).

✔ Linkage of privatization to other macroeconomic and regulatory reforms including:

- Foreign Investment Act
- Repeal of foreign exchange controls
- Stock Exchange Act
- Banking and Financial Services Act
- Companies Act

Implementation Factors

✔ The establishment of ambitious and specific targets and the emphasis on transaction results.

✔ Professional marketing, public relations, and educational campaign.

✔ Broad base of Zambian support through local stakeholder participation in various steps such as privatization studies, valuation, negotiations and legal assistance, share ownership, etc.

✔ Greater openness to foreign investment than in the past.

PRIVATIZATION POLICY AREAS REQUIRING FURTHER ATTENTION

While the evaluation team is of the opinion that the Privatization Support Project is on track to reach its principal objectives, there are a few critical privatization policy issues which require further attention to ensure that the program remains on track and is not undermined.

Minimizing Asset Stripping

Asset stripping prior to conclusion of sales agreement is becoming a serious problem in Zambia, leading to:

- substantially lower sales price;
- protracted negotiations with buyers and sometimes re-valuations of companies; and
- a serious burden on ZPA staff time.

In order to overcome the problem, the evaluation team suggests that a number of "carrot and stick" measures be introduced to minimize this problem.

On the "stick" side, in cases where the threat of asset stripping by existing management becomes evident, the evaluation team recommends that the Directorate of State Enterprises, in collaboration with the ZPA, move swiftly to appoint administrators to manage company assets until the privatization transaction is completed. The Directorate of State Enterprises and the ZPA could also move quickly to appoint replacement Board members to help monitor the SOEs' balance sheets during the transition period until the sale agreement is signed. ZACCI has offered to assist in the balance sheet monitoring by offering a list of experienced business people who are willing to sit on SOE Boards during the transition period.

Since the experience to date with the "stick" approach to the problem has not been very satisfactory, it may also be necessary to combine the above measures with some "carrot" approaches to the same problem. On the "carrot" side, ZPA may want to consider some simple, positive financial incentives to existing SOE managers to protect the balance sheet prior to sale. One simple financial incentive that ZPA could reward existing managers and employees with is shares in the privatized companies through partial MBOs or ESOPs, on the condition that those managers maintain or improve the balance sheet of the SOE prior to sale.

This approach is already being implemented on an informal basis; for example the managers of National Breweries are being rewarded for good management practices with a minority share holding in the privatized company. This type of incentive package would need to be negotiated by the ZPA with potential buyers as part of the negotiations process on a selective basis, and could not be mandated as an across-the-board policy.

Cleaning Up Enterprise Liabilities

One of the biggest risks to the successful implementation of Zambia's privatization program is the threat of large unsettled liabilities which will make it impossible to sell the companies as going concerns unless some of the debts are written down. In the companies which are now being offered for sale, a large number of them have negative net worth, but for sound economic reasons (employment, investment, future generation of tax revenues, etc.), ZPA does not want to liquidate them as mere asset sales.

Many other countries world-wide have tackled this same problem by writing down SOE debts prior to sale. In Zambia, systematic procedures will need to be clearly defined to settle certain liabilities prior to sale including:

- settling selective government debts (e.g. ZRA tax arrears and cross enterprise debts); and
- paying out minimum standard retrenchment payments if some workers are to be made redundant.

The overall objective of this exercise would be to settle just enough liabilities so that the company's liabilities no longer exceed assets. One source of funds to pay off these liabilities is the Privatization Revenue Account -- similar to the trade sector exercise, but on a more systematic basis.

The evaluation team understands that the ZPA recently reached an agreement with the Ministry of Finance that will allow the ZPA the to create a memorandum account for past taxes[1] which are considered not collectable from SOE's being privatized. ZPA would then keep a running tally of these debts that have been removed from the balance sheets. These taxes will have been considered collected by the ZPA, although the cash will not move at the prior to the sale of the company. The ZRA long-term claim on these past taxes will be on the Privatization Revenue Account. The Minister of Finance, with his authority over the use of proceeds in the Privatization Revenue Account, would eventually make the decision about paying back the government debts from those funds.

Since the current taxation law does not foresee Government debt write down or write offs even to clean up balance sheet prior to privatization sale, if the ZPA intends to use selective debt write down as part of the process of readying companies for sale, it may be desirable to have explicit authorization to do so through a modification to the Taxation Act, or through a statutory instrument related to the Taxation Act. This would serve to provide an even stronger legal basis for the actions proposed in the agreement with the Ministry of Finance.

Labor and Retrenchment Issues

In many countries around the world, including Zambia, privatization is sometimes associated with labor downsizing. Employment restructuring is a sensitive issue and has political ramifications. Offering fair, but realistic severance packages before or after privatization is one method of limiting labor opposition and creating a minimum social safety net. Given the limited overall government revenues and scant cash reserves of enterprises being privatized, it will be essential that a minimum standard for retrenchment payments be established, in line with existing terms of service and consistent with the Companies Act. Particularly in the period leading up to elections, there could be strong political pressures to offer enhanced retrenchment packages.

It will be necessary to have a clear and firm policy in place before those demands arise. One source of funding for the severance payments would be the use of privatization proceeds, which is a practice used by many countries dealing with this issue. In order to ensure this, ZPA would need more direct access to a portion of the Privatization Revenue Account. One of the major constraints is the fact that the Privatization Revenue Account

[1] Senior staff at the ZPA have clarified in their review of the earlier draft evaluation report that much of the government debt, with the exception of taxes, has already been removed from parastatal balance sheets prior to sale.

may not have sufficient revenues to cover the entire range of legally mandated severance benefits. This problem underscores the necessity of working out a minimum standard severance package which is fair, but affordable within the constraints of the available resources.

Overcoming Capital Constraints

The shortage of capital and liquidity is making the privatization process more difficult, but solutions can be found to facilitate buying such as:

- Continue to encourage buyers short of capital to find a financial partner either national or foreign;

- Reduce price and/or clean up balance sheet to encourage buyers;

- Be cautious of deferred payment schemes and seriously consider action for payment arrears or default;

- Pursue measures to widen ownership (stocks, mutual funds, ESOPs, etc.);

- Try to establish or tap venture capital funds quickly -- through such sources as the CDC, GTZ, IFC, private financial institutions, or the GRZ through proceeds in the Privatization Revenue Account. It is understood that USAID has received a request from the CDC for training and technical assistance to help start up their venture capital fund. It is recommended that USAID and the other donors move as quickly as possible on the venture capital establishment in order to help finance some of the privatization transactions which are coming up over the next six to nine months.

- Pursue comprehensive reform and new legislation in the pension and the insurance sectors so that private institutional investment capital can be introduced as new source of long-term capital in Zambia.

I. EVALUATION PURPOSE AND METHODOLOGY

A. Introduction

Chapter I of this report provides the purpose and methodology of our evaluation. Chapter II discusses the social, political, economic and institutional political setting at the time of project design. The chapter then assesses changes in the project setting that have occurred between project design and November 1995, with a view towards determining whether the changes have affected project impact in a positive, neutral, or negative way.

Chapter III outlines the basic project objectives, assumptions, and targets and assesses contractor and ZPA performance against those targets. The chapter focusses on contractors and project performance in the key project component areas.

Chapter IV summarizes the privatization procedures and methods currently followed by the ZPA with assistance from the CFED team. It is the opinion of the project evaluation team that only by "walking through" the transactions procedures can the realities of the process be observed and assessed.

Chapter V provides the overall summary and conclusions and recommendations presented by the evaluation team.

B. Purpose of the Evaluation

USAID requested that SRI International conduct a mid-term evaluation of the USAID funded Zambia Privatization Support Project. The Project Paper and contract with the prime contractor (Center for Financial Engineering in Development, Inc, or "CFED") anticipated that a mid-term evaluation would take place.

The objectives of the mid-term evaluation, as set forth in the evaluation team's Scope of Work are to:

- assess whether the planned results are being achieved and what impact the project is having in Zambia;

- evaluate the effectiveness of the institutional contractor in achieving project goals and objectives;
- determine whether the laws, regulations, and support structure for privatization are sufficient in Zambia;
- ascertain whether there are areas of concern or problem areas which need correcting; and
- assess if there are areas of achievement which are notable and could be replicated.

The overall intent is that this evaluation will provide USAID and ZPA with an objective and rational basis for making decisions about future privatization program and project priorities.

C. Evaluation Methodology

The evaluation team utilized the following evaluation methodology consistent with USAID Handbook 3 Chapter 12[2]:

1. Define "baseline" project targets, assumptions, and objectives.
2. Assess changes in the project setting.
3. Gather information and data on progress.
4. Compare progress with objectives targets.
5. Explain results.

The principal documents which were used by the evaluation team to define the project's targets, assumptions and objectives of the Zambia Privatization Support Project (PSP) include the Project Paper and the contract agreement with the prime contractor, and

[2] See in particular Appendix 12B "General Guidelines for Evaluations Conducted During Implementation."

agreements with other project contractors.[3] The key elements of project design (i.e., objectives, performance indicators, targets and baseline assumptions) are critical factors and provide the basis on which this evaluation is carried out.

In order to gather the information required by the Scope of Work and assess project impact, the evaluation team conducted an extensive set of interviews with some 55 different individuals in Zambia (see Annex 1) during the period from October 16 to November 2, 1995. The categories of persons interviewed included:

- ZPA Board members;
- USAID project managers;
- GRZ officials from link ministries;
- ZPA professional staff;
- CFED headquarters staff;
- CFED team[4] advisors;
- Other USAID funded consultants who have worked on the privatization program;
- Individuals and companies who performed privatization related tasks for ZPA including company assessments, valuation, advertising, merchant banking, legal work, and negotiations;

[3] On this project there were a number of smaller task order agreements and other contracts undertaken outside of the prime contract. These tasks orders and contracts were concluded with companies such as Price Waterhouse, Chemonics, Ostrer & Associates, Tropical Research and Development, and PH Associates.

[4] In this report "CFED" refers to the prime contractor itself, while the "CFED team" refers to the prime contractor and its subcontracting companies which include Deloitte Touche Tohmatsu International, Eccles Associates, Devman Consulting Limited, and Young & Rubicam.

- Associated organizations such as the SEC (Securities and Exchange Commission), Privatization Trust Fund, and the LUSE (Lusaka Stock Exchange); and

- New owners of privatized firms and other bidders.

II. PROJECT SETTING - ENVIRONMENT FOR PRIVATIZATION IN ZAMBIA

A. Pre-Project Economic and Policy Environment

Under the guidance of the United National Independence Party, which remained in power uninterrupted from the early 1960's to the early 1990's, Zambian economic policy espoused widespread nationalization, and implemented a policy of import substitution, which was bolstered by an overvalued exchange rate, high import tariffs, and low interest rates. This policy, as with so many similar policies in Africa, led to virtual collapse of the economy by the end of the 1980's.

A major problem lay in the country's heavy dependence on exports of copper. When copper prices rose, it affected growth positively, but when they fell, the negative effect on growth reverberated throughout an economy that was unprepared for significant shocks. Efforts to maintain living standards led to substantial borrowing from both domestic and foreign sources. The result of this was monetary expansion and high inflation, so that by the early 1990's, Zambian per capita GNP was less than a third of what it had been in the late 1970's, inflation rose to over 100 percent per annum, and foreign debt rose to a level that was among the highest in the world.

At the same time, little had been accomplished to grow domestic enterprises. Companies that had been nationalized in the early 1960's, often owned by very successful foreign multinationals, languished to a shadow of their former selves, and local entrepreneurs were stymied by a legal and regulatory framework that was not conducive to development, and a trade regime that made it impossible to compete internationally. By the early 1990's, many companies were effectively bankrupt, while others only survived through injections of Government capital while amassing huge debts to financial institutions and the Government itself.

Against this backdrop, a new Government was elected which promised sweeping changes in an effort to turn around the economy. Backed by the World Bank and the IMF the Structural Adjustment Program that was adopted focused on macroeconomic stabilization, trade liberalization, exchange rate adjustment, privatization of all SOEs, and a revamping of the legal and regulatory framework to allow unhindered private sector development in a social, political and economic environment that stimulated rather than hindered economic development.

