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**MONITORING AND EVALUATION OF PRIVATIZATION PROGRESS
IN DEVELOPING COUNTRIES**

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MONITORING AND EVALUATION OF PRIVATIZATION PROGRESS IN DEVELOPING COUNTRIES

PURPOSE

The purpose of this monitoring and evaluation mechanism is to identify where a given country is located at the present time in terms of privatization commitment and activities and to assess its progress over the life of this Privatization and Development project (PAD) undertaken by the International Privatization Group (IPG).

This mechanism will be used with those countries where IPG has technical assistance activities, training or applied research activities. It can also be used by the IPG as a country selection mechanism for IPG involvement because IPG's target countries are the ones with strong commitment to privatization and which have a high chance of success.

THE MECHANISM

I. COMPONENTS AND VARIABLES

The major components of the mechanism used to monitor and evaluate privatization progress in developing countries should contain the relevant variables cited in the literature of privatization as well as by the practitioners and they could be grouped into five categories: 1/ host country government's (HCG) commitment to privatization; 2/ institutional adaptation to the privatization requirements; 3/ SOEs' readiness; 4/ investors' interest and trust in participating in the privatization process and 5/ donors' interest and commitment to support the privatization effort discussed as follows.

A. Government Commitment

The government commitment could be measured by the absence (0) vs. the existence (1) of the following variables needed to enhance the likelihood of success in privatization:

1. **Privatization Policy:** The HCG's commitment to privatization is clear when there is an explicit privatization policy which spells out in writing what and why the HCG wants to privatize the SOEs. The existence of such policy would enhance the likelihood of success because not only commitment is important but also such policy provides a clearer direction for privatization planning and implementation.

2. **Privatization Strategy:** The HCG's commitment becomes even stronger when a strategy of privatization exists because it shows clearly that it has seriously considered how to carry out its policy. Once again, the existence of a strategy would enhance the chance of success.

3. **Privatization Committee:** The existence of a privatization committee is indicative of the HCG's commitment to privatization. A permanent committee shows a stronger commitment than an ad-hoc one. Also, a permanent committee tends to produce better privatization decision than an ad-hoc one for the simple reason of time commitment and hence higher learning curve. Finally, a privatization committee normally consists of representatives from the responsible ministries which have SOEs under their umbrellas as well as representatives from the private business sectors. Such committee would tend to understand better what might be successful and what might not as it has the balanced view of all constituencies of privatization, namely the sellers, the potential buyers and the management of the SOE which constitute the product in the transaction.

4. **Target List of SOEs for Privatization:** The longer the list, the higher the desire of the HGC to privatize its SOEs. Normally, the list would exclude the national-security sensitive SOEs and hence, the risk of renationalization of the privatized SOEs would be diminished; therefore, enhancing the chance of successful privatization.

5. **Public Statements Made by Political Leaders:** The HCG's commitment would be most obvious if the Prime Minister or better than that the President himself makes a public statement supporting privatization.

6. **Privatization Law/Decree:** The HCG's commitment translated into actual action by issuing a Presidential decree/law would enhance the privatization success as such law/decreed describes the rule of the game for the involved parties to follow.

7. **Privatization Fund:** The establishment of a privatization fund would provide the necessary source of financing which constitutes one of the major bottleneck to privatization. This is indicative that the HCG has carefully planned its privatization effort and hence the likelihood of success would be greater.

8. **Number of Privatized SOEs:** Finally, the number of SOEs which have been actually privatized is the strongest indicator of the HCG's commitment to successful privatization.

B. Institutional Adaptation

The prerequisites to successful privatization are the institutional adaptations which would provide a favorable economic environment discussed as follows:

1. **Fiscal Policy:** Tax incentives on dividend and capital gain are necessary to stimulate ownership of stocks issued from privatized SOEs which in turn facilitates the development of a capital market and promotes financial broadening and financial deepening. Tax incentives are also necessary to attract foreign investors to participate in the privatization

transactions. Also, a decrease of subsidies to the SOEs is a clear indication of HCG's firm intention to force privatization of inefficient SOEs.

