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**Deloitte Touche  
Tohmatsu**



*Assessment of the  
Macedonian Privatization  
Program to Determine  
Technical Assistance  
Requirements*

*Presented to:*



*Presented by:*

*Deloitte Touche Tohmatsu ILA Group Ltd.  
Washington, D.C.*

*September 1994*

**Deloitte Touche  
Tohmatsu  
International**

I. TASK ORDER OBJECTIVES AND TECHNICAL REQUIREMENTS

A. TASK ORDER OBJECTIVES

USAID has established the following objectives for the work funded under this Task Order:

- Get privatization off to a good start with the successful privatization of 5 - 10 "pilot project" companies of interest to foreign investors.
- Assure that the privatization is clearly understood and well received through assistance in developing a public education/public relations program.
- Assist the Privatization Agency to develop processes and procedures to smooth the privatization flow, and directly assist in processing privatization proposals.

The Task Order calls for the following amounts of specialist time to achieve these objectives:

<u>Functional Labor Category</u>	<u>Work Days Ordered</u>
Project Manager	220
Financial Planners	1,100
Capital Markets Specialist	30
Attorney	90
Accountants	140
Industrial Engineer	10
Market Export Promotion (Public Relations)	220
Local National Supervisor/Senior	140
Local National Senior Consultant	100
Local National Assistant/Associate	<u>75</u>
Total	2,125

For clarity, we would like to underline that the intention of the task order is to obtain quick results by selling 5-10 enterprises, modify the process based on the lessons learned, and then move into a high volume sales program, similar to the ones in the Czech Republic and Hungary.

The purpose of this present assignment is to assess the current realities facing this project and determine how a viable program should be structured for early, cost-effective success. Below we develop a work plan that will clearly identify objectives for each function in the scope of work, clear performance indicators

(milestones) and reasonable intervals/timeframes within which those milestones will be accomplished.

**B. BRIEF ASSESSMENT OF THE CURRENT SITUATION AND THE EFFECTS UPON THE PRIVATIZATION PROGRAM**

This chapter discusses the current realities affecting the privatization program in Macedonia, including:

- The economic and political environment
- Privatization initiatives
- Privatization pipeline
- Our counterparts.

**Economic and Political Environment**

Current conditions are not propitious for a significant revival of the economy due to the external embargoes on both the northern and southern borders. Serbia, the former major trading partner, is closed to trade, and this affects trade normally passing through Serbia to other markets as well. The tightening of the U.N. embargo works against the interests of Macedonia. Similarly, the disagreement with Greece regarding the national name and symbols restricts commerce to the South.

These restrictions come at a time when Macedonia is attempting a serious restructuring of its economy moving from a mixed socialist system to a free market. The privatization program upon which the present Government puts much emphasis could be affected since investors may be less inclined to act and foreign buyers could be seriously discouraged.

In November 1994 a general election will be held and any misstep by the Government could influence the electoral outcome. Therefore, all actions by the Government have political implications. In the short term, the Government wants to establish a favorable track record in privatization to justify the concept as well as the expenditure of time and effort to date. Much preparatory work has been done but to appease critics and strengthen public acceptance of the reform program tangible evidence is needed to demonstrate the value of the policy. Therefore a concerted effort is needed to divest several companies quickly, but it is highly unlikely that enterprises can be divested prior to the elections. Rapid mobilization of this project as well as the implementation of the public relations program already planned by the Government will lend credibility to the its program of economic reform and privatization.

Inherent in the privatization process is the potential for increasing the already high unemployment problem. While on an adjusted basis the unemployed figure may rise, the overall situation may be little altered since many companies are overstaffed and some employees are paid who produce nothing. The matter may therefore be one of appearances but in the light of the political environment such appearances are important. Furthermore, additional funds will be needed for redundancy payments, further straining company and Government resources.

As a result of mismanagement under the old system the financial structure of the country is in disarray. The banking institutions are illiquid, overwhelmed by non-performing loans. Industrial companies are in default on loans from the banks, the prospects for a near term solution is bleak and no long-term solution may be viable without the assumption of the debts by the Government. Subsequent sale of those companies to private investors could subject the Government to criticism of selling the properties on too favorable terms and squandering the public patrimony. Therefore, a public relations campaign is planned under professional direction to persuade the public of the need for realistic pricing and timely action if the privatization program is to succeed, and the economy made more efficient.

While the economic reports are negative, the daily life in the capital city, Skopje, appears little affected. An underground economy is reputed to be active. Many workers hold more than one job, in some cases being paid not to work in one instance and working and earning a wage in another job.

Macedonia has some natural resources including coal and non-ferrous metals, particularly chromium. Energy needs are mostly met from external sources including imported oil, electricity from the Serbian grid, other contiguous countries and local hydroelectric power generating facilities.

Near term political stability depends on several factors:

- Progress of the transition to a free market economy with acceptable social costs
- Control of inflation
- Limitation on the unemployment caused by industrial rationalization and privatization.
- Public perception of fairness and equity in the reform process
- Civic education of the populace to gain support for the free market economy and democratic government.

Incorporated in our strategy for the implementation of this project is a series of elements intended to address these

problems.

### **Privatization Initiatives**

In many regards, the privatization program is ready to proceed. The Privatization Law, officially the Law for Transformation of Socially Owned Enterprises, was enacted in June 1993. This law authorizes the privatization of about 100 large, 300 medium and 1100 small enterprises. The privatization of about 450 enterprises was already begun when Macedonia was a Yugoslavian republic.

A minister without portfolio, Dr. Jane Miljovski, named last year, is technically in charge of privatization. An Agency for Transformation of Enterprises with Social Capital (the Privatization Agency) was formed in November 1993 and has a staff of about 25 persons.