Considerable progress has been made towards achieving this objective. The 1992 Privatization Act established the Zambia Privatization Agency, which was thereby empowered to privatize through whatever means possible all state-owned enterprises. This was further supported by other changes in the legal environment. For example, exchange control regulations were repealed. A new Companies Act, an Investment Act, a Banking and Financial Services Act, a Zambia Revenue Authority Act, a Mines and Minerals Act, and a Lands Act, among others were quickly implemented. In order to develop capital markets within Zambia, a Securities Act was passed, and an incipient Stock Exchange was authorized under the Lusaka Stock Exchange Act.

B. Assessing Changes in the Privatization Environment Since Project Design

The changes in the legal and regulatory environment were slowly followed by changes in social and political attitudes. In particular, considerable public worry about the future as a result of economic liberalization and particularly of privatization was apparent at all levels of the populace. This was fueled by often ill-informed press coverage and political pronouncements that were mainly based on their ability to garner votes rather than reflecting the accuracy of the situation.

To overcome these social and political concerns, a well-organized ZPA public relations and public information campaign has accomplished much to allay fears among the Zambian population in general regarding loss of jobs, and particularly the sale of the country's "crown jewels" to foreigners. In addition, offering shares to Zambian citizens has contributed substantially to public acceptance of the process, although some questions arise over the ability of Zambians to raise the necessary resources to purchase shares in the future.

At the political level, considerable progress has been achieved. Politicians generally no longer fear the effects of privatization, again due to the public education efforts initiated by the ZPA. Further impetus towards understanding the need for and the benefits of privatization has been provided by the World Bank, the IMF, and the donor country agencies who have been intimately involved in the privatization process, in particular USAID, GTZ (the German Aid Agency) and the ODA (the British Aid Agency). The most significant element in changing the face of public sector acceptance has been the elimination of ZIMCO, an organization with a corporate agenda diametrically opposed to the privatization agenda of the ZPA. USAID, the World Bank and the other donors attending Paris Club meetings were instrumental in requiring that ZIMCO be liquidated.

On the economic front, one of the most significant barriers to the success of the privatization effort is the unwillingness of the banking system to provide capital on other than a stringent short-term basis. Bank liquidity also is in question in at least some cases. Interest rates remain exorbitantly high as a result of inflation, which shows little sign of abating. This leaves local borrowers with little recourse, except in cases where cash flow is such that short-term lending is a viable option, but it almost precludes the involvement of local businessmen in purchasing companies on the basis of long-term borrowing.

In sum, significant strides have been made in arresting the downward economic spiral of the twenty-year period that ended in the early 1990's, but a great deal remains to be accomplished. The privatization project is only a start in the right direction.

III. PROJECT OBJECTIVES AND ASSESSMENTS OF ACHIEVEMENTS TO DATE

A. Project Objectives

The goal of the project, as stated in the Project Paper, is to support Zambia's efforts to attain "market-oriented, sustainable, broad-based" economic growth. The principal output indicator used in the Project Paper was the successful privatization of 50-75 state owned companies. In addition to that key output indicator, at least 20 Zambians were to be trained in privatization techniques.

Because there was a lag between the obligation of project funds and signing of contract with the institutional contractor, USAID/Zambia utilized centrally funded projects to finance short-term consultants to the ZPA in 1993 and early 1994. During this time period, the ZPA completed 9 privatization sales agreements. In the CFED contract, which was signed in February 1994, the prime contractor was to be responsible for "actively performing the privatization of no less than 50 parastatals and training Zambian counterparts to continue in this work."

The only output indicators included in the Project Paper Logical Framework were the privatization of 50-75 companies and the training of 20 Zambian professionals in privatization techniques. Other end-of-project indicators listed in the Project Paper included: the ZPA will have reduced its staff by 20 percent; the GRZ will have reduced it subsidies to parastatals by 95 percent; and the ratio of parastatal credit to total credit will decrease by 75 percent. Most of these other indicators are related to the overall effects of privatization, but only indirectly. Progress on the reduction of credit and subsidies to parastatals appear to be substantial as of October 1995. These policies are under the control of the Ministry of Finance and the Central Bank, and are consistent with the overall objective of privatization and reducing the government's role in the economy.

The primary input to be used to achieve the project outputs was technical assistance (long and short term) totaling some $14.2 million before inflation contingencies. In addition, some $1.3 million was to be spent on training and commodities such as computers and software.

While the project design was very specific about output targets (number of companies to be privatized), it was quite general about how the job was to be done. Most of the detailed implementation issues such as the desired structure of the ZPA, methods of privatization (e.g. private sale, public flotation, mass privatization, etc.), strategies for valuation and negotiations (e.g., in house versus contracted out) were left to the ZPA and the contractor to determine.

In hindsight, the evaluation team is of the opinion that the project design approach is quite appropriate and suitable for privatization programs of this kind. Under the design approach, the essential output indicators and inputs were established, but the detailed implementation strategies were left flexible. In this way, the implementing agency and contractor were given the responsibility and latitude of determining the most appropriate implementing strategy, given Zambia's particular legal, institutional, and social and economic parameters. With this approach, the ZPA and the contractors were more free to adjust the implementation strategy, as necessary, to fit the circumstances and to achieve the ultimate project goals and objectives.

B. Organizational Structure of the ZPA

Before discussing the performance of the project and the principal contractors, the evaluation team thought that it would first be useful to describe the organizational structure of the ZPA -- the organization which is the center of all activities funded under this project.

The legal status and functions of the ZPA are specified in the 1992 Zambia Privatization Act. The Act establishes the ZPA as an independent, centralized body responsible for the privatization of parastatals in Zambia. It has a mixed (private and public sectors) Board of Directors. The Privatization Act gives the Agency almost total authority to carry out privatization of state owned enterprises, after Parliament's decisions about the list of companies to be privatized, and Cabinet's decisions[4] about the appropriate method. Essentially, once the list of companies and methods have been approved by GRZ, the ZPA has strong authority to supervise the negotiation of the sale of State Owned

[4] To date Cabinet's choices of privatization methods for companies are based heavily on ZPA's recommendations.

Enterprises, and privatization decisions and terms and conditions are not being "second guessed" by government departments or officials.

The ZPA is currently generally well organized for the job assigned to it, following several evolutionary years prior to its current high-performance status. It was reported to the team that in 1993-1994, ZPA organization performance was hindered by managerial ineffectiveness and bureaucratic inefficiency that was characteristic of the ZPA in the early years of the project. In particular it was reported to the evaluation team that the incumbents in the position of Director from the ZPA's inception up to October 1994 did not display the full strength of managerial leadership required for the role. The turnover of the senior management team, combined with the lack of managerial focus, resulted in exceptional work burdens being placed on the advisory team and less-than-satisfactory job performance on the part of a majority of the local staff.

Nevertheless, during the period from late 1994 to April 1995, a great deal of the groundwork was laid for the current effectiveness of the ZPA by the then acting Director of the ZPA, now in charge of the Directorate of State Enterprises.

It was also reported to the evaluation team that the Board of Directors of the ZPA was not a very efficient operation during the 1994-95 period. According to Board members interviewed by the evaluation team, in 1993-94 the ZPA Board was characterized as following a "bureaucratic approach." For example, during this time the Board would meet only once every two months, the minimum required in the law, even when important business was pressing. Board meetings would carry on for long hours often with few clear decisions taken. Beginning in 1995, however, a new Chairman of the Board was appointed and it is reported that Board Meetings are now well organized and the Board is tackling the issues facing it in a decisive fashion.

The Chief Executive and Technical Director were recruited in 1995, following a worldwide advertising search. The managerial experience and expertise of these two individuals has had a strong positive impact on the organizational efficiency of the ZPA. New managerial changes brought in by the new top management team have emphasized the team concept for handling the privatization workload, as well as initiating improvements in staff morale and performance through contract related pay/performance schemes that are now proceeding towards implementation.

The organization is structured around the Chief Executive who reports to the Board of Directors. He is advised by a Chief Advisor, who is funded by Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ). The ZPA Public Relations function reports directly to the Chief Executive. The Chief Executive's role is correctly seen as combining facilitation for the privatization process with a demand for quick results. Day-to-day operations fall within the remit of the Technical Director, who, in effect, acts as Deputy Chief Executive.

Operationally, the organization is based on the team approach initially envisaged by the Task Force that set up the ZPA, and subsequently endorsed by a Price Waterhouse organizational report undertaken in 1994. Five transaction teams report directly to the Technical Director. Four of these deal with privatization, and the fifth with liquidations and debt.[5] Under this teams approach, each team is responsible for a portfolio of companies for the entire transactions process from assessing a company for privatization through the final sale. Other functions reporting to the Technical Director are Asset Monitoring, Social Impact, and Legal Affairs. A Planning and Development Manager is in the process of being hired, and this function will also report to the Technical Director. Administrative functions report to the Agency Secretary. These include Accounts, Information Systems, Personnel, and Office Administration.

While some modifications of the organizational structure are still foreseen, the evaluation team considers that the basic organizational structure of the ZPA is now sound enough to support ZPA's mission of privatizing companies in a transparent, efficient and effective manner. Organizational changes under consideration as of November 1995 include allowing the Publicity Department to shed most of its responsibility for education of the populace. The ZPA feels that this function more properly is the responsibility of the Zambia Information Service within the Ministry of Information and Broadcasting, and proposals to divest this function are now being developed.

C. Principal Project Components

Based on the project objectives described in the Project Paper and the Scope of Work in their contract, the CFED team has broken their work programs into the following four components:

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[5] The ZPA also has a Property and Titles Department.

1. Privatization Transactions
2. Marketing of SOEs
3. Publicity and Education
4. Training and Institutional Development

In the sections below the evaluation team assesses achievements to date in each of the four component areas.

Privatization Transactions

As of end-September 1995, 31 companies had been privatized (sales agreements concluded) under the ZPA program compared with overall life-of-project target of 50-75. During this same time period, some sales agreements for some 48 business units were concluded[6]. From the start of the CFED contract (February 1995) through the end of September 1995, sales agreements have been concluded for 22 companies compared with a target of 50 for the life of CFED's contract. In addition six companies were dissolved or liquidated between 1993 and September 1995. As of October 1995, privatization sales had raised some $ 26 million in proceeds for GRZ.

Given the current pace of privatization, the evaluation team believes the ZPA is on course to exceed the target set in the Project Paper of privatizing 50-75 companies during the life of the project. These forecasts for transactions to be completed are based on the following:

- The large numbers of companies in the "transaction pipeline" (as of end of September 1995, 68 companies had started, but not yet concluded, negotiations);

- ZPA staff have improved and tightened procedures considerably over the past two years (valuation, advertising, board submissions and approvals, negotiations);

[6] **CFED's method of reporting privatization sales is conservative in that it only records a sale when an entire company has been sold. It does not count it as a privatization sale when just a business unit has been sold even if it involved concluding a separate sales agreement for that business unit.**

