A Dynamic Approach to Donor-Funded Privatizations

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An Example from Burundi

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Good afternoon, Ladies and Gentlemen. I am very pleased to have this opportunity to talk to you about privatization, USAID, and Burundi. I'd like to start with Burundi. Your presence here leads me to infer that all of you have at least heard of Burundi, but I know from experience that most of you know little about this tiny, beautiful country. I'd love to spend an hour doing nothing but singing the praises of Burundi as a place to live and work, but time constrains me to give you only the most meager notion of where we are and how small our economy is.

My presentation is entitled "a dynamic approach to donor-funded privatization." Although a few of you here represent donors—World Bank, the UN, USAID, perhaps other bilaterals, most of you represent governments concerned with privatization programs or consulting and auditing firms which assist in the technical processes. Donor agencies are middlemen in this environment—often powerful middlemen insofar as they supply substantive financing. Frequently they have large roles in defining a country's privatization objectives and strategies; often they both recruit and to a large degree manage technical assistance. Therefore I believe I am speaking to all of you as I present our case, which I hope will offer some useful insights.

In 1990 USAID received a request from the Government of Burundi to assist in privatization. We responded to the overture diffidently. The privatization program looked like a quagmire; it was often regarded as an imposition from the World Bank. But the Bank itself was increasing pressure on the Government to accelerate divestiture of state-owned enterprises, and at USAID we knew we could not turn our backs on an opportunity that fit within our core strategy of private sector development.

We took our time to become thoroughly familiar with the economy and the society, and we listened to everyone interested in privatization in Burundi. In June of 1991 we decided to participate in the Fifth Privatization Conference of this venerable Institute. At that time we made some rewarding contacts which have served us and Burundi well these two years. We learned a great deal at the Fifth Privatization Conference—not the least of which was that even though the financial dimensions of privatization in Burundi seemed miniscule, the problems we and much larger economies face are very similar. We returned to Burundi confident that we could move forward.

We would eschew general studies: USAID's competitive advantage lay in direct action and concrete results. With the responsible agency of the Government of Burundi—the SCEP (Service Chargé des Entreprises Publiques)—we would follow a single transaction from beginning to end. In any event we knew at this point that we would learn on-the-job; we would only undertake a transaction that held promise of success and which could be completed in under one year. To the GRB we stated four principles to which we would zealously adhere:

- all work on the chosen transaction would be carried out in full transparency;
- tenders would be issued through public offerings;
- the State would not retain control over the privatized firm either through shareholding or voting rights;
- there would be no long-term protectionism for the newly privatized entity.

At this point USAID contracted for technical assistance, and in June, 1992, Price Waterhouse's International Privatization Group sent a consulting team to begin work on identifying and proposing selection of a single firm for divestiture.

Working from a short-list, the Price team, with SCEP and USAID, identified ONAPHA, a pharmaceutical manufacturer, as the right target for our intervention. ONAPHA is 100 percent state-owned. With a product line of some fifty medications, the firm enjoys about 15 percent of the wholesale drug market in Burundi and has been profitable for each of the last five years. Both management and employees of ONAPHA believed that they could benefit from privatization, and latent external opposition was disarmed by the transparency and excellent public relations of the Price consultants and of USAID.

ONAPHA's potential looked good. Remember, in Burundi we have only small businesses, and ONAPHA for all its local prominence does under $1.5 million in gross sales. The graph shows the profile of the pharmaceutical market in Burundi. At present ONAPHA, with its 14-15% of the market is operating at about 35% capacity. The next graph, on the firm's sales segments, shows the Ministry of Health to be a preponderant client.

This dependency on the Ministry of Health—a guaranteed customer—inevitably led ONAPHA down the road to complacency like most state-owned companies. But a close look at the graphs invites deeper analysis: ONAPHA sells nearly five times more to the Ministry than to the pharmacies, but pharmacies' market segment is nearly double that of the Ministry. The reason for ONAPHA's disparate position vis a vis its two clients is not just one of public sector coziness. It is one of product. ONAPHA sells generic medicines; doctors prescribe, pharmacies push, and the public requests, brand-name drugs. Suddenly we faced a policy issue: would the Government be willing to change reimbursement legislation of the Mutuelle? Rather than reimburse 80% of *any* prescribed medication, the Mutuelle could be responsible for reimbursement of 80% of those generics locally available. The policy issue, more than any other, galvanized interest in the ONAPHA case; it also raised the stakes, developmentally and politically, of the privatization.