A methodology for Valuation of Enterprises with Socially Owned Capital was approved on December 10, 1994, which officially set the timetable for submission of privatization plans by small, medium and large enterprises subject to the Law. Small and medium enterprises must prepare and submit their plans by December 10, 1994, and the large enterprises by December 10, 1995. Despite the timetable set forth in the law, The World Bank has wanted to accelerate the process.

To overcome the delayed timetable problem, particularly regarding the large enterprises, the Privatization Agency urged companies that wanted to privatize immediately to develop their privatization plans now, even though they were not legally obligated to do so. The Agency also identified 25 enterprises that are the largest money losers as targets for restructuring and ultimately privatization.

The 21 companies actually picked as the prime targets are now preparing their privatization plans. Seven have actually submitted plans, but these were returned for additional information.

In the case of the 25 seriously money-losing companies, The World Bank and USAID are supporting the development of preprivatization restructuring plans. The teams developing these analyses were in-country in August-September 1994.

Despite the political impediments facing the country, 10 foreign buyers have already expressed interest in companies in the program, namely textile, tobacco, tourism and medical equipment operations. KPMG has just signed a success fee-based contract to sell the tobacco company, similar to the transaction agreements they made in Kazakhstan and Uzbekistan. Nevertheless, attracting foreign investment

will be difficult for the reasons given in the previous section.

Approximately 450 enterprises were privatized in 1989-1991, as a result of the Markovic Law, which was promulgated by the Yugoslavian government. These companies were privatized primarily through management-employee buyouts, which are viewed by many to have fallen short of the goals hoped for in a privatization program. Many of these privatizations are yet incomplete and are considered by the Privatization Agency to be a part of this project. It is envisioned by Government that they may be completed by assisting well-qualified management to buy out the control of these companies.

In the new Law, which is largely based on the Markovic law, the Government has chosen to continue with a transactions program, as opposed to what might be a more politically popular mass privatization program. The Government feels they want to create real change as a result of real money paid for the controlling interest in the companies. The Government stresses that their goal is economic efficiency, not just privatization, and thus the use of the term "transformation" in the Law. Despite clauses in the law allowing employee buy-outs, the Government clearly wants to implement the program in a way that responsible, capable managers and/or foreign investors obtain controlling shareholding in the enterprises with the employees usually holding a minority participation.

#### **Privatization Pipeline**

There is presently no pipeline of enterprises to be privatized. The 21 companies selected for accelerated privatization are listed in Exhibit 1 along with their line of business, their status under the Markovic law, number of employees and percentage of privatization already completed. Small enterprises are defined by the new law as having less than 50 employees; medium ones have 25-250 employees; and large enterprises have more than 250 employees.

The Minister feels that the near term goal is the privatization of 25 medium companies and 5 large companies. The Director of the Privatization Agency agreed with this as a goal, plus 70 small companies. We have responded to this expressed need by adding a small enterprise sales specialist to our list of advisors, to assist in setting up the small enterprise program. The Agency suggested that they would like to achieve these goals by the end of the year; however, we feel that their expectations are too high given the economic conditions in the country.

EXHIBIT 1  
Enterprises Selected for Pilot Program

Name of the Enterprise	Sector	Markovic Law Privatization	No. of Employees	% of Privatization Completed
"Alumina" - A.D. Industrija za alum. polufabrikati - Skopje	Metal ind.	Yes	1104	24
"Astibo"-A.D. Holding-Modna konfekcija - Stip	Textile	Yes	2620	6
"Belica"-D.O.O. za riboproiz.trgov. i ugost. - M.Brod	Fisheries	Yes	45	48
"Bel Kamen" Proizv. na bicena graga i ambal. - Vinica	Wood processing	No	68	0
"Video Inzineriing" - Inzineriing, proiz. i uslugi - Ohrid	Electronics	No	165	21
"Galeb" - Transportno pretprijatie - Ohrid	Transport	In process	373	0
"Makedonija"- Gradezen Institut - Skopje	Construction	Yes	226	0
"Deplast" - Fabrika za prerabotka na plasticni masi - Debar	Plastics	No	176	0
"Electron" - Proektiranje, izvedu. na mali grad. rab. - Skopje	Construction	No	8	0
"Izolmont" Bitumenski proizvodi - Gradsko	Non-metal	No	56	0
"Komuna"-A.D. za proiz. na hartija i ambalaza - Skopje	Paper	No	868	23
"Makedonija Turist" Ugostitelstvo i turizam - Skopje	Tourism	Yes	420	57
"8 Oktomvri" Proizvod. na metalna galanterija - K.Palanka	Metal ind.	Yes	50	7
"8 Noemvri" A.D. za gradezni materijali - Negotino	Construct mats.	No	207	7
"Prima" Modna konfekcija - Kocani	Textiles	No	854	0
"Radika"-Kombinat za gips i gipsani prefabrikati - Debar	Non-metal	No	323	40
"Ruen" Proizvodstvo na avto delovi - Kocani	Car parts	Yes	1355	46
"Skopski Saem" Organizairanje na saemi - Skopje	Expositions	Yes	75	20
"Tigar" Trgovija, ugostitelstvo - Kriva Palanka	Commercial	Yes	211	59
"Hidromontaza" Hidrogradezni raboti - Skopje	Construction	No	50	0
"Sarpromet"-Trgovija - Tetovo	Commercial	Yes	19	71
Totals		Yes 10 No 10 In-process 1	9273	20.4