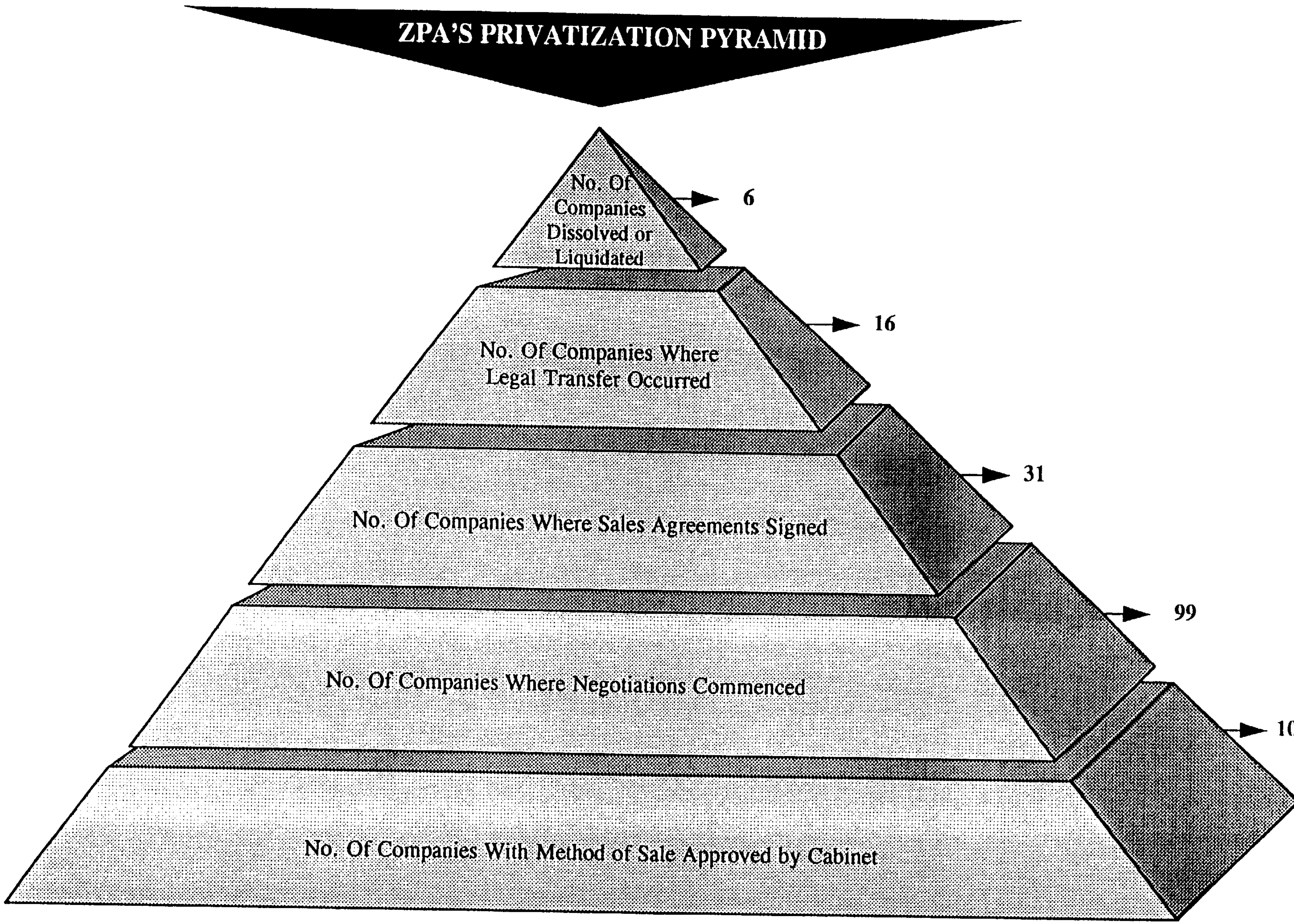
- Training and skills development in negotiations have improved the quality of negotiations and as a result, negotiation time is dropping (from 2 months - 2 years to as little as 1 day);

- Momentum has been built and there are no major barriers in sight for privatizing the remaining 145 or so companies in ZPA's divestiture sequence plan.

The figure below with the privatization pyramid provides information about Zambia's "privatization transaction pipeline" as of end of September 1995. The size and shape of a country's privatization pyramid would differ according to a number of factors, including the speed and efficiency of the country's privatization agency and government ministries in completing key steps such as company assessment and preparation, valuation, negotiations and legal formalities for transfer of deed.

In Zambia, the base of the pyramid is relatively wide compared with the top. The size and shape of Zambia's privatization pyramid suggests three key priorities:

- The relatively large number of companies still under negotiation but which have not yet concluded sales agreements (68), suggests ZPA should place a major emphasis over the next quarter or so on rapidly concluding negotiations for companies which have already begun. Different from other major steps in the privatization process, the negotiating step is largely under the control of ZPA and its Board. Since the independent negotiators are hired by the ZPA, the ZPA has the authority to closely supervise negotiations and ensure they do not lag. The ZPA has the power to set deadlines for negotiations, follow up with negotiators and companies to find out about what is causing delays, and help problem solve, if obstacles emerge.



Source: CFED/ZPA as of September 30, 1995

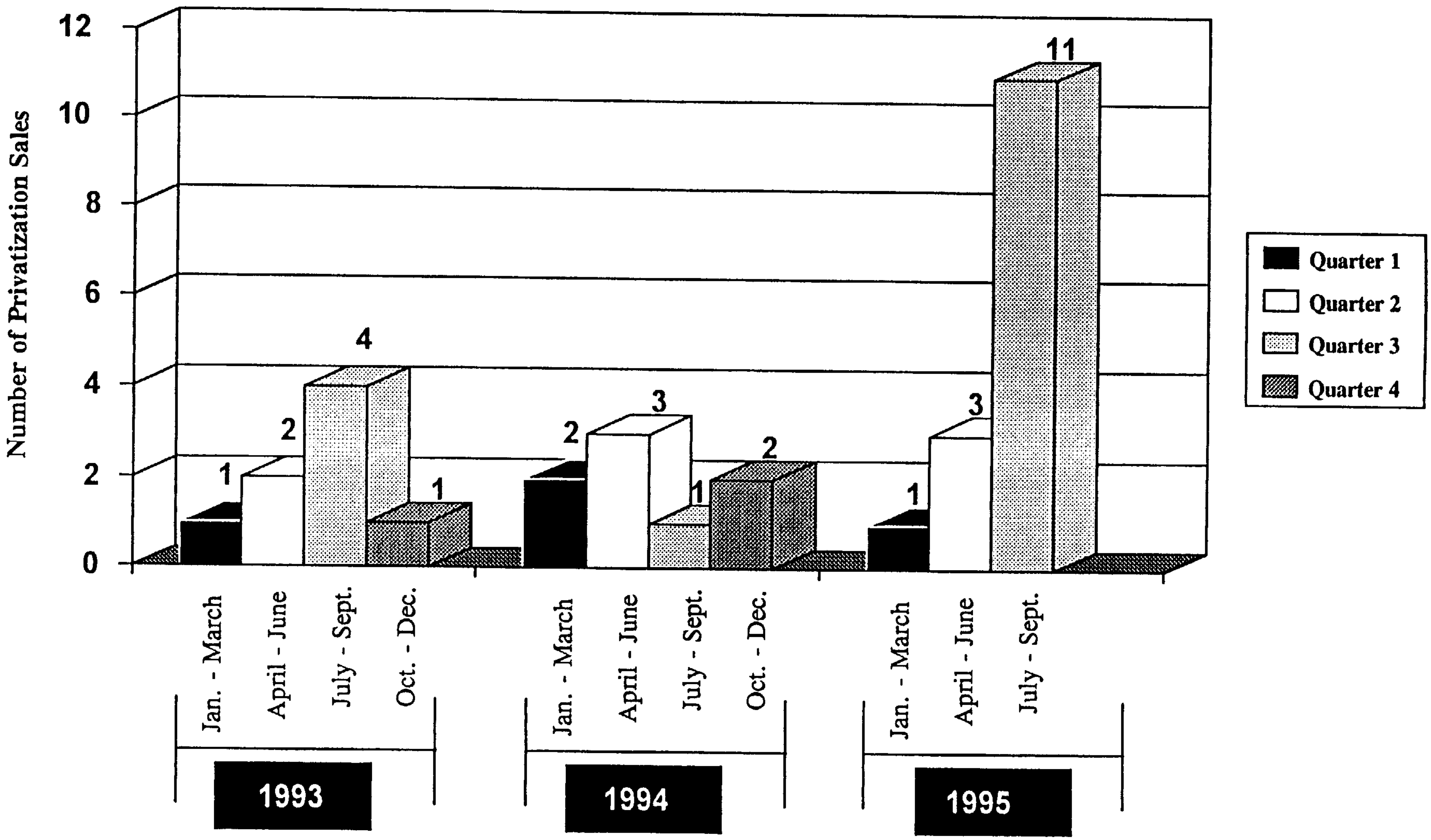
- Once substantial progress is made on the first priority, the ZPA will also need to focus on ensuring that final legal transfer takes place. Only 16 of the 31 companies which have concluded sales agreements have completed legal transfer. The legal transfer of land titles is under the control of the Ministry of Lands, while share transfer is the responsibility of the Directorate of State-Owned Enterprises, with the concurrence of the Liquidator of ZIMCO. Companies sold as asset sales require transfer by the company's Board of Directors. ZPA will need to focus the work of its legal staff and independent attorneys on ensuring that legal transfer can be completed in a more timely fashion.[7]

- While the above two priorities are being tackled, the ZPA should also focus attention on assisting Cabinet to approve methods of sales of additional companies (base of pyramid) so that the transactions pipeline is replenished.

The figure below on privatization sales by quarter since project inception indicates the pace of transactions progress. This figure clearly demonstrates that privatization progress was, however, exceedingly slow and deliberate until the period June-September 1995. During that quarter, the number of sales agreements finalized jumped to 11 -- by far the most ever in the program. The large number of companies already in negotiations suggests to the project team that similar transactions results can be expected over the next several quarters.

[7] The evaluation team was informed of the complications in carrying out the title search and in obtaining the actual deeds. If the problems and delays cannot be resolved by ZPA attorneys and independent attorneys hired by ZPA then the ZPA Board may need to recommend to Cabinet special assistance to help streamline the title transfer process at the Ministry of Lands.

ZPA PRIVITIZATION SALES BY QUARTER SINCE PROJECT INCEPTION



Source: CFED/ZPA

Marketing of SOEs

Marketing and promotion have correctly and usefully focused on a two-pronged approach -- general investment promotion and individual company marketing. Although the original budget is considered highly inadequate, the following achievements have been recorded:

1. Image building of Zambia as an investor-friendly location for international companies:

- A Zambia special supplement in Fortune Magazine which highlighted the privatization process as well as investment opportunities. Over 750 highly-cost-effective inquiries have been generated as a result.

- A Zambia survey in the Financial Times provided international readers with editorial material on Zambia and information on the privatization process.

- Advertisements were carried in two editions of Business Strategy International. The advertisement included was an editorial page message from the Chief Executive.

- A ZPA marketing brochure was developed and is used extensively by Government Ministers, ZPA executive staff, the Zambia Investment Center and others as a promotional tool. It is also sent in response to all inquiries such as those generated by the Fortune Magazine supplement.

- Government Ministers, ZPA executives and advisors attended the following international investment promotion conferences:

  - Africa Trade And Investment Opportunities (London)
  - World Economic Forum (Johannesburg)
  - Southern Africa Investment Summit (Johannesburg)
  - Southern Africa Development Corporation (Johannesburg)
  - Made In The USA Trade And Investment Forum (Johannesburg)
  - Emerging Markets CEO Round Table (New York)

- Thirty individually-tailored investor group presentations were made to potential investors, mostly foreign.

- Substantial progress was made towards the organization of an investment opportunities conference to be held in Lusaka in 1996. The conference will be sponsored by the Financial Times private sector financial support (approximately $250,000) has been raised for this activity by the CFED Chief of Party.

2. The following company-specific marketing activities were carried out:

- Print advertising was developed and carried out on behalf of over 75 companies in local, regional, and international markets.

- A country-wide marketing campaign was implemented in support of the Chilanga Cement flotation.

- Over 100 company marketing profiles in accordance with the divestiture sequencing plan were produced. These are included in the marketing brochure or are used individually as appropriate.

- Targeted marketing visits were undertaken to/from investors in the region from Botswana, Ghana, Malawi, South Africa, and Zimbabwe. International locations visited were Finland, Germany, India, Italy, Netherlands, United Kingdom, United States and Yugoslavia. At least 70 interested investors were visited.

- A targeted investor marketing campaign was carried out to publicize Zambian companies to be privatized. This involved sending material to individuals, institutions, companies, foreign missions in Zambia and Zambian missions overseas, Chambers of Commerce, and conference participation.

- Successful solicitation of funds ($350,000) from the World Bank by the CFED Chief of Party to support placement costs for international advertisements.

The evaluation team believes that the marketing and promotional activities have been, and continue to be, carried out in a professional and cost-effective manner.

Publicity and Education

Public relations or "selling the privatization program" to the general population is considered a very important element in the process. The following achievements have contributed substantially to the success of the privatization public awareness campaign:

- A series of World Bank-funded radio programs were produced.
- Information brochures in seven regional languages and English were widely distributed.
- The ZPA marketing brochure is widely distributed for information purposes; two-phase television, radio, and print media advertising campaign was carried out.
- An essay competition was held as a means of educating students on privatization.
- Other public awareness educational tools used included seminars for GRZ officials, ZPA forums, radio and TV talk shows, press briefings and public service announcements.

A significant amount of effective public education has been carried out by the ZPA. The team concurs, however, with the opinion of the Chief Executive and the CFED team that the business of public education should not reside exclusively within the ZPA, although there will be at least some need to continue it through press briefings, television and radio interviews, and other methods.