2. **Monetary Policy:** Policy which promotes the development of existing financial institutions such as insurance companies or pension funds in order to allow them to actively participate in the financing aspects of privatization would enhance the likelihood of success of privatization. Monetary policy could also promote the creation of new financial institutions such as mutual funds or investment companies in order to help the process of financial intermediation between savings and securities investments rather than the traditional bank deposits.

Favorable monetary policy would stimulate the capital market with new instruments created for trading, giving the investors more choices. With more participants and a place for trading, the trading volume would increase and the necessity of an uniform accounting procedure would have to be used in order to maintain investors confidence especially when a strong Security Exchange Commission is put in place.

3. **Development Plan:** The existence of a substantial section reserved specifically for privatization planning would normally enhance the likelihood of success because objectives are normally spelled out, costs, financial resources and impacts are identified.

4. **Private Sector Development:** Investment laws and price decontrol policy need to be stimulative to the development of the private sector in order to support the privatization effort as more competition will take place and efficiency becomes a must for survival in the absence of government subsidies.

C. SOEs Readiness

1. **Management Support:** Management of the privatized SOEs need to be involved from the outset of the privatization effort in order to ensure their support. Contrary to general belief that SOE management would automatically object to privatization because of the fear of losing jobs, well informed management which knows about the short term and long term impacts of privatization and the measures to be taken to smooth out the ownership transfer process would give the support.

2. **Employee Communication:** Communication with the employees, training for relocation, compensation for early retirement and the possibility of employee ownership of the SOEs to be privatized would normally reduce resistance from the employees.

3. **SOEs Performance:** Highly liquid, efficient and profitable SOEs are always more likely to be successful post-privatization. Yet, less profitable SOEs or even losing ones could also be successful post-privatization if they have the necessary ingredients for profit such as without price control for example. The financial performance variables to be used would be as follows:

- . *Liquidity:*
 - . Current ratio
- . *Efficiency:*
 - . Account receivable turnover ratio
 - . Inventory turnover ratio
 - . Current asset turnover ratio
 - . Fixed asset turnover ratio
 - . Total asset turnover ratio
- . *Leverage:*
 - . Debt to total asset ratio
 - . Interest coverage ratio
- . *Profitability:*
 - . Return on investment
 - . Return on equity
 - . Gross profit margin
 - . Operating profit margin
 - . Net profit margin
 - . Earning per share

D. Participation

Privatization cannot be successful unless there are potential investors who are interested in the SOE because they foresee the potential profit earned from the enterprise. The interest can be from the local business community as well as from foreign investors. The broader the impacts on the country post privatization, the better. For this reason, the method of ownership transfer could affect the scope of the privatization impacts. An outright liquidation can simply transfer the ownership to a few owners and this approach might not be beneficial in the long run to the development of a capital market because such method does not provide the ingredients for financial broadening nor deepening. In contrast, a public offering of stocks coupled by an employee stock ownership plan (ESOP) would create a broader impact.

E. Donors' Commitment

The donors' commitment could be indicated first by the interest of the head of mission in the HC, whether the person represents AID or any other aid development institutions. The next indicator of donors' commitment which are facilitators to successful privatization consists of the existence of a written strategy for privatization and the financial resources allocated.

DATA & METHODOLOGY

The monitoring and evaluation matrix as shown by the attached exhibit could be used for each country based on data provided by the field consultants as well as by interviews with those who have worked in a given country of interest to IPG. The sources of information could also come from the HCGs or the international donors operating in the countries.

Each variable could receive a weight and the total number of scores would determine whether a country belongs to which of the following five categories:

- . Category I: countries with no interest in privatization;
- . Category II: countries with some interest in privatization but which do not have a clear commitment by the HCG to such plan;
- . Category III: countries with interest and HCG's commitment to privatization but which have not privatized any state-owned enterprises (SOEs) yet;
- . Category IV: countries with interest and HCG's commitment to privatization and have privatized some SOEs but are still lacking the proper institutional adaptations and technical know-how in order to do it successfully and;
- . Category V: countries with interest and HCG's commitment to privatization and have successfully privatized their SOEs because all necessary ingredients are present.