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## Counterparts

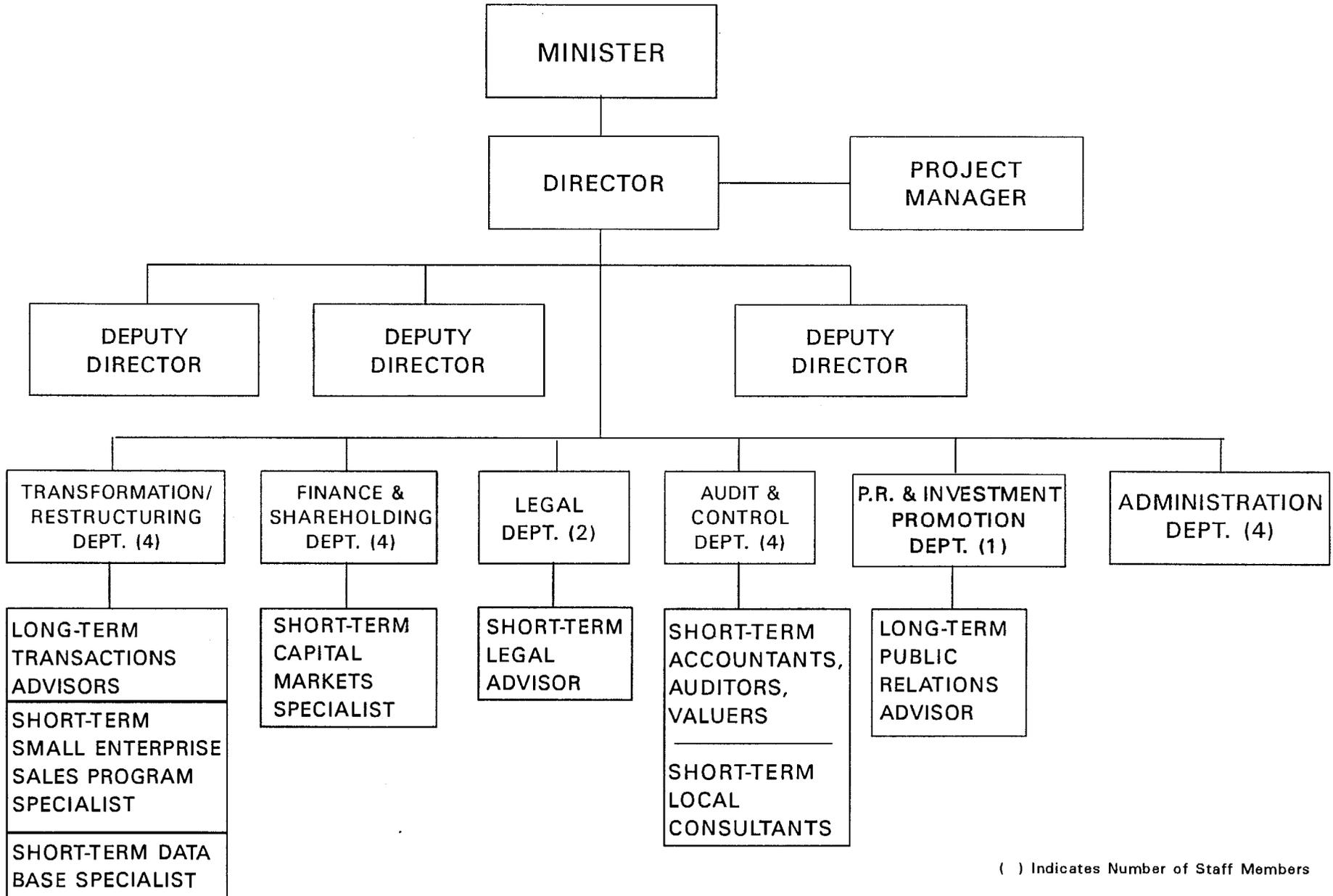
Our proposal places a strong emphasis upon teaming each advisor with a counterpart. We have made an effort to identify the key counterpart for each advisor. The advisory team is most fortunate to have a core group of professionals who are highly motivated, well educated and fluent in English. An organization chart of the Privatization Agency is shown in Exhibit 2, along with the envisioned locations and counterpart relationships of the team.

The key members of the staff have done considerable research on privatization in the CEE and FSU regions and have been instrumental in the formulation of the program in its present form. The key counterparts are listed below with a brief summary of their qualifications:

1. Dr. Jane Miljovski serves as the Minister without portfolio whose main responsibility is privatization. He is a professor on the Faculty of Law, where he teaches political economy. His Ph.D. is in economics. He did not express an interest in having a counterpart, and it is probably not appropriate to provide him with one. He is fluent in English.
2. Dr. Miroljub Sukarov, Managing Director of the Privatization Agency, previously worked at the Economics Institute of Macedonia. His Ph.D. is in economics and his specialty was urban planning. He did not express an interest in having a counterpart; however, it would be appropriate if the Project Manager work directly with Dr. Surakov on a day-to-day basis. He is fluent in English. Three deputy directors report to him as well as the department directors described below. The three deputy directors do not appear to have influential roles in the operations of the Agency.
3. Dr. Evgeni Zografski, Director, Finance & Shareholding Department, has a doctorate in economics, and he has studied abroad in the Netherlands and has also taken a short course on capital markets development from INTRADOS in Washington. He previously worked as the Director of Planning with the Skopje City Council. He will serve as the counterpart for the capital markets specialist. He is fluent in English. He has three staff members.
4. Ms. Verica Hadzi Vasileva-Markovska is the Director of the Transformation and Restructuring Department. She holds an M.A. in marketing and has a graduate certificate in business administration from Melbourne University. She recently completed the INTRADOS course on Managing Privatization Programs. She worked for 7 years at the Economics Institute. She is fluent in

EXHIBIT 2  
ORGANIZATION CHART

MACEDONIAN PRIVATIZATION AGENCY



( ) Indicates Number of Staff Members

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English and has three staff members. The transactions advisors will be her counterparts.