Training And Institutional Development

The development of privatization skills within Zambia is considered important for several significant reasons. First, Zambia has no previous experience in privatization, although it has a core of well-qualified lawyers, accountants, and corporate finance executives. Second, the ZPA requires significant technical capacity in the areas of negotiations, legal issues, marketing, debt restructuring, financial appraisal, and labor/retrenchment issues. Third, Zambians themselves need to have the skills to run a privatization program on their own when the CFED contract terminates. At that stage very well-developed skills will be necessary to effectively manage the large privatization that will come on stream in the later years of the project.

The CFED program for building local capacity is based on the development of:

a) technical and promotional skills; and

b) enhanced technical capacity within the ZPA.

The approach utilized to develop technical and promotional skills has been threefold: on-the-job training, a comprehensive formal training program, and participation in conferences and seminars outside Zambia.

On-the-job training is a continuous process. Each CFED consultant, as advisor to one or more ZPA teams, is extensively involved in coaching ZPA staff, both individually and as a team, in the following:

- team development: team planning and accountability through organization of workloads, monitoring progress, problem identification, alternative strategy development;
- project management: work planning, setting objectives, meeting deadlines, and reporting on progress;
- technical aspects of privatization: asset and company valuations, strategic analysis of companies, negotiation frameworks and strategies, investor relations, and closing requirements;
- systems development: forward planning and tracking of all steps in the transaction sequence, identification of key tasks and outputs, and tracking performance versus planned progress.

In the opinion of the evaluation team, on-the-job training has been highly effective for two main reasons: the zeal of the CFED advisors to impart knowledge, and the receptivity of their Zambian counterparts to absorb it. As a result, a strong core of knowledge and a new capability now exists within the ZPA. Both the Publicity and Marketing Department and the Liquidation/Debt Unit appear now appear to function well with without heavy direction of advisors. The Social Impact function is now at a similar stage where technical assistance is being scaled down and re-allocated to the Social Safety Net activities. However, this is not universal - while many of the staff have moved to a higher plane in terms of knowledge and capability, a significant number have not. Furthermore, there are still few signs that the ZPA teams are fully capable of handling day-to-day work without significant hands-on involvement of the CFED advisors.

Formalized skills training was provided by CFED and other contractors through a series of short courses specially designed to maximize knowledge of the privatization process. Courses were provided to ZPA staff in the following areas:

- Privatization Negotiations Techniques;
- Overview of the Privatization Process;
- Leadership, Team-Building and Management Decision-Making;
- Business Analysis;
- Public Relations in the Privatization Process;
- Marketing Management;
- Information Systems/Computer Training;
- Financial Restructuring and Preparing the Firm for Privatization;
- Privatization Methodologies.

Several difficulties have been encountered in carrying out the formalized training. In particular, the scope of the training program originally envisaged had to be reduced and its implementation held up due to delays in the scheduled reorganization of the ZPA. Thus, training that was to begin in 1994 did not commence until summer 1995. This delay was entirely attributable to the failure of the ZPA Board and the management to implement the recommendations in the Price Waterhouse report as soon as it became available in 1994.

A second difficulty encountered involved the scope of the training program that was eventually implemented. This was substantially less than originally planned for. Furthermore, it was compressed into a shorter period of time, and was carried out on workdays and Saturdays, without any relief being provided for the ZPA staff from their regular workloads. In the work program, it was intended that 20 ZPA staff should participate. However, the staff did not attend consistently, and the numbers ranged from 11 to 22, depending on the type of course being offered.

The evaluation team feels that the staff who completed the training courses benefited substantially therefrom. The ZPA's management style is action-oriented. The Chief Executive believes in obtaining results as quickly as is reasonably possible, in line with instructions from the ZPA Board and the Ministers of Finance and Commerce and Industry. There accordingly is a trade-off involved between the work input needed to achieve results and the allocation of time for training purposes. On the whole, the achievement of results is to be paramount, given the urgent need to divest.

It should be recognized, however, that there can be a natural conflict in the short run between the goal of maximizing transactions progress and the goal of building local skills capacity. The emphasis on short-run results puts a greater burden on the CFED advisors to carry a heavy responsibility for transaction progress, and also reduces the ability of some national team members to fully avail of the training offered, and thereby improve their own performance. This is likely to affect the ability of at least some of the Zambian staff to be fully-productive team members and thereby gradually reduce the operational workload of the CFED advisory staff. It will be necessary for the ZPA management and foreign advisors to find the right balance between these two sometimes contradictory objectives to ensure that ultimately both goals are being met in a satisfactory way.

Under the project, ZPA staff participation has also been arranged in several third country training courses and conferences. These have included the following:

- Communicating in Southern Africa (Johannesburg);
- Capital Markets: Development and Regulation (Washington, D.C.);
- Legal Issues in Implementing and Monitoring Privatization (Washington, D.C.).

In addition, several staff together with representatives from the Ministries of Finance and Commerce and Industry attended conferences and seminars in London, Johannesburg and New York which are also considered to be educational. These are covered above under Marketing of SOEs.

D. CFED Project Management and Performance

Profile of Technical Assistance Team

The PSP is managed by the Center for Financial Engineering in Development which supplies ongoing project management from its headquarters office in Washington, D.C. and field management through its Chief-Of-Party. Other long-term advisors under the CFED team are supplied by CFED and its sub-contractors, Deloitte Touche Tohmatsu International (Washington, D.C. and Lusaka, Zambia) and Eccles Associates (New York).

The CFED project start-up was delayed and made more difficult by the prolonged period from August 1994 to February 1995 where there was effectively no Chief-of-Party for the CFED contract. During this period, several Chiefs-of-Party were field-tested and turned down by USAID. Multiple CVs were also submitted and rejected by USAID before the present Chief-of-Party was appointed as acting Chief-of-Party in February 1995. The lack of a Chief-of-Party during the first year resulted in less administrative and technical guidance to the CFED team of advisors. Despite this adverse situation, team members persevered remarkably well during this period, and helped lay the ground work for future more favorable results.

The CFED Chief-of-Party was originally assigned to the project on a short-term basis from April to May, 1994 as advisor on public relations and marketing, and subsequently returned as a long-term advisor on public relations and marketing in August 1994. In February 1995 he became Acting Chief-of-Party and he was confirmed as Chief-of-Party in May 1995. In addition to his duties as Chief-Of-Party, he has guided the direction of the public education program, as well as managed advertising and promotional efforts to attract buyers both nationally and internationally. He has been instrumental in developing the marketing and public relations functions within the ZPA. The evaluation team considers that the successful direction of the project since March 1995, as well as the successful public relations and advertising and promotion campaigns, have been largely attributable to the administrative style and professional competence of the Chief-of-Party.

Apart from the Chief of Party, the CFED team of long-term advisors consists of four[8] members each of whom acts as advisor to a ZPA Transactions Team. The background of the advisors is in general management, accounting, auditing, legal, and housing privatization and finance. The evaluation team believes that the professional skills brought to the project by the advisors is very high caliber. This opinion was reinforced by unsolicited testimonials from multiple sources: from within the ZPA, from independent negotiators, and from purchasers of companies. Furthermore the advisors have shown significant concern for imparting their skills and knowledge to the Zambian team members through on-the-job training.

Due in part to the advisors enthusiasm for the work, but also because of pressures to achieve ambitious transactions targets, the Zambian staff may have become over-reliant on them in their day-to-day activities. One of the challenges for the advisors for the remainder of the project will be to progressively hand over responsibilities for the day-to-day operations of the teams, with the advisors taking on more of a coaching and training role.

E. Sub-Contractor Performance

Sub-contractors to CFED on the project include Deloitte Touche Tohmatsu, Eccles Associates, Devman Consulting Ltd. and Young and Rubicam (Zambia) Ltd. The major contribution of DeloitteTouche Tohmatsu and Eccles Associates has been to supply long term-advisors (two and one respectively) to the project. Devman Associates has provided logistical support for in-country training courses. Devman also provided short-term privatization transaction support immediately following the removal of the Chief of Party in 1994.

CFED has worked very closely with Young and Rubicam on both the educational campaign and on the country marketing and company marketing campaigns. To date, Young and Rubicam has been responsible for Phase I and Phase II of the television advertisements. These advertisements used Zambian proverbs to subtly gain the attention of the Zambian populace regarding the need for and the benefits to be derived from

[8] A sixth team member, Grant Henderson, also works for the CFED Team and is making substantial contribution as both a legal advisor and transaction advisor to Team 1. Other short term-consultants have also made a significant contribution including Mike McWherter and Myra Tabor.

privatization. Y&R also developed the four-color Fortune Magazine Supplement, as well as produced the company advertisements that have been placed in domestic, regional, and international newspapers. The evaluation team considers that the combination of CFED and Young and Rubicam in the marketing and publicity area have produced top quality material, particularly in light of the limited budget available for marketing and promotion.

F. Other Contractors

Ostrer and Associates This company provided training in the area of negotiations skills development. The training was delivered to ZPA staff, ZPA Board Members, government officials, politicians, members of the press, local professionals, and local business executives who were interested in being independent negotiators for the ZPA. A total of eight workshops for 20-40 participants each were given between October 1994 and November 1995.

The training program taught the art and business of negotiating deals to the mutual satisfaction of buyer and seller. The CFED team worked very closely with Ostrer and Associates in the development of the privatization case studies and materials used in the negotiations skills training courses.

The course was given almost universal superlatives by participants in terms of its effectiveness in teaching negotiating skills directly relevant to the Zambian privatization deals. The training program also gave participants the opportunity to discuss the goals and objectives of the privatization program and the importance of the program to the Zambian economy. The course was also credited with helping improve public opinion on privatization by giving participants a clearer understanding of the goals, objectives, and benefits of privatization.

In addition to the negotiations skills training, Ostrer and Associates was contracted to provide ZPA with model legal sales agreements. Under this contract, Ostrer and Associates provided both a model for a share purchase agreement and a model for an asset sale. Attorneys hired by ZPA to draft the legal sales agreements found both models to be useful, thorough, and helped provide them with a clearer picture of ZPA standards and expectations for the legal agreements.

Price Waterhouse Price Waterhouse was contracted in 1993-94 to carry out a human resources evaluation for the ZPA in order to make the agency more effective in achieving its mission. The terms of reference were to carry out an internal and external institutional review; develop an effective organizational structure for ZPA; review salary and compensation packages; assess human resources needs; adjust existing systems to new ones; and implement the proposed new systems.

The study was supposed to assess the skill gaps in the organization, and identify specific training and recruitment priorities to overcome those deficiencies. The report was also supposed to address the paper flow and organizational systems with various areas of responsibility and delegation identified. According to current senior management and advisors at ZPA, however, the report was deficient in the latter areas, and left the job of tightening paper flow and reporting responsibilities to the present senior management and advisory teams to tackle. For example, the terms of reference for the Technical Director, the Planning Manager, and the Team Leaders were written by the GTZ advisor.

According to ZPA senior managers and advisors a controversial aspect of the Price Waterhouse study was the "psychometric" testing of individual ZPA national staff and subsequent open presentation of results. On this test, several of the ZPA staff were given low marks for their qualifications for the job. The open presentation of these negative test results had a very demoralizing impact on ZPA staff during the third and fourth quarters of 1994, according to senior ZPA staff members.

The main positive points that emerged from the Price Waterhouse study were the recommendations for the appointment of a new Chief Executive and the Technical Director, as well as the positive changes it occurred in the Board composition. The two high-level appointments have given the organization new management strength and leadership that has accelerated the privatization process, focussed the sense of purpose among the staff, and given a higher profile to the organization. In addition, the Price Waterhouse emphasis on the need for new recruitment and training to improve technical capacity was seen by the evaluation team to lead to positive results.

PH Associates PH Associates were contracted by USAID in late 1994 to carry out a number of environmental assessments of those tranche 3-7 companies deemed to be in the "potentially-high environmental risk category." The company had previously been contracted to carry out a study to further determine the level of effort needed to assess the environmental risk potential of companies being privatized following earlier work carried out in 1993 on tranche I and II companies by Tropical Research And Development Ltd. (TR & D Ltd.) Twenty assessments (out of a total of 32 identified as potentially high-risk companies) were carried out by TR & D Ltd. prior to the termination of their contract due to a dispute over report content. To date 35 assessments have been carried out by PH Associates. A further 15 are scheduled for delivery in October, and 15 more will be completed before the contract terminates in December 1995. The total number of assessments to be completed by PH Associates in the period April-December 1995 is thus 65. The quality of the work and the volume of work carried out by PH Associates is considered to be fairly high, insofar as it responds to the Terms of Reference.