The weight given to each variables could be zero (0) vs. one (1) with nominal answers are applicable such as "yes" or "no". For example, if a country has a written privatization policy then the answer is "yes" and one point (1) is given. A zero (0) is given if there is no privatization policy.

If attributes are nominal and some intensity of such attribute could be determined then one (1) would be used for the weakest intensity and two (2) would be used for the higher intensity. For example, a one (1) is given if the Prime Minister has made public announcements in support of privatization while a two (2) is given if the President himself has done it instead.

Variables which are quantifiable are given the numerical weight. For example, a country with five SOEs which have been privatized would receive a weight of five (5) while another with 12 would receive a score of 12.

The evaluation would be made each year as well as by comparing the change overtime based on higher score and on the kind of variables which have taken place throughout the life of this project.

The examination of the evolution overtime could also provide some clue as to how and which variables would correlate the most with the increase in privatized SOEs and the impacts of such privatization efforts on certain aspects of developing which could be attributed more distinctly to the privatization effort such as financial deepening and

broadening, higher efficiency of privatized SOEs, higher business income tax collected by the HCGs or reduced subsidies to SOEs.

MONITORING AND EVALUATION MATRIX

(1)

PRIVATIZATION ACTIVITIES

COUNTRY X

Temporal Development and Scoring

Activities/indicators	Information Requirement and Methodology *	Through 1990 BASE	1991	1992	1993	1994	1995	Evaluation
<p>GOVERNMENT COMMITMENT</p> <ul style="list-style-type: none"> - Privatization Policy - Privatization Strategy - Privatization Committee <ul style="list-style-type: none"> o Ad hoc o Permanent - Target list of SOEs - Public Annoucement/PR <ul style="list-style-type: none"> o Prime Minister o President - Law/Decree on Privatization - Privatization Fund - Request for donors help <p>INSTITUTIONAL ADAPTATION</p> <ul style="list-style-type: none"> - Fiscal Policy <ul style="list-style-type: none"> o Taxation o Subsidies Reduction to SOES - Monetary Policy <ul style="list-style-type: none"> o Financial Institution Development 	<p>AID Missions then the pertinent ministries are called upon as prime sources of information</p> <p>Prime Ministry (PM) / AID Missions</p> <p>PM</p> <p>PM / Missions</p> <p>PM</p> <p>AID</p> <p>PM</p> <p>PM / Missions</p> <p>Finance Ministry</p> <p>Central Bank</p>							

* Single indicators (with sub-categories) are given the weight of 1.

* Indicators with a numerical output are given the weight of the output.

*Indicators with sub-groups which indicate a stronger commitment to privatization are given a weight of 2.

MONITORING AND EVALUATION MATRIX
PRIVATIZATION ACTIVITIES
COUNTRY X

Temporal Development and Scoring

Activities/indicators	Information Requirement and Methodology *	Through 1990 BASE	1991	1992	1993	1994	1995	Evaluation
<ul style="list-style-type: none"> - Securities Markets <ul style="list-style-type: none"> o Types of instruments o Securities Exchange Commission o Accounting Procedure & Audit - Private Sector Development <ul style="list-style-type: none"> o Price Decontrol o Investment Laws SOEs READINESS - Management Support - Employees <ul style="list-style-type: none"> o Communication/PR o Training/Relocation o Compensation o ESOPs - Performance <ul style="list-style-type: none"> o Profitability o Efficiency o Liquidity - Rehabilitation/ Revamping PARTICIPATION - Interest <ul style="list-style-type: none"> o local o international - Transactions <ul style="list-style-type: none"> o local ownership o international ownership 	<p>Central Bank</p> <p>PM</p> <p>PM / SOEs</p> <p>Chamber of Commerce / Business Association</p> <p>PM/ Privatization Committee</p>							

*Single indicators (with sub-categories) are given the weight of 1.

*Indicators with a numerical output are given the weight of the output.

* Indicators with sub-groups which indicate a stronger commitment to privatization are given a weight 2.