5. Ms. Olga Mihajlova-Tikvarovska, Director, PR & Investment Promotion Department. Ms. Mihajlova formerly worked at the Economics Institute; before that, she worked at the Office of City Services. She will travel to the U.S. in October for a course on promoting investment. She is fluent in English. She has no staff members.
6. Ms. Slobodanka Ristovska is the Director of the Audit and Control Department. She, too, was employed previously at the Economics Institute, and holds a U.S. masters in Public Finance and Sociology, and a graduate certificate in business administration from Melbourne University. She is fully fluent in English and will act as counterpart for the accountants, auditors and valuers working on the project on a short-term basis. She has three staff members.
7. Mr. Sajnoski is the Director of the Legal Department, who holds an M.A. in law and has passed his bar exam. He has no English; he will serve as the counterpart for the legal advisors working on a short-term basis. He has one staff member.
8. Mr. Sahov, a lawyer, is the head of the Administrative Department. He has 10 staff members and will have no counterparts under this project.

The Privatization Agency only has one secretary to serve all the professional staff.

#### **C. PROPOSED TASKS VERSUS CURRENT REQUIREMENTS BY TASK**

This section discusses each task, comparing what is required by the task order, the current reality concerning each task, and our recommendation for implementation. Tasks A and B of Function A constitute a quick action program that will result in the successful sale of 5 to 10 enterprises. Tasks C, D and E are those activities supporting an ongoing privatization program that will proceed forward at a rapid pace.

##### **Function A -- Pilot Project Assistance**

- **Task A -- Identify and Rank Companies to be included in the Pilot Project**

Task Order: The Specialist will work with the Agency Director to identify and rank companies for the pilot

project. Inclusion will be a function of a) the attractiveness of the enterprise to foreign investors, b) the receptivity of these companies to foreign investment, and c) the ability to create "success stories" (high upside, low downside).

Current situation: At least some level of initial screening has already been done by the Privatization Agency in the selection of the 21 enterprises deemed most promising for privatization and the 25 money losers. The 21 successful enterprises were identified by placing an advertisement in the newspapers encouraging enterprises to contact the agency for further information on the program. The criteria used for selection were profitability of the company; location (for locational diversity); industrial sector (again for diversity); and ownership structure (a company is considered privatized if 51% is in private hands). The latter criterion was exceeded in three of the selected firms. There are five small, seven medium, and nine large companies among the 21 companies.

Thus, there will probably be no requirement for screening of enterprises, as the pipeline for this project will most likely be composed of these 21 companies, plus portions of some of the 25 enterprises undergoing restructuring. There will be a requirement to review the privatization plans submitted to select five or so companies for immediate action. Over the next year screening will be required of the privatization plans of other large enterprises that decide to accelerate their privatization. In addition, the privatization plans for medium enterprises will be available for review after December 10, 1994, and these may constitute an attractive group for assistance because the industrial statistics show that the lower the employment levels, the more likely the company is to be profitable.

Regarding the Task Order's emphasis on foreign investors, it is not fully clear that this objective is shared by the Privatization Agency, either as a political or practical matter. And while foreign investment is highly desirable, the current political and economic environment will pose a considerable challenge to success in this endeavor. Conversations with Privatization Agency staff indicated a dissatisfaction with "self management," where the employees have ended up with majority control under the Markovic program. They want to achieve privatization by supporting buyouts by capable managers. Thus, the assistance provided will be by virtue of the realities in the country be somewhat different and broader than

those envisioned in the Task Order.

The Minister and key staff at the Privatization Agency have captured the concept of early success stories (in fact, they wish they had one or two success stories to relate as they go into the November elections).

- **Task B -- Assist Target Companies in Analysis of Operations and Identification of Potential Foreign Investors**

Task Order: The Specialist will work directly with targeted companies to review operations, analyze and value business units and identify potential foreign investors for same. In this process, specialists will:

- Identify business units of interest to foreign investors
- Create, convert and restate financial statements acceptable to foreign investors (GAAP or international standards)
- Value the enterprise
- Identify potential foreign investors
- Prepare Offering Memoranda and communicate with potential investors
- Assist company in identifying acceptable foreign partners, and commence negotiation with same.

Current situation: Under normal circumstances, it would be relatively easy to **identify business units of interest to foreign investors** by looking at returns, product compatibility, market networks, etc. However, this may prove to be quite a difficult task here because what might constitute under normal circumstances a good target for a foreign investor may be limited by the external factors affecting Macedonia. Nevertheless, we will strive to achieve this objective, while also pursuing other practical means of involving foreign interests such as licensing, purchase of shares by international investment funds, and other means.

Reliable **accounting** figures pose a large problem for the process. At the present time, enterprises must submit balance sheets once a year and income statements semiannually to the State Auditing Agency (SDK). These statements are never audited. We know from the restructuring work now underway under the auspices of the World Bank that the financial information of the enterprises is inconsistent from year to year, is sometimes denominated in different currencies, appears unreliable because of anomalies, and sometimes contains fabricated figures. We believe, therefore, that a considerable amount of work may be required in developing such financial statements for use as the

basis of the valuations and for inclusion in the Offering Memoranda for the sale of enterprises to foreign and domestic investors. The country hopes to achieve international standards by 1996. Until then, our team will work to transform the statements using GAAP.

Furthermore, with the exception of Coopers & Lybrand, there is practically no **audit** capability in the country. Technically the SDK is allowed by law to do audits, but with only 10 staff the undertaking of an audit is quite rare. Further, we learned that a new commercial audit law has been drafted, and although not been enacted by the Parliament yet, when it is enacted it will remove all auditing powers from SDK and encourage private auditing. It is expected that some level of auditing work will be required of our team.

With regard to **valuation**, considerable effort has already been made to train local valuers. Twenty-three valuers were trained and licensed in January-February 1994. Since then an additional 126 valuers have been trained. In addition, 600 asset appraisers, who mostly have engineering backgrounds, have also been trained.

The valuation methodology itself seems fairly well-founded; however, the primary technique that must be used in every case is the adjusted balance sheet method, cross-checked by the DCF method. Again, based on the current restructuring assignment, we believe that balance sheet items will be more unreliable than income statement figures. This is likely to lead to adjusted balance sheet valuations that are too high.