The environmental assessments carried out by PH Associates are specifically designed to flag areas with potentially-troublesome environmental conditions, which need to be addressed either before or after the sale agreement has been completed. The major focus of the reports is on how the industrial process affects water, soil and air quality within the immediate environment of the facility. Scientific analysis of water, air or soil quality is not part of the team's Terms of Reference. Each report consists of an analysis of the environmental problems encountered from personal interviews and visual inspection of the facility. Recommendations are made as to what is required in order to comply with the laws dealing with the environment. Photographs, site plans, and details of the environmental laws are also included in the reports.

There are, however, a number of problematical areas. While work on environmental assessments was specifically intended to be integrated into ZPA valuations, PH Associates perceives its client to be USAID, and all reports are delivered directly to USAID on completion. USAID then provides copies to ZPA, to the Environmental Council of Zambia, and to the company that has been assessed. PH Associates, whose office is located in the Intercontinental Hotel, does not liaise directly with ZPA except to find out if ZPA has any potentially useful information on the companies it is assessing. There is furthermore little correlation between the sequencing of the environmental assessments and of companies scheduled for privatization.

The reports, however, are not used by the ZPA for the purpose which they were intended and are generally not included as part of the company valuation that is provided to the potential purchaser. They are, in fact, viewed as relevant to the process only to the extent that they may be utilized by the company concerned after the sale has been concluded. The contractor has worked hard on preparing and completing the large number of reports, however, and has attempted to respond to the terms of reference the best it can.

There are multiple reasons why little use is made of the environmental assessments. The PH team is not an integral part of the technical assistance team. It is based in a remote location and has little contact with either ZPA or the CFED team. The PH team originally was sited in the ZPA office, but changed locations due to poor telecommunications and computer facilities. As a result, the team and its work are at best, peripheral to the privatization process. The assessments themselves are not an integral part of the valuation process. Because they do not present hard scientific evidence, do not quantify environmental liabilities, and their recommendations are viewed as less essential than hard financial information, the work is perceived as less critical to the effort. Although the PH team has attempted on numerous occasions to involve the Environmental Council of Zambia in its work, the Council lacks the personnel and financial resources either to become involved in the process, or to enforce the PH team's recommendations.

G. Work Plans

The preparation of work plans and quarterly technical and financial reports are a contractual obligation that CFED has been fulfilling under the project. The first work plan for the project was drafted by CFED in July 1994 but was not finally approved by USAID until February 1995, a year after CFED project implementation began. Quicker approval of the plan would have meant less time spent on project administration and discussion with the client, and more time focussed on direct implementation of privatization activities.

The first work plan covered the period February 1994 to September 1995. It sets out the objectives of the ZPA project as well as the methodology to be employed in achieving the following four objectives:

1. Facilitate the privatization of at least 50 SOEs by the project completion date;
2. Facilitate completion of transactions through an effective marketing program;
3. Educate the population on the privatization process; and
4. Build capacity within the ZPA to enable it to implement and negotiate privatization transactions on its own by the end of the project.

The evaluation team considers that, in general, the work plan is well written and covers the main targeted activities and issues quite well. At the same time we feel that some of the charts and figures[9] could be simplified in future work plans and the overall length shortened so that only the most important strategic objectives and targets are presented in a more "boiled down" fashion. The same would apply to the quarterly contractor reports.

The second work plan covers the 9 month period from October 1995 through June 1996. It has a similar lay out to the first plan and provides objectives and outputs envisaged for the 1996 planning period. In addition, it assesses progress achieved during the first work plan. Similar comments hold for the second plan as for the first. Due to limited budget for marketing activities no extensive marketing plan was incorporated into the second work plan. However, for the more complex larger companies, international marketing, investor searches, and conferences will be required. The ZPA/CFED will need to begin planning and organizing these campaigns soon, and identify additional sources of revenue to support these activities as it has done in the past.[10]

H. Information and MIS

The first initiative to establish an MIS system for the project was undertaken in December 1993 when a "baseline survey" of indicators related to privatization was conducted. The final report produced from this exercise was called "Privatization Computerized Monitoring and Evaluation System." This report provided baseline economic data on privatization-related indicators including parastatal employment, private sector employment, subsidies to parastatals, and parastatal credit allocations. While the report was based on solid economic logic and methodology, much of the data included in the baseline survey was macroeconomic data -- relating to parastatal subsidies and credit, money and interest rates -- data which is outside of the immediate interest and responsibility of ZPA. In addition, a good part of the data base was left incomplete in that

[9] **It should be noted that the format of the charts and figures were requested by the USAID Project Officer.**

[10] **The recent fund raising activities by the CFED team (UNDP commitment of $430,000 have facilitated development of the 1996 Investment Promotion and Marketing Plan. In addition, the successful solicitation of £180,000 from private sources will make possible the November Conference in Lusaka.**

report, with a source of data and methodology identified so that the ZPA would be able to identify and gather these data from those sources in the future.

The evaluation team has some fundamental criticisms of the baseline study. First, it contained too much macroeconomic data, which, even if suggested by the Project Paper, was at best only peripherally related to core ZPA activities, and if serious attempts had been made to gather all this data on a regular basis this activity could have become a major distraction for ZPA. Second, not enough data in this proposed MIS system was management information directly related to the privatization transaction process -- which is the core focus of ZPA. Third, the baseline study, unlike its title suggests, had no discussion about appropriate software or hardware systems necessary to implement the system.

The next major attempt to introduce and implement an operational MIS system was undertaken by CFED during the period between February 1994 and September 1995. Although this component was not explicitly part of the CFED contract, the contractor began implementation of this component, with USAID's approval based on the observed needs, as a means of building capacity and institutional efficiency at ZPA. Part of this work was related to the general implementation of computer literacy and core competencies at ZPA.

The main work of MIS installation and training was undertaken by CFED's Director of Computer Services (an information specialist) during a series of short-term assignments from early 1994 to September 1995. During that period, CFED procured the necessary hardware and software, designed and constructed an MIS system, and undertook training of ZPA staff in how to maintain and protect the system. During implementation the system ran into a number of obstacles. Some of the implementation problems related to the hardware supplier in Zambia. Eventually, in an event that turned out to be a serious catastrophe, the Information Manager at ZPA mistakenly erased the entire network data. The tragic event resulted in the irretrievable loss of all network data. Hard copies of much of the data are still available, but the time and effort to replace the entire computerized system could be enormous.

It would not be appropriate for the evaluation team to try to pin blame for this unfortunate event on any particular party. We feel it would be more productive to look forward at what is needed rather than looking back. At this stage, the most important lesson is that a network system is a precious commodity and must be treated with utmost care. Highly trained personnel, whether from Zambia (inside ZPA or outside contractor) or overseas, would be needed to manage the network, train the users, handle problems, and protect the system.

I. Accounting/Finance

The project has a total life-of-project budget of $18 million. This total budget includes $14. 2 million for technical assistance and project management support, $706,000 for training, $558,000 for commodities including computer hardware and software, and $2.3 in inflation and other contingencies.

The original CFED team contract set at $ 8.9 million but was increased to $11,461 million in April 1995 for the three year period from February 1994 to end of January 1997. The CFED has one option year (February 1997 to end of January 1998) with an indicative budget of $2.27 million.

The other project costs of some $ 4.5 million have been spent on other project contractors outside of the CFED contract (such as Price Waterhouse, PH Associates, Chemonics, Tropical Research and Development, Ostrer and Associates) and on USAID Personal Services Contract personnel. CFED reports on accounting and finance information in a timely manner as part of its quarterly reporting reports.

For the remainder of the CFED contract between November 1995 and January 1997, there is an estimated $4.5 million or so budgeted funding. The majority of this expenditure will be on long-term technical assistance. Outside of long-term salaries and benefits, the disposable funds for MIS, training, and marketing or other short-term technical assistance are quite tight. Some $145,000 is available in short-term technical assistance, and some $300,000 is remaining in commodities (this is the budget category from which they are funding marketing and promotion activities) and about $360,000 remains for training. For 1996, the following budget allocations have been identified: $167,000 for public relations; $62,000 for third-country training; and $79,661 for third country marketing.

IV. CURRENT PRIVATIZATION PROCEDURES AND METHODS

A. Methods Used

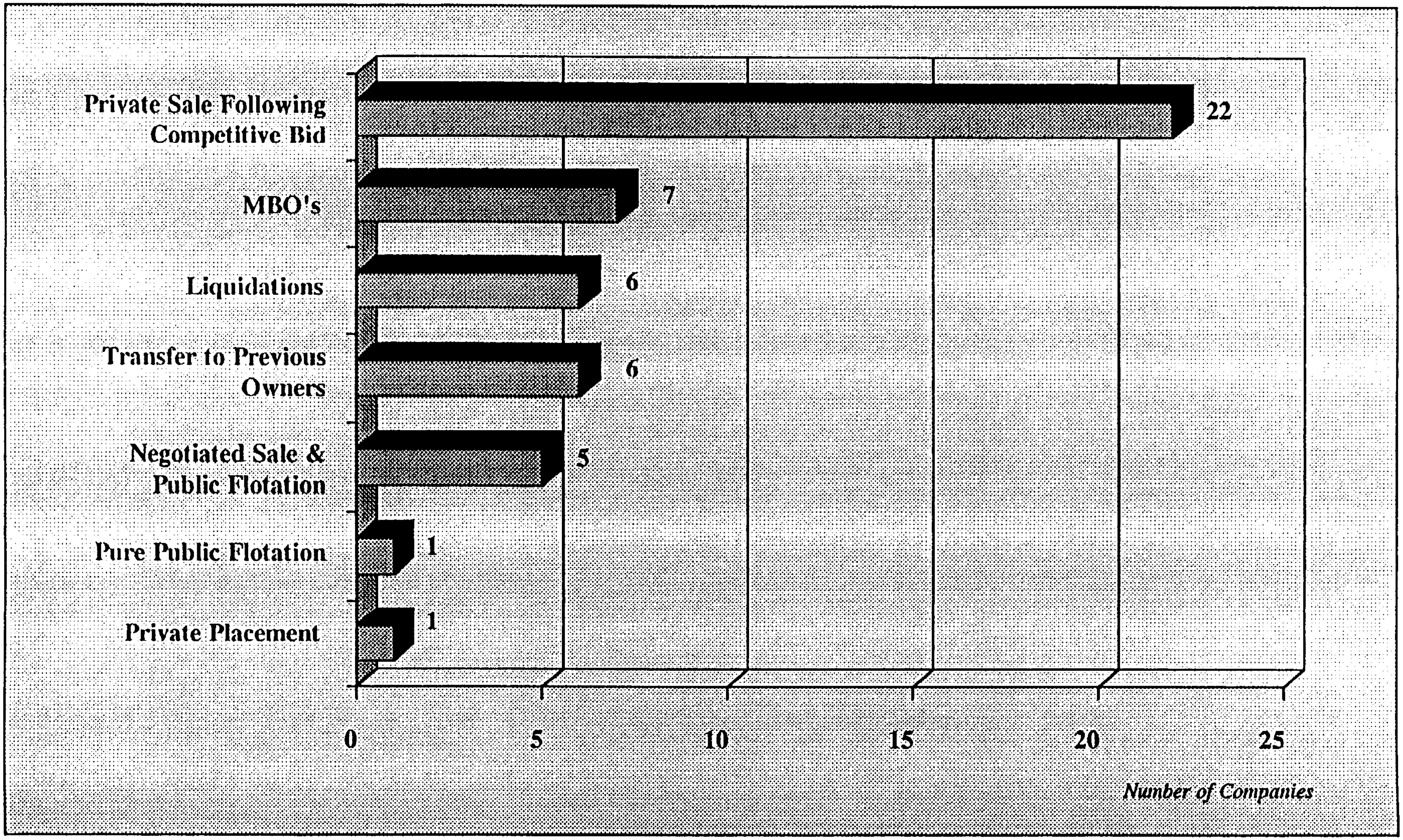
The ZPA has used a "diversified portfolio" (see figure below) of privatization methods showing flexibility to fit the circumstances:

- Private sale (following public advertising) -- most common method to date, a few of these (7) included MBO's and ESOPs (100% or smaller part);
- Public offering for "blue chip" type companies (5 including 1 where the initial public offering has already taken place);
- Private placement (1 taken place, others being planned and prepared);
- Direct transfer to previous owners (6);
- Public auctions (several companies and farms in the agricultural sector will be sold by this method);
- Liquidation sales of assets (6 to date).