The ONAPHA transaction quickly became the hottest number in town. The company was profitable; it had no debt; it could develop into a dynamic private manufacturer capable of expanding its range of generics, moving into production of intravenous fluids, and boosting its market share. The policy implications of its privatization meant foreign exchange savings for the State and better provision of affordable medications for the population. With their combination of financial analyst and investment banker, the consulting team was able to initiate a series of actions almost concurrently: valuation of the business, contacts with potential investors, contacts with the financial institutions, and promotion of the deal. Marketing did not wait for finalization of the prospectus.

The consultants also looked at the financing of the deal: they contacted the commercial banks, the IFC and the PTA Bank—a regional trade bank of eastern and southern Africa.

Now one issued loomed large: there was a need to structure the sale. Two extremes had to be avoided: sale to local speculators who would bleed company profits without improving management or committing to capital investments; sale to a foreign interest which would simply use the business as a distribution point for its own products. The process finally agreed upon is unusual and in Burundi required an amendment to the privatization law. I think you will appreciate the logic behind what we were doing when, after many deliberations, the GRB consented to the following structure:

- Private local investors 35%
- Technical Partner 25%
- State Insurance Company 20%
- IFC 15%
- Employees 5%

When the prospectus was completed, it became the first truly professional document of its sort ever prepared for a privatization in Burundi. The developmental implications are noteworthy: the GRB felt that at last it was being shown how privatization should be conducted. Technical standards for both the Government and other donors were established; information was available and transparent. On a technical side the price tag on an enterprise no longer was simply its equity capital but its discounted future value. To value an asset not in terms of its cost but in terms of the benefits it can produce was a real break from tradition, and we emphasized to the Burundians how this perspective could build value into the entire privatization program. Because of the highly collaborative nature of our work, on-the-job training was a natural part of the process.

As I talk to you today, the tender for ONAPHA has been out for just over three weeks. Ten days ago SCEP held a public press conference. Divestiture is not assured and could be several months away. You are justified in wondering how I can present this transaction as if it were a success when it has just gone onto the auction block. Certainly USAID is eager to see divestiture. But remember, a donor agency cannot measure its success in terms of a sale; as anyone close to privatization programs knows, successful transfers can sometimes be developmental calamities. For us success is also measured in the transfer of know-how, the "professionalization" and empowerment of an indigenous agency, and the social acceptance of an economic imperative. Value has been added into every step. The bogeyman of privatization has been exorcised. If the sale goes well, investors will reap good returns, the Central Bank will realize foreign exchange savings, and the people will have greater access to necessary medications and intravenous fluids at moderate prices.

This is a story in the implementation of policy. It has suffered more delays than we like, and it has cost more than it should. Nonetheless, we feel that our strategy has been vindicated, and consultants with multi-country experience tell us that it could serve as a model for other programs. I would like to present the principal elements of this strategy as we see them at USAID:

First is *preparedness*: you must have sound knowledge of a country's economy, society, and politics before engaging in privatizations. Value technical expertise, but do not suppose it sufficient for the process. If you feel the need to commission a study on the enabling environment for privatization, you are probably not ready as an agency to manage the task.

Next is *action*: it is a bias for action that is missing in many privatization programs. Once the indispensable studies are complete, select an enterprise and effect the transaction. Learn on the job. Action will tell you more about the government's will to privatize than a year of studies. If opposition seems to hide in the shadows, action will scare it out. A warning, however: only undertake, or even promise to undertake, those transactions which you have good reason to suppose you can bring to the sales point in a year or less.

Be *value-driven*: never look at the privatization of a going firm as simply a sale. You will skew your own measures of success and risk crippling your work. What are the policy implications? How can the government, employees, segments of society benefit? Are there budgetary or foreign exchange implications? Then concentrate on selling. Build value and make it known. In this way you will put marketing where it should be: up front and in every phase of the work. By the time you are ready to issue the tender, your salesmanship has preceded you.

Remain *close to the stakeholders:* in privatizations, the stakeholders are many and heterogeneous: customers, the government, employees, management, labor unions, and so forth. Know their concerns, meet with them, sell them on the deal.

Manage your *technical assistance*: the experts you contract with have their own corporate objectives. They are private firms seeking a profit for their services. Write your terms of reference together, listen to them carefully, but also communicate your own benchmarks of progress and success to them. And make sure you have the right combination of expertise. Especially salesmanship. You need salesmen.

These guidelines may seem self-evident. Believe me, one or more of them is too often ignored. There are no enshrined formulas for privatization programs. But at USAID/Burundi we believe that the elements I have presented are dependable companions. I commend them to you.

Thank you for your interest and patience. I want to urge all of you to find an opportunity to visit Burundi--not for its privatizations but for its lakes and beaches, its mountains, its perfect climate, and its wonderful people. For the moment, however, I will be glad to answer your questions and to learn from your observations.