Having reviewed the valuation methodology prepared by Coopers & Lybrand, the Netherlands, we believe that it is implausible that these local valuers, who have had only 4 weeks of training, can carry out what will be one of the most politically sensitive steps in the privatization process. Therefore, additional valuation resources will be provided by our firm.

Regarding **transactions assistance**, the level of knowledge of Western financial concepts is modest at best in Macedonia. To assist the Government to transform the economy, privatize business, and create a capital market is a major undertaking which will require a significant effort. While the broad outlines are valid, each piece of the project will need considerable effort. It may take more time to bring the first deals to market, until some transaction experience is gained by the Agency staff and consultants. In addition, resources will need to be redirected to insure appropriate allocation according

to the actual need.

Fundamentally, the transaction assistance will involve the following activities:

- Review of the restructuring plans may reveal flaws requiring additional effort to make modifications to attract a foreign buyer.
- Preparation of all financial statements, assembly and correlation of corporate data, and preparation of an offering memoranda and strategy for marketing.
- Solicitation of potential buyers, via mail, with telephone follow up, and where considerable interest is created, arrange a presentation in Skopje, including present management, where appropriate. A concerted marketing effort to foreign buyers may entail a program in European financial centers, such as London, Frankfurt, Zurich, Milan, and Genoa, plus New York to promote Macedonian investment.
- Assistance in evaluating offers and advice in negotiating terms, price and conditions of sale with the buyer.
- Preparation all selling documents, using local and consultant legal counsel. Representation of the Privatization Agency at the closing, if requested to do so.

Recommendation: While we have an approved 140 person-days of accounting services plus nearly 315 person-days of local staff time in our Task Order, the allocation for the expatriate time must be increased to about 210 person-days. This should be added to the front-end of the program to ensure that it initiates on a sound footing with figures will provide a solid basis for the valuation as well as to provide a high level of confidence for foreign investors. Additional assistance will also be provided in valuations and we will endeavor to involve local valuers in this process.

To accommodate the additional accounting, auditing, and valuation resources required, we recommend the deletion of one of the Transactions Specialist positions. Because of the lack of pipeline, we also recommend that the Transactions Advisors be phased in based on expanding program requirements. It would be counterproductive to place all these advisors at the Agency at the initiation of the project.

- **Task C -- Preparation and Approval of Privatization Plans**

Task C refers to the post-pilot sale stage, when the process has become more systematic.

Task Order: Deloitte is to:

- Assist the Privatization Agency in the required valuation of the enterprise
- Assist the State Accounting Agency in establishing correct share ownership positions
- Solicit bids from foreign investors
- Prepare privatization plans for submission to the Agency
- Work with the Agency to obtain approval of the plan
- Assist in shepherding approval through the Privatization Committee.

Current situation:

This description of this task is somewhat convoluted:

- Valuation will not be the first step
- The State Accounting Agency will have nothing to do with establishing correct share ownership positions. This, in fact, will be proposed in the privatization plan prepared by management and negotiated with them by the Privatization Agency with the assistance of our advisors.

The privatization process will more or less follow this sequence:

- Review of the privatization plan submitted by the enterprise
- Approval of the privatization plan by the Agency
- The determination as to whether the enterprise is inherently viable as a result of careful consideration of the company's present and future financial situation
- Valuation
- Preparation of the information memorandum
- Foreign investors are contacted and encouraged to visit the operation and make offers, probably in the form of a public tender

- Award, negotiation and preparation of the sales agreement
- Transfer of the shares to the buyer.

According to the Privatization Law, the enterprise management is obligated to prepare its own privatization plan and the freedom to select its own strategy for privatization from among several options provided in the law. These options include a leveraged buy-out, leasing with the intent to purchase in 7 years, bankruptcy, debt-equity swaps (executed by creditors, excluding banks). Former owners may also file claims for restitution that must be considered. The LBOs can be structured for the management, employees, a foreign or domestic investor, or a combination of any of these. A desirable LBO might, for example, have an ownership structure of 51% for the new owner, 30% for the employees, 15% Pension Fund (a requirement of the Privatization Law requiring the transfer of non-voting, preferred shares bearing 2% interest) and 4% for the Privatization Agency, which must offer the shares to the public in due course.

Given the privatization planning process prescribed in the Law, it is likely that the team will be involved in reviewing privatization plans submitted (because these will be in Macedonian, translation will be required) and making suggestions for their upgrading. We foresee some conflicts in the process that our advisors can assist with, for example, where a company that is ideal for foreign investment has developed a plan involving a management-employee buyout.

Recommendation: While it is obvious that the Task Order is out of synch with the procedure set forth in the Privatization Law as well as the logical steps to be undertaken to sell the shares, it is clear that there are important steps that must be undertaken to prepare the company for sale, and in the case where the privatization plan seeks foreign participation, we will set up a marketing and tendering framework that will lead to the submission of offers from foreign buyers.

- **Task D -- Negotiation and Close with Foreign Investors**

Task order: Deloitte will:

- Negotiate to maximize bids
- Negotiate terms and conditions to assure

- transactions meet the requirements and expectations of the Macedonian government
- Close transactions with the winning bidders
- Assist the Agency in final approval and implementation.

Current situation: These steps seem logical and reasonable. However, preparing the documentation for the closing may take some research and considerable input from our legal resources.

The Company Law is based on former Yugoslavian law, and a new company law is not expected for a few years. Such laws normally prescribe how property can be transferred. We did not have an opportunity to review this law while in-country.

Local lawyers are available who may be able to handle the local transaction work, and the American Bar Association is planning to provide training to them on negotiations. This training should facilitate the domestic sales process considerably.

However, no local lawyer can presently handle international transactions. Therefore, it is critical that our lawyers be made available at appropriate times (negotiation, closing) in the transaction process.