It is the opinion of the evaluation team that the diversified approach has helped contribute to the program's success to date. In the future if the circumstances dictate speed over other strategic factors such as selection of a strategic investor, the use of quick sale methods such as auctions could become increasingly more prevalent.

DIVERSIFIED PRIVATIZATION PORTFOLIO: MODES OF DIVESTITURE USED BY ZPA

Companies/Business Units Privitized Through September 30, 1995



Source: CFED/ZPA

B. Key Privatization Steps and Procedures

The principal privatization methods used in Zambia, including private sales following competitive bids, MBOs, public flotation, or a combination of these methods, all involve a large number of steps to complete. Several of the steps are mandated by law such as valuation, independent negotiation, preparation of a prospectus for public flotations, public announcements of winning bids, legal review by Attorney General, and other steps are driven by necessity of having a fair transparent system that also attracts the attention of buyers.

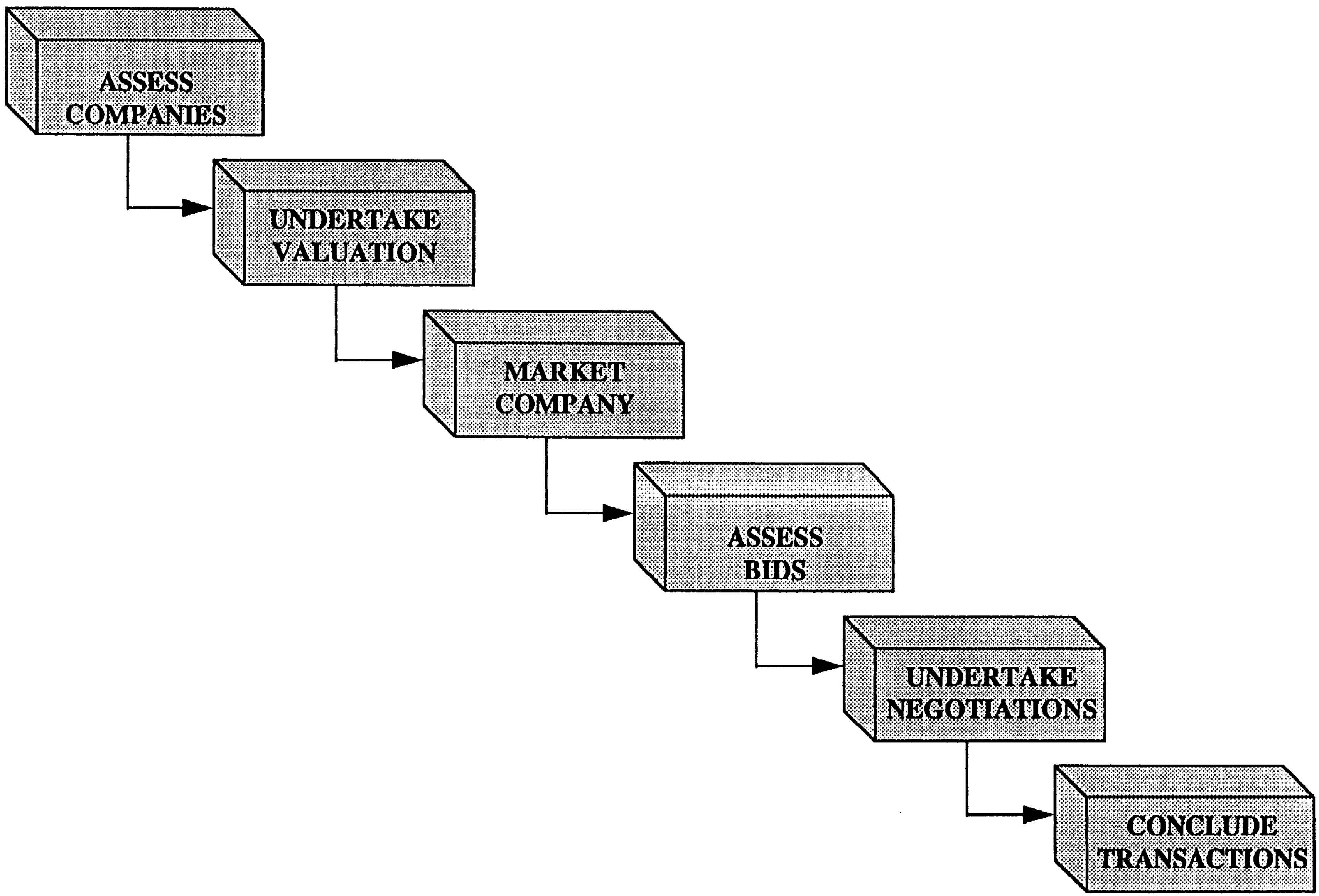
The main methods selected in Zambia, while not the most rapid in the world compared with other methods (such as mass privatization, auction sales, or asset sales), are thorough and place a premium on transparency. The methods also emphasize the importance of the identification and selection of the highest quality buyers who are likely to make the most positive contribution to the economy through their levels of investment, business knowledge, technical know-how, marketing capabilities and other attributes. The main steps in a typical private sale following competitive bids are illustrated in the figure below.

Because of the numerous steps and the different levels of accountability in the process it is not possible to complete the process in a very rapid time frame. For example, even under the most efficient and rapid timetable for a private sale following competitive bid, the process is likely to take at least three months.

One of the successful practices of the ZPA is the outside contracting of consulting firms and professionals to undertake key tasks such as company assessment, valuation, and negotiations[11]. This has been a successful feature for several reasons including: it frees up scarce ZPA staff time; it brings in outside specialized expertise to areas where objectivity and professionalism are of utmost importance; and it widens the "ownership" of the privatization program.

[11] The Privatization Act requires that ZPA hire independent consulting firms and professionals to undertake both valuation and negotiations of sales. The Act does not require that company assessments be done by outsiders, however, the ZPA, in practice, hires outside firms for assessments of larger and more complex firms, otherwise this activity is done "in-house".

TRANSACTION STAGES FOR A PRIVATE SALE FOLLOWING COMPETITIVE BIDS



Source: CFED/ZPA and SRI International

The principal steps and procedures for privatization are described in the sections below. It is important to note that the procedures described in this report are current procedures, and that there have been dramatic changes (e.g., Board authority and objectives, scoring bids, negotiating deals) since the 1993-94 period.

Assess Companies

Under this initial step, an outside consulting firm is usually hired to conduct a "privatization study" for larger and more complex companies to be divested. Otherwise, the study is performed in house. The study includes a market analysis, technical assessment of the company and its management, financial analysis, and review of constraints and issues to be dealt with during the privatization process. The information gathered in the privatization forms the basis of information that the ZPA includes in the Confidential Information Memorandum sent to interested bidders (see discussion below on bidding for companies).

Valuation of Companies

Valuation provides an independent and, in principle, objective assessment of what a company should be worth prior to offering it for sale. The Privatization Act requires that all companies being privatized undergo an independent valuation. In the ZPA program, fixed assets have been valued separately by real estate valuers. Current assets and current and long-term liabilities are appraised by another firm, usually an accounting and audit firm.

Various methods for determining value can be applied to enterprises targeted for privatization in the Zambian program. These methods can be generally classified as asset-based, income-based or market-based. The asset-based methods interpret company value solely as a function of the worth of tangible assets; income-based methods (discounted future cash flow) consider the revenue-generating capacity of the assets to arrive at a fair market value for the enterprise; market-based methods consider the performance of firms in the same or similar lines of business to derive a comparable value for the firm.

All three methods have been used and accepted by the ZPA, but the agency generally gives the most weight to the discounted cash-flow method. The asset-based methods ran into numerous technical limitations including the issue of book value of the asset versus market value, and replacement costs versus "market ability to pay". Another problem with the asset valuation approach in Zambia is that the real estate valuers have been paid as partly as a percentage of their appraised value of the fixed assets. The resulting high valuations of fixed assets was an indication that the remuneration method was probably flawed, and encouraged overly optimistic valuations of property worth.

In the early years of the program, valuation was becoming a stumbling block instead of a facilitator of the process. The valuation procedure, as in other countries, was becoming highly politicized. Various outsiders (including ZIMCO) were known to criticize privatization transactions where the selling price was seen to be too low compared to the valuation price. Also, negotiations become stymied due to the lack of flexibility on the part of ZPA at the bargaining table if the bidder did not offer the valuation price.

ZPA learned a great deal through this experience and the agency and its Board now fully understand the proper use of valuation. It is now widely recognized that it provides only a benchmark estimate for what the company might be worth and the most accurate measure of a company's worth is what a top range of private bidders are willing to pay.

Marketing of Companies and Identification of Buyers

The ZPA marketing process consists of an evaluation of whether the company is likely to be sold locally, regionally, or internationally, the development of marketing materials that are company-specific, and their dissemination through print advertising in local, regional or international news media. Other methods used to publicize companies for sale involve company-specific presentations, promotion of inward visits by potential investors, presentations to commercial sections of foreign missions in Zambia and dissemination of materials through Zambian missions overseas, and briefings to banks, and accounting/auditing companies for dissemination to their clients. All of the channels capable of being used are being exploited, subject to the constraints in the CFED/ZPA budget. Because of the constraints imposed by the budget and the need to divest quickly, it is often not possible for Zambia to mount a strong marketing campaign to investors outside of the Southern Africa region. Respondents to all are provided with the ZPA brochure containing details of the specific company to be privatized.

Bidding For Companies

Interested respondents may purchase from the ZPA a tender package related to the specific company to be privatized. The tender package contains information on the company to be privatized, including details on what the company consists of and number of employees; the objectives to be achieved for the company through privatization; full instructions for submitting bids; details on submission and opening of bids; bid evaluation criteria; notification to bidders on commencement of negotiations; details on sale and purchase agreements; and publication of notices in the Government Gazette on finalization of the sale.

The tender package also includes the company Confidential Information Memorandum (CIM). The CIM is a comprehensive description of the company to be sold that is prepared by the ZPA team and is based on information provided by the company. It is not intended to be the sole basis for submission of a bid by an interested party, but is provided in order to assist a prospective purchaser in making their own investigations and appraisals of the company. The CIM typically contains extensive information on the sector the company operates in; what the objectives to be achieved by privatization are; a history of the company; how it is organized and managed; how it operates; a financial appraisal of current operations and a balance sheet review; details on employee retirement and redundancy costs; and a marketing analysis. Supplementary information included with the tender package may include a fixed asset valuation, detailed financial statements, and a schedule of employee benefits.

Bid documents must contain comprehensive information regarding the bidder and the bid. They must include the name of the business to be acquired together with details of any assets/liabilities not included, if the bid is only for a part of the business, and confirmation of the length of time the bid is valid. It must state the price offered and the form and timing of payment, and the currency in which payment will be made, as well as the extent to which the business will be financed by borrowing. Full details must be provided on the bidder including authorization of the bid by the bidder's Board of Directors, a Certificate of Incorporation or registration of the bidder, and the bidder's latest available audited financial statements. Details must include the name, nationality, address and date and place of incorporation, location of head office, ownership structure, curriculum vitae of senior management, nature and description of the business, and the reason for the bidder's interest in the company being privatized.

A synopsis of the bidder's business plan must also be provided, including a comprehensive explanation of his capability to make the business successful and profitable, an outline of the investment planned for the company to be purchased, as well as the bidder's future operational plans. Plans are also required as to how the bidder will provide for Zambian participation in the workforce, management and/or ownership structure, as well as what policy will be applied to the existing workforce and future employment. In making a bid, it is considered essential for bidders to demonstrate their technical and managerial competence in operating and developing similar businesses, as well as displaying that adequate financial resources exist to complete the undertaking. An exemplary record of past performance and reputation must also be displayed.

Potential bidders are strongly warned that due diligence is their responsibility.

Evaluation Of Bids

Evaluation of the bids commences immediately after the designated tender opening date, and are evaluated against a standard set of quantitative and qualitative criteria. These criteria include the price; the form and timing of payment; plans for capital expenditure; technology improvements to be introduced; the range of products to be provided; the impact on Zambia's foreign exchange earnings; future business plans; verifiable characteristics and background of the bidder; amenability of the bid to concluding the sale transaction expeditiously; proposed ownership structure, and particularly the degree of public or employee ownership; employee retention or expansion plans; and the bidder's policy on pension rights and liabilities for employees.

The scoring system used to evaluate the bids differs from company to company, but is typically based on a total score of 1000, of which 500 points may be allocated for "quantitative" factors and 500 for "qualitative" factors. The quantitative factors are price-related, with typically 400 points allocated for the price offered and 100 points for the payment terms. The qualitative factors (typically 500 points) assessed are the business development plan, the investor's track record, and employment prospects, including retention of existing staff and/or expansion, employee development and training, and a policy statement on the bidder's plans for the existing workforce. Financial stability and industry specific management experience are the criteria used to measure the bidder's track record.

The bidding system clearly gives a great deal of weight to the qualitative factors, which is an indication of the ZPA and GRZ priority to the quality of the investment and the expected economic impact of the investment. The strong emphasis on post-privatization commitments by the buyer also implies that ZPA or GRZ should eventually focus attention and some resources to post-privatization monitoring and enforcement.

Following the analysis of the bids, a document is produced for the ZPA Board for the purpose of requesting approval and negotiating authority to proceed with negotiations with the selected bidder or bidders. This document provides background details on the company to be privatized as well as a summary of the bids received and the outcome of the bid evaluation by company. Finally a recommendation is made on which bidders should be invited for bid development sessions with the independent negotiating team.

Negotiations

Negotiation is the most critical step in the transactions process. If negotiations drag or end in an impasse, the goal of privatizing firms is not reached. On the other hand, when the ZPA and its outside negotiators conduct successful businesslike negotiations, it creates a very positive impression to the investor and makes it more likely that the buyers will put forward a favorable bid.

In the first year of the project, negotiations often got bogged down due to lack of flexibility on the ZPA side, and protracted discussions occurred when bids were lower than valuation prices. To overcome these problems, a company called Ostrer and Associates was hired to train independent negotiators, lawyers, ZPA staff, ZPA Board Members, and other privatization stakeholders including some members of Parliament on successful negotiations techniques.

According to the individuals taking the course, the training was highly effective in improving negotiation skills, helping negotiators understand what their objectives are, and what their strengths are. Negotiators also learned about flexibility, trade-offs, and determining what their best alternative solutions are in case their first choice is not realized. Consistent with GRZ privatization objectives, the training program also emphasized a "total value package" approach to negotiations. Under this system important consideration is given to non-price issues such as employment, training, investment, technology transfer, business knowledge and plans etc.

Following the training of a solid cadre of independent negotiators, and with further skills development through practice, the time necessary to conclude negotiations is now dropping considerably. In 1993-94, negotiations lasted in the range of 2 months to 2 years, now the process has accelerated to as little as 2 days with no reported drop in quality or thoroughness of the process. The current ZPA practice is that the negotiators appointed by ZPA must have attended the negotiations skills training course. If the individual has not attended he/she is not considered.

Finalization Of Sales Agreements

Negotiation results in a Heads of Agreement, which is a non-binding document that relates to the sale of the company between the ZPA and the purchaser. The Heads of Agreement records the terms and conditions which are to be recorded in a Sales Agreement to be drawn up between the two parties to the transaction. It typically covers what is to be sold, the purchase price and how it is to be paid, the terms under which possession will take place, the conditions under which penalties are payable, and the completion date for the sale to be concluded.

On signing of the Heads of Agreement the Sales Agreement is drawn up, agreed to by the legal representatives of the ZPA and the purchaser, and sent to the Attorney General's Office for authorization. This process previously took a considerable amount of time but has now been reduced to about two weeks. This acceleration has taken place due to the Attorney General's appointment of two staff members who are specifically accountable for privatization sales agreements review. In addition, the introduction by ZPA of model agreements with standard clauses to protect the ZPA and the GRZ also helped to improve quality and reduce delays at the Attorney General's Office. After the Attorney General's approval, the Sales Agreement must then be signed by the Minister for Finance and the buyer to complete the sales agreement.

So far in Zambia the completion of this step has been sufficient for buyers to take over control of the companies. However an important legal formality still has to take place after this step -- which is the transfer of deed or title, through the Department of Lands. This step is slow in Zambia and as of end-September 1995, only 16 of the 31 companies sold had completed their transfer of deed.

Post-Privatization Monitoring

Due to the heavy burden of work related to all of the steps leading to privatization, the ZPA so far has not given a great deal of consideration to post-privatization monitoring. Post privatization monitoring will be important for at least two purposes: (1) to track the socio-economic impact of privatization, which will help GRZ to determine whether privatization is achieving the expected economic results in terms of employment, income, taxation, etc.; and (2) to monitor whether buyers are living up to their sales agreements targets and commitments with regard to: payments to the government; investments in the company, training programs, etc.

The ZPA has taken steps to set up a small post-privatization monitoring unit to perform this function. The principal purpose of this unit will be to arrange and organize the enforcement of post-privatization commitment made in the sales agreements. In the socio-economic areas, the GTZ have funded a study to establish the social impact baseline data, and the World Bank are expected to fund a separate study which examines the current availability of social benefits. These two studies will form the baseline data for further monitoring. Following the winding up of ZPA, this unit would eventually need to be transferred to another government agency such as the Investment Promotion Centre.

Use of Privatization Proceeds

The use of privatization proceeds is defined by Section 39 of the Privatization Act. The Act gives complete control of the use of privatization proceeds to the Minister of Finance. The Act specifies that the proceeds from privatization sales be paid into a Privatization Revenue Account established by the Minister of Finance at the Bank of Zambia. All accounts at the Bank of Zambia are non-interest bearing. The Act provides for a very broad range of uses (10 in all) including an "all-inclusive" category which includes "funding any social project that will be in the public interest."

It was reported to the evaluation team by the Ministry of Finance that as end of October 1995, a total of K 21 billion was received in the gross privatization proceeds in the account. Account expenditures at the end of October amounted to K 20.5 billion, leaving a balance of K 500 million. Privatization related expenditures, including retrenchment payments for Zambia Airways and retrenchment and tax liability settlement for the trading sectors accounted for some 47 percent of the account's expenditures to date.

The evaluation team was informed by the Minister of Commerce and Industry that he is preparing a Cabinet submission which would give the ZPA direct access to a greater share of the privatization proceeds for purposes such as retrenchment payments, liabilities settlement, etc. If this proposal is approved, it would be a major boost to the privatization program, as those funds are sorely needed to allow the Agency to sell most remaining companies as going concerns with targeted buyers, instead of mere liquidation asset sales.

Social Safety Net Programs And Issues

Worker retrenchment issues loom large in the privatization process because Zambia has scant provision for social welfare, other than a weak pension and health care system for retirees after age 55 which is vested in the National Provident Fund. In some cases, these social benefits may not even be available because some parastatals withheld deducted contributions for other uses. In some cases, management has been provided for adequately on retrenchment, as a result of upgraded settlements negotiated through ZIMCO prior to its dissolution.

Union workers are eligible for redundancy payments based on their contracts of employment. To date retrenchment has mainly been restricted to the trading sector, where 3,000 workers have been affected. In addition some 1,298 workers were retrenched from Zambia Airways, and 1,438 from Zambia Bus Company, but these were bankruptcies, and do not strictly fall within the responsibility of the ZPA.

While worker contracts are clear, the money often is not available to fund retrenchment payments. Additionally, such payments are only considered after secured creditors and debts owed to the Government have been satisfied. ZPA accordingly encourages purchasers to retain all workers and factors company plans for retention of workers into the points system used to rank bidders prior to negotiation and sale.

However, in cases where retrenchment is unavoidable, significant problems exist in relation to payments to workers. Recourse accordingly must be made to the Ministry of Finance, as in the case of the trading sector, which may provide resources from the Privatization Revenue Account for the payment of severance payments.

A social impact function is maintained within the ZPA. Reporting directly to the Technical Director, and staffed by a Manager and four assistants (together with an advisor who is funded by GTZ), the job of the Social Impact Department is to inform employees in tranched companies how privatization will affect them, to collect retrenchment data from the parastatals, and to handle worker complaints in regard to retrenchment payments. This function is especially important, given the extent of worker uneasiness in regard to the retrenchment issue, but the function also needs to be capable of encouraging workers to continue to perform well in their jobs in the interim, in order to be more confident of retaining them following privatization and in order to protect company assets prior to sale. The Social Impact Department also provides briefing papers on the social issues for each company to be privatized to the relevant transactions team.

V. CONCLUSIONS AND RECOMMENDATIONS

A. Overall Assessment of Project Performance

It is the opinion of the Evaluation Team that the PSP project is on track to achieve (and exceed) all of the substantial goals and objectives set forth in the project paper and contractor agreement. The GRZ, USAID, the ZPA, CFED, and the major Sub-Contractors should all be credited with very strong performance to date.

B. Key Factors in Project Success to Date

It is the assessment of the evaluation team that there are a number of factors which have been key in project success to date. Many of these factors have acted as "turning points" in the successful implementation of the privatization program. Without some of these issues resolved, the project would not have been so successful and or could have even stalled as a complete failure. The principal success "drivers" to date include:

Support for Privatization Process

- ✔ Strong support for privatization at the highest political level including the Minister of Finance and the Minister of Commerce and Industry.
- ✔ Unwavering support of privatization from key donors such as USAID, World Bank, and other donors.
- ✔ Liquidation of ZIMCO, the holding company for many of the parastatals. Until its liquidation, it was emerging as an obstacle to the privatization process. USAID and the World Bank played a key role in convincing the government to liquidate ZIMCO, and also to proceed with other key steps such as the ZCCM privatization.

Institutional Factors

- ✔ Recruitment of top level Chief Executive, following a world-wide search.

✔ Strong commitment and technical strength of CFED advisors, who have been willing to assist local staff, but also have been ready to "roll up their sleeves" to get the job done.

✔ Highly effective training course in negotiations skills delivered by Ostrer and Associates to a solid cadre of independent negotiators. The approach taken emphasizes greater flexibility through a "total value package technique," and negotiating time has been reduced substantially as a result of the training course.

Legal/Regulatory Framework

✔ Sufficient legal framework for privatization (Privatization Act).

✔ Centralized, independent privatization agency and Board of Directors with significant decision making authority.

✔ Transparent divestiture process (valuation as benchmark for price, competitive bidding, clear scoring criteria and ranking process, independent negotiators, public announcement of winning bid and reasons).

✔ Linkage of privatization to other macroeconomic and regulatory reforms including:

- Foreign Investment Act
- Repeal of foreign exchange controls
- Stock Exchange Act
- Banking and Financial Services Act
- Companies Act

Implementation Factors

✔ The establishment of ambitious and specific targets and the emphasis on transaction results.

✔ Professional marketing, public relations, and educational campaign.

- ✔ Broad base of Zambian support through local stakeholder participation in various steps such as privatization studies, valuation, negotiations and legal assistance, share ownership, etc.

- ✔ Greater openness to foreign investment than in the past.

C. Outlook for End-of-Project Success

The evaluation team believes the outlook for end-of project success is very favorable. The evaluation team expects that the ZPA/CFED program will be able to meet and exceed the life of project total of 50-75 firms divested. Based on the current pace and momentum, it is not overly optimistic to project that by the current end of project date (January 1997) the ZPA will have divested some 100 to 140 companies. Even with those accomplishments however, the privatization program will not be completed at that time. Some 35 more companies would remain divested after that date. This means project goals will have been met and exceeded, but the total privatization task will still need completion at that time.

D. Recommendations

ZPA/CFED ORGANIZATIONAL ISSUES

Progressively Transferring More Responsibilities to Local Staff

Now that national staff are becoming more familiar with the entire privatization transaction process, the evaluation team believes that during the next 10 months, Zambian nationals can gradually assume a greater portion of responsibility for the actual work, while the advisors' role of trainer and coach can progressively increase. The awareness of the need for this evolution has become increasingly clear to both ZPA senior management and to the team of foreign advisors. It has become increasingly clear that it is neither healthy nor sustainable for the local staff than the consultants.

There are various ways in which this strategic objective could be achieved. First, the Team Leaders could be asked to take on managerial responsibility for all projects in their team's portfolio. This step would automatically assign greater responsibility to Team

Leaders. Second, as a general principle, at least one Zambian staff member should be deeply involved in each company in the Team's portfolio. Third, the remuneration system should be geared towards recruiting, retaining, and rewarding the most qualified Zambian for their privatization transaction performance. Performance incentives in the remuneration system would give the Zambian staff a greater stake in the work responsibility and performance.