Recommendation: Only 90 days have been provided for expatriate legal resources and this should be increased, given the number of transactions envisioned. We recommend that at least 140 person-days be provided.

• **Task E -- Provide Training to Counterparts**

Task order: Throughout the process, the specialists will provide on-the-job training to Agency counterparts.

Current situation: Agency staff appear anxious to have specialists on-site and are quite receptive. They are even willing to share their limited office space. The technical team should develop a program of seminars that will take advantage of the work of short-term specialists, special financial analyses and valuations, specific transactions, etc. so that the staff of the Agency can expand their knowledge and skills. An Industrial Engineer should be included as a presenter in one of these seminars -- perhaps in a seminar on company analysis.

**Function B -- Public Relations/Public Education**

- **Task A -- Create and Implement a Domestic Public Awareness Program to Support the Launching of the Privatization Program**

Task order: Create and implement a domestic public awareness program to support the launching of the privatization program through:

- Research and analysis of public opinion
- Research communications channels
- Development of a public relations/public education strategy and campaign
- Implementation of the strategy.

Current situation: This task has been essentially superseded in that the Privatization Agency signed a contract in June 1994 with Saatchi & Saatchi (from among three bidders) to develop a campaign directed at the public to inform them about privatization. So far, Saatchi & Saatchi, which has offices in Skopje and Belgrade, has already developed a communications strategy involving advertising on local television and radio. The Agency paid Saatchi & Saatchi \$13,000 for the development of the strategy. After a presentation to the Agency on September 15, Saatchi will initiate the campaign, which will last for three to six months. This campaign will cost the Agency about \$60,000.

Saatchi & Saatchi has based its strategy on Gallup polls performed on various dates over the last year. Those polls found the following:

Public in favor of privatization	42%
Public opposed	42%
Undecided, neutral	16%

They found that those favoring privatization were the youth, those with higher education, students, intellectuals, private owners, political supporters, non-egalitarians and non-authoritarians. Those opposed were the elderly, lower educated persons, pensioners, workers, political opponents, egalitarians and authoritarians.

The apprehensions registered were quantified as follows:

Loss of workers' rights	62%
Increasing of corruption	58%
Impossibility of control of assets	57%
Disparity in income	56%
Inflation	54%
Impossibility of control under foreign ownership	51%

Increasing unemployment

49%

The Saatchi strategy aims at every segment, reinforcing those who favor privatization, and reducing the fears of the opposed and complacency of the indifferent due to lack of information. The slogan, which they believe will be agreed to by all segments, is: "The Macedonian Economy Needs a Landlord."

Recommendations: Saatchi in Macedonia is a young firm and can use immediate assistance in public relationships concepts for the domestic campaign. They suggested we work together as a "team," which is a valid approach. We suggested that assistance could also be rendered in monitoring the Saatchi & Saatchi activities and suggesting improvements in their campaign, as appropriate. These were acceptable activities to the Agency staff.

- **Task B -- Create a Foreign Investors Public Awareness Program**

Task order: Does not specify activities.

Current situation: Nothing has been initiated at the Privatization Agency to date; however, this will be a critical activity for achieving success in the transactions involving foreign investment. Strong efforts must be made to enhance the image of Macedonia abroad as a country undertaking serious reform efforts and running a serious privatization program. We need to place the public relations advisor in Skopje as soon as possible, preferably by mid-October 1994.

- **Task C -- Establish a Public Relations/Public Education Capability at the Agency**

Task order: Establish an ongoing capability at the Agency with which to sustain the public relations/public education. We will undertake this through the one-on-one relationship with the P.R. Department Director and through seminars, as described above under Function A, Task E.

**Function C -- Ongoing Assistance to the Agency**

- **Task A -- Assess Needs and Advise on Agency Processes and Procedures**

Task order: Deloitte will:

- Identify staffing and equipment needs and

potential system problems

- Develop processes and procedures to speed the privatization process
- Develop a status monitoring system.

Current situation: While the staff at the agency is small, the Minister felt that it is important that the pipeline for selling the enterprises move quickly and flexibly. The staff will probably increase to 60 persons from its current level of 25. This will require job descriptions, regularizing meetings and communications, setting up reporting and control systems, etc.

Developing the systems early will avoid gridlock as the process moves forward and expands in scope. If the Project Manager does not have this experience, someone with the experience in developing such agencies should be incorporated on the team. The required skill set may be that of the long-term advisor Deloitte provided to the State Property Agency in Hungary for 4.5 years.

We believe that it is important to develop a database early in the process. Such databases have proven useful in other programs to measure progress, provide information for the public relations program and provide the basis for post-privatization support, especially for the smaller enterprises.

Recommendation: If the Project Manager does not have adequate institution building skills, a short-term advisor should be brought in to assist with the organizational aspects of the Agency. Under all circumstances, a short-term advisor needs to be made available to define the requirements of the database and to assist in setting it up. A counterpart must be identified, equipment and software specified, and training provided.

- **Task B -- Assist Companies Directly in Developing Privatization Plans**

Task Order: Deloitte will support companies in all aspects of preparation of privatization plans, including structuring, valuation, preparation of projections, etc.

Current situation: While this task is somewhat misdefined, the requirements are quite well understood by Deloitte. As noted above, there will certainly be considerable work to assist the enterprises to refine their privatization plans. Additional analysis of the

enterprises will be invariably required to determine their inherent viability (can they make a profit?), which will require the diagnostic operational and financial reviews. These will lead in some cases to restructuring recommendations. Valuations can then be prepared of the viable segments of the enterprises. These valuations must be done in conjunction with the locally trained valuers, providing them with guidance and advice.

- **Task C -- Assist the Agency in Processing Privatization Plans**

Task order: Deloitte will review, negotiate and close privatization plans.