Over the next 10 months, until scheduled project completion, the advisors could spend more time on technology transfer and training, coaching, and quality control and less on direct privatization transactions work. This decline should be progressive, however, and should not preclude the advisors from taking joint responsibility with local staff for transactions performance.

Strengthening MIS, Record Keeping, and Post-Privatization Monitoring

The ZPA senior management recognizes the that the Management Information Systems (MIS) and general storing of information and records at ZPA could be improved. The evaluation team agrees with this assessment. The major priorities are outlined below.

First, the company files (paper copies) could be arranged in very systematic ways: by sector, by year, by company with file tabs for each of the major steps from gazetting through to final transfer of deed.[12] Second, a computerized MIS could be phased in to complement the paper system and provide more quantitative and qualitative data such as: number of companies sold, revenues from sales agreements, timetables for transactions steps, key dates to watch (e.g. close of bid, negotiations, receipt of funds, etc.) and other data such as responses to advertisements or other forms of promotion. Third, before a MIS network can be of universal use to all the operators on the system, mandatory operational protocols have to be established and enforced. Simple protocols, such as establishing that all personnel adhere to the "long file name" available on the system, utilization of common directories and read/write hierarchy standardized database input and reporting have to be established and enforced at the ZPA.

The advantages of a good MIS are numerous: (i) it can help with work load management; (ii) it can help with quality control through better information flow and

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[12] **ZPA has recently employed a librarian and a budget has been provided by UNDP to purchase the furniture and reorganize the archives.**

quality checks; and (iii) it can facilitate reporting to USAID and other donors such as the World Bank and GTZ. The MIS could also help ZPA to track key post-privatization indicators such as: employment levels; retrenchments; training programs; output; investment levels; and loan repayments, etc.

ZPA senior management and the evaluation team agree that the MIS system should be a demand-driven system, and not supply driven. Only the most important data to ZPA management and the Board should be tracked in the system. The responsibility for MIS should fall within the Technical Director's Division. Management information systems are critical for generating reports at every stage of the privatization process, for tracking progress on projects, and for monitoring and follow-up procedures. Computerized systems (with hard-copy back-up) should be the operational norm, and this is more useful to, and more appropriately falls within, the day-to-day operations function.

The USAID/CFED budget currently available until end of project has very little discretionary funding available to introduce and support the system. Supplemental funds are probably needed from USAID or other donors such as the World Bank in order to properly set up the system.

Handling Larger SOEs

As the small and medium sized companies in the ZPA portfolio gradually wind down over the next 10 months, the preparation work for the larger companies should be phased in. These larger companies include commercial banks, insurance companies, ZCCM, and some utilities (PTC).

Under the Privatization Act, the ZPA has the legal authority to manage the privatization of the larger SOEs, including ZCCM. However, ZPA senior management and the evaluation team recognize that the ZPA will not have the capability to carry out the process for these types of companies without significant outside specialist assistance. The bigger companies will require more specialized expertise including investment bankers, law firms, regulatory experts, and industry experts.[13] The timing, costs, and donor support for the bigger projects should be worked out soon, possibly over the next 3-4 months.

[13] The ODA is supplying two lawyers to ZPA who will help strengthen the legal department, which will be particularly necessary for the larger and more complex privatizations. The GTZ will provide a mining expert which will be critical for the ZCCM privatization. Donor funding is available from USAID, World Bank, and GTZ for further technical assistance to support the privatization of the larger companies.

We believe the ZPA should continue to play the technical leadership and coordinating role for the privatization of these larger companies. This role would include: helping draft terms of reference for consultants and outside experts; being involved in the selection of consultants; overseeing their work; advising on methods; overseeing/participating in negotiations; setting time tables; etc.

Marketing Activities

There will be a need for expanded marketing activities to promote the larger SOEs. The USAID funded CFED contract budget for this item is currently quite limited -- about $160,000 to the end of the project. Additional funding will be needed from donors or GRZ sources to cover the following types of marketing expenses:

- Direct marketing and visits to investors.
- Investor conferences in Zambia and abroad.
- High quality marketing materials.
- Advertising and investor searches.

Staffing Needs

As the number of small to medium companies to be privatized decreases by the end of next year and the large, more technically complex companies come in to the ZPA portfolio, there may be a need for a smaller staff with the strongest technical skills. The legal department could use strengthening in order to oversee or conduct negotiations on the big and complex companies.

Finishing the Job and Finding Donor Assistance

We recommend that the ZPA keep its goal of working itself out of a job in the next few years. However, in the meantime there are still some 145 or more companies to privatize including some big and complex SOEs. To complete the job, ZPA will need to identify sources of funding beyond the current USAID project and beyond the World Bank $10 million Privatization Credit. [14] Some of the larger companies will cost in the range

[14] The GTZ advisor to the Chief Executive is reportedly active in this role of finding donor assistance to support ZPA activities.

of $2 million or more for merchant bankers, lawyers, and industry specialists. ZPA should not stop until the job is complete.

Regarding the CFED contract expiration date, the contract is currently due to finish in January 1997. By that date, a majority (but not 100 percent) of the 145 or so companies remaining in the GRZ's divestiture plan will be privatized. Most likely some of the more complex SOEs such as the PTC, some banks and insurance companies, and ZCCM will not yet be complete by that date. Due to the strong overall performance of the Contractor and Sub-Contractor, the need to finish the job, and the need for project continuity, the Evaluation Team recommends that USAID/Zambia strongly consider extending the CFED contract for the extension year that was envisioned in their original contract. The essential criteria for project extension are in place: strong GRZ support for privatization, very good ZPA and CFED transaction performance, and the need to finish the job.

Environmental Issues

Overall the environmental reviews have not been well integrated into the privatization process, in contrast with the experience in countries like Poland. In order to have a real impact, the reviews would need to be closely linked with the company valuation process and this involves providing a more quantitative assessment of the extent of environmental liabilities, particularly for serious high-risk companies. Other privatization steps where an impact could be felt include the placing of environmental provisions, when necessary, into the sales agreement or legal deeds. This has not occurred in this project to date.

To ensure that the reports were used for their intended purpose, the environmental component of the project should have been fully integrated into the CFED project from the beginning. The PH team should have been located within the ZPA office, despite the lack of communications facilities and other difficulties. The project would also have benefited from a less extensive list of companies to be assessed, with the focus only on those companies where a very significant environmental risk was apparent and a more rigorous scientific assessment made of those companies. A third area where the project could have been more effective relates to the education of Zambian officials within the ZPA as to the importance of environmental monitoring in the overall scheme of industrial development. It could also have flagged the possible future costs involved in ignoring potential risk areas.

PRIVATIZATION POLICY ISSUES

Minimizing Asset Stripping

Asset stripping prior to conclusion of sales agreement is becoming a serious problem leading to:

- substantially lower sales prices;
- protracted negotiations with buyers and sometimes re-valuations of companies; and
- serious burden on ZPA staff time.

In order to overcome the problem, the evaluation team suggests that a number of "carrot and stick" measures could be introduced to minimize this problem. The Directorate of State Enterprises should take a lead role in monitoring assets and liabilities of SOEs prior to privatization. ZPA would need to monitor the balance sheet more routinely as part of the valuation and sales agreement processes.

On the "stick" side, in cases were the threat of asset stripping by existing management becomes evident, the Evaluation Team recommends that the Directorate of State Enterprises[15], in collaboration with the ZPA, move swiftly to appoint administrators to manage company assets until the privatization. This has been done in a few cases, but the need for this type of solution may become greater as the program continues. The evaluation team feels that the Directorate of State Enterprises most likely already has the authority to appoint administrators through it shareholding rights and its authority as a member of the SOE's Board of Directors.

As a another "stick" measure, if a few flagrant cases of enterprise theft were tried and successfully prosecuted in the court system, this will serve as a more effective deterrent to future asset stripping.

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[15] It is possible that the Privatization Act would need to be strengthened to give either the ZPA or the Directorate of State Owned Enterprises the authority to appoint a receiver to supervise company operations and protect assets before the sale agreement proceeds. The Tanzania Privatization Act gives their privatization agency this authority.

The Directorate of State Enterprises and the ZPA could also move quickly to appoint replacement Board members to help monitor the SOEs' balance sheets during the transition period until the sale agreement is signed. ZACCI has offered to assist in the balance sheet monitoring by offering a list of experienced business people who are willing to sit on SOE Board during the transition period.

On the "carrot" side, ZPA may want to consider some simple, positive financial incentives to existing SOE managers to protect the balance sheet prior to sale. One simple financial incentive that ZPA could offer would be to offer certain percentage of shares to existing managers and employees through partial MBOs or ESOPs, on condition that they maintain or improve the balance sheet of SOE prior to sale.

Cleaning Up Enterprise Liabilities

One of the biggest threats to the successful implementation of Zambia's privatization program is the threat of large unsettled liabilities which will make it impossible to sell the companies as going concerns, unless some of the debts are written down. In the companies which are now being offered for sale, a large number of them have negative net worth, but for sound economic reasons (employment, investment, generation of tax revenues, etc.), ZPA does not want to liquidate them as a mere asset sales. Private buyers have made it clear they don't want to take on all of these liabilities, as they seek immediate positive cash flows to reduce risk and help finance investment.

Debt write down has thus become standard practice for divesting governments world-wide. The governments of Argentina and Venezuela assumed debts of $930 million and $471 million respectively prior to selling one enterprise -- their telephone companies. Ghana assumed $6.3 million in debts and unpaid taxes prior to divestiture of a few SOEs. In Germany, the government assumed 70 percent of all the SOE debt prior to sale. Many other countries world-wide have tackled this same problem by SOE debt write downs prior to sale.

Systematic procedures will need to be clearly defined to settle certain liabilities prior to sale. This would involve:

- Settling selective government debts (e.g. ZRA tax arrears and cross enterprise debts); and

- Paying out minimum standard retrenchment payments if some workers are to be made redundant.

The objective would be to settle just enough liabilities so that the company's liabilities no longer exceed assets. One source of funds to pay off these liabilities is the Privatization Revenue Account -- similar to the retail sector exercise but on a more systematic basis.

Since the current taxation law does not foresee Government debt write down or write offs even to clean up balance sheet prior to privatization sale, and if the ZPA intends to use selective debt write down as part of the process of readying companies for sale, it would be desirable to have explicate authorization to do so through a modification to the Taxation Act, or through a statutory instrument related to the Act.

Overcoming Capital Constraints

The shortage of capital and liquidity is making the privatization process more difficult, but solutions can be found to facilitate buying. The financing of privatization transactions situation is constrained in Zambia because: (i) relatively few Zambian companies and individuals have accumulated enough significant capital to provide significant equity in their privatization bids; and (ii) the fact that the banking system offers almost no long-term debt finance, partly as a result of high inflation. Donors are discussing the establishment of venture capital funds but, to date, no venture capital funds have been tapped for privatization transactions.

The evaluation team recommends the following strategy for overcoming the capital constraints in Zambia:

- Continue to encourage buyers with limited capital to find financial partners either national or foreign;

- Reduce price and/or clean up balance sheet to encourage buyers;

- Be cautious of deferred payment schemes and seriously consider action for payment arrears or default;

- Pursue measures to widen ownership (stocks, mutual funds, ESOPs, etc);

- Try to establish or tap venture capital funds quickly -- through such sources as the CDC, GTZ, IFC, USAID, private financial institutions, or the GRZ through proceeds in the Privatization Revenue Account.

Social Safety Net Issues

There are two major issues that need to be addressed.

First, funds need to be available to ZPA from the Privatization Revenue Account without the necessity of extensive negotiations with the Ministry of Finance. This will require that the ZPA have more direct access to the privatization proceeds for retrenchment payments -- when these are necessary and in line with what the government can support.

Second, Zambia needs to develop a social welfare system. A National Social Safety Net Coordinating Committee that reports to the Ministry of Labor, that has produced a draft social policy, including a retrenchment policy. Six iterations have been produced but no decision taken on implementation. Models of effective social safety net financing systems exist and such a system is a realistic medium-term objective. The major question is how long it will take to implement in the Zambian context. In order to make further progress towards a resolution of this issue, the Social Impact Advisor, who is knowledgeable about how such systems work, could be seconded to the Ministry of Labor to help develop a viable policy on issues such as private pensions, payment during illness, loss of income, financial assistance for the disabled, and assistance for children.

ANNEX

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