Current situation: This step is misspecified as well. In fact, as noted above, there may be some negotiation required with the enterprise in that the plan that it has prepared as a guide to its own privatization may not take advantage of certain elements in the law to maximize the level of proceeds, attract a foreign majority owner who can undertake restructuring, installation of new equipment, processes and systems, and new marketing initiatives.

- **Task D -- Provide Training to the Agency**

Task order: This will be done in the manner described above under Function A.

- **Task E -- Develop Securities Processing Capabilities.**

Task order: Assess securities processing requirements, identify the anticipated volume of securities transactions and review existing capabilities. Develop adequate securities processing capability.

The steps specified in the Task Order are an oversimplification of the complexities involved in designing and implementing the development of a capital market, with initial emphasis on creating an market for shares.

Current situation: Currently, no capital market exists in Macedonia but Government plans to create a stock exchange. Only the most basic and limited steps have been taken to implement such plans: specifically the selection of two banks, the Stopanska Banka and the Almarkar Bank, as initial shareholders of the contemplated stock exchange. The legal basis for a securities industry, the "Law for Securities Papers"

and other implementing rules and regulations are expected to be in place in October. The Privatization Agency indicated that 13 institutional and individual brokers had been licensed, but it is not possible to gauge their level of proficiency.

A means to settle transactions, transfer shares, and make and receive payments will be critical elements in the market and will require careful design and implementation. Failure to process transactions efficiently could imperil a market and discredit the entire privatization process as a result of investor dissatisfaction and losses. The processing could be handled by a bank unit specifically trained to do so but no such capability exists at present.

Further, the operation of a capital market will require oversight and supervision to enforce regulation and ensure an orderly market. Supervisory units must be formed in the Government and legal and monitoring personnel trained. Regulatory reporting procedures must be created. Unlike other industries, the role of government to protect the public interest is significant.

The privatization program will place a number of shares in the hands of many individuals who may want to add to or reduce their holdings. A market mechanism therefore must be created to trade the shares (and create liquidity). In addition to liquidity, an established market with a public stock exchange provides visibility to the market for the regulatory agencies, the investor and the public at large. The investor must have accurate and timely information to be confident in the market.

A capital market may have a variety of components each designed to meet a specific need generally categorized for equity and debt instruments.

The equity market can take several forms: informal, over the counter (OTC); and formal, which includes a stock exchange. Historically, stock exchanges and the formal market have evolved from informal, over-the-counter markets. In more advanced financial systems both types of markets exist and provide a larger marketplace for company equity shares, thereby increasing liquidity.

Considering the enormous undertaking of financial reform needed in the country, it would appear that simplicity in the development of new institutions would be desirable. Current plans by the Government include banking reform. Changes in the banks could include the

formation of broker/dealer departments that could be the nucleus of the market in shares. The clearing and settlement of securities trades have been handled by banks in many countries with success, at reasonable costs. This activity also provides a source of revenue to the banks as a result of fees charged for processing each transaction.

Should the volume of transactions grow to large proportions, a separate clearing house could be established to process securities transactions. Often, the banks sponsor such an organization to achieve economies of scale.

The staffing of a capital market will require **training** of a number of individuals to perform a variety of functions. On-going training of all personnel is necessary and a formal procedure for training and testing will be required.

The establishment of a capital market will be an integral part of the privatization process. The Government sponsored publicity program should point out that shares received by the public may be sold through a new market mechanism, the stock exchange.

It is the initial goal of the Government to privatize a number of companies over the next year, thus introducing a supply of shares for trading. Any residual shares owned by the Privatization Agency or the Pension Fund and those shares paid to the former owners in settlement of claims arising from the nationalization of their property can be sold in the marketplace after a mechanism is put in place. Such sales will provide additional supply, allowing other new investors to buy shares and allowing initial investors receiving shares under the privatization plans to accumulate additional shares.

Generally, a large number of shares are sold through an underwriting, wherein an investment bank purchases the total number of shares to be sold and then at risk re-offers the shares simultaneously to the public at a fixed price, including a negotiated fee paid by the sellers. The advantage of this system is that sellers can combine their shares in one transaction and receive the same price and the buyers will have the opportunity to purchase shares at the same price. This type of transaction requires capital and is performed by an investment bank which must commit capital in the process. This "secondary offering" provides no new capital to the company but allows shareholders to sell large blocks of shares without disturbing the market since the price and timing of the sale is negotiated.

In the early stages of the privatization program such procedures will not be in place. However, as the program progresses it is reasonable to expect a private investment bank will be established to provide such financial services. In the interim, such offerings can be done directly by the Privatization Agency on the Stock Exchange.

As the privatization process moves forward, new institutions will appear to fill the market need. A variety of investment banking and brokerage services will be needed to develop the capital market.

Initially, the **investor group** will be made up of dominant investors who purchase control of a company with a single bid and workers and managers who receive shares under a privatization plan. The Pension Fund may also receive shares. As the economy rebuilds, such investors may add to existing holdings or make new investments in other shares. A popular vehicle for small investors is the mutual fund, a vehicle that provides professional management of funds for small investors at low cost. At present the amount of funds will be limited, but legislation should anticipate a growing market.

Investors will require basic **brokerage services** initially but more sophisticated services such as investment research and advice to manage a growing portfolio as new securities come to market in the privatization process.

Accurate investment information will be essential to the orderly function of a securities market. Therefore, standards must be established and training programs developed to license persons who will function as brokers, dealers, research analysts and managers in an emerging capital market.

Uniformity of standards for investment activities dealing with the public and other sophisticated investors will be needed to prevent financial scandals that could embarrass the Government and discredit the privatization program. Such training should be a part of another Government effort.

The primary focus of the initial capital markets effort is on equities. To function efficiently, a market for **debt instruments** should also be eventually designed to provide an alternate capital-raising mechanism for companies and Government.

Such debt instruments include:

- Short term government tax anticipation notes.
- Commercial paper issued by companies for short term financing as a supplement to bank borrowings.
- Longer-term mortgage bonds for corporate capital improvements such as new plants.
- Longer-term government bonds for general borrowing or specific projects such as additional toll roads.

In order to effectively protect the public interest and to ensure a fair and efficient market, Government must institute a series of procedures to insure the integrity of the market by fair business practice. A body of regulations should be developed which provides:

- Full disclosure of all relevant financial data, disseminated to all parties in a timely fashion.
- Reasonable disclosure on share transactions and market activity by broker/dealers.
- Establishment of capital requirements for broker/dealers, either in the OTC or stock exchange.
- Monitoring and regulation of the emerging investment industry through the establishment of an oversight agency, a Securities and Exchange Commission.

The privatization program and the creation of a capital market will require considerable **public education**. The purpose and operation of a stock exchange will be explained and promoted to the public through a professionally managed campaign. Building public confidence and trust is essential to the acceptance of new free market concepts by the general public.

Recommendation: The need for a capital market development plan will become increasingly clear as the privatization program moves forward. We have provided for a capital markets specialist and legal advisor to further that development and assist the Government of Macedonia. However, the task of creating a capital market is substantial and beyond the scope of this project requiring the provision of additional resources to:

- Advise and assist the government in general capital markets planning and implementation and cooperate with the Public Relations advisor
- Advise and assist the Public Relations advisor on the financial elements of the Capital Markets Development program.

To achieve this, we have doubled the time allocated for the Capital Markets Specialist to 60 person-days.

Specifically, the subsequent project should:

- Develop a multi-phase general plan for a capital market, in cooperation with Government personnel.
- Design and implement the creation of financial institutions, including a stock exchange.
- Design and implement the creation of a securities clearing mechanism.
- Provide legal advice for any modification of laws governing securities transactions.
- Design an oversight mechanism for security transactions reporting to regulatory agencies.
- Design a training program for all securities industry personnel.
- Develop a general plan for investment industry development.

## II. DEPLOYMENT OF RESOURCES UNDER THIS PROJECT

### A. Space Limitations

The lack of physical office space will limit the effectiveness of the team in that early phases of the project. For example, Agency staff indicated that it would be best to field only three of the proposed staff at the present time because of the lack of space in the building (the former Central Committee building) in which they have offices.

However, the Minister of Privatization suggested that the time come when it is appropriate because the "only way problems are resolved in the country is when they become severe." The more likely scenario is that the Transformation & Restructuring Department and the Audit & Control Department will move into new space. We received assurances that the long-term transactions advisors would have space there, which is appropriate given their counterpart.

It is advisable that we start with an initial core team expanding it team as the workload merits. As suggested elsewhere, the actual pipeline at the present time is nonexistent; although, when the first 21 companies have presented their plans, implementation can begin in earnest.

### B. Important Dates

The section provides a list of dates that will be important in the early implementation stages, along with estimates of the arrival time of different key personnel.

#### LIST OF IMPORTANT DATES

9/15/94	Saatchi & Saatchi initiates domestic PR program
10/06/94	Project Manager arrives Public Relations specialist arrives One Transactions Advisor arrives
10/16/94	General Elections
10/??/94	Privatization Agency PR Director goes to U.S. for training
11/1/94	Review of the privatization plans of the initial

21 companies undertaken  
 Five (5) pilot companies selected

11/10/94 Short-term accounting, auditing  
 and valuation specialists arrive to  
 analyze pilot companies

11/15/94 Second Transactions Advisor arrives

12/1/94 Information Memorandum of the first  
 company initiated

12/10/94 Deadline for medium and small enterprise  
 privatization plan submission

12/15/94 Marketing contacts begun

12/31/94 Information Memorandum of first company finished

1/3/95 Third Transactions Advisor arrives

1/5/95 Transformation/Restructuring Department and Audit  
 and Control Department move to new office space,  
 with long-term Transactions Advisors

1/10/95 Seminar on the Transactions Process presented by  
 Project Manager and Transactions Advisors

1/10/95 Small Enterprise Sales Program Specialist arrives  
 for two-month assignment to design program

2/1/95 Capital Markets Specialist arrives to advise the  
 Government on the creation of a capital market and  
 to design parallel project

3/1/95 Fourth Transactions Advisor arrives

3/15/95 Legal Advisor arrives to draft sales agreement and  
 closing documentation for the first transaction

12/10/95 Deadline for submission of large enterprise  
 privatization plans.

**D. REALLOCATION OF PERSON-DAYS**

Based on the discussion in Chapter I of this report, we have estimated in Exhibit 3 shifts of person-days among the labor categories while maintaining the Task Order dollar ceiling.

EXHIBIT 3

Macedonian Privatization Project  
Allocation of Person-Months

Task Order Budget

Functional Labor Category & Specialist	Work Days	Fixed Daily Rate	Total
Project Manager	220	950	209000
Financial Planners	1100	950	1045000
Capital Market Specialist	30	900	27000
Attorney	90	700	63000
Accountants	140	750	105000
Industrial Engineer	10	350	3500
Public Relations Specialist	220	600	132000
Local Nat'l Supervisor/Senior	140	530	74200
Local Nat'l Senior Consultant	100	317	31700
Local Nat'l Assistant/Associate	75	194	14550
Ceiling Price			1704950

Recommended Allocation

Functional Labor Category & Specialist	Work Days	Fixed Daily Rate	Total
Project Manager	220	950	209000
Financial Planners (incl. Small Enterprise Spec.)	980	950	930848
Capital Market Specialist	60	900	54000
Attorney	140	700	98000
Accountants	210	750	157500
Industrial Engineer	9	350	3150
Public Relations Specialist	220	600	132000
Local Nat'l Supervisor/Senior	140	530	74200
Local Nat'l Senior Consultant	100	317	31700
Local Nat'l Assistant/Associate	75	194	14550
Ceiling Price			1704948

Note: Financial Planners work days figure is rounded.