

PREPARING FOR PRIVATIZATION

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I. Introduction

This paper is concerned with the steps one should take in preparing for a privatization initiative. What is a privatization initiative? In my experience, it can take two forms. First, it can be a commitment by a government to lay the policy and administrative foundation to support a government-wide privatization program. This involves creation and implementation of policy, organization, staff, budget, and administrative procedures to manage a privatization program. Although this is a formidable undertaking, my experience shows that it is a critical component in the success of individual privatization actions.

The other form of privatization initiative I will discuss is the actual transfer of a government function to the private sector. The preparatory work for a privatization project can also be a complex and controversial undertaking because of the project size, its influence on the local economy and employment situation, and a host of other factors. All too often these project initiatives are conducted in an ad hoc fashion. That is, the privatization project is planned and conducted in a government environment in which there are minimal policy and procedure guidelines. Privatization can be a long, arduous, and often fatal trip if there is a poorly prepared roadmap.

II. Some Terms of Reference

I define privatization as the process by which government or its designated representative considers the feasibility of transferring functions and facilities from a public to a commercial operation and, if appropriate, take actions to accomplish a transfer. Privatization can take many forms, from the sale or denationalization of a state-owned activity to the lease or contracting-out of a government function.

Based on my experience over the past 25 years in working with alternative delivery systems for public services, there are three basic phases in the privatization process. They are:

- Preparing for privatization;
- Implementing a privatization program and projects(s); and
- Monitoring and enforcement of a privatization agreement(s) and applicable laws and regulations.

Preparing for privatization is the topic of this paper. The preparatory phase of privatization is of extreme importance because, if done properly, it sets the stage for successful privatization, which turns on four central components:

- Examination of governmental organization and staff performance (organization productivity issues).
- Selecting of a responsible private sector replacement (investment, business analysis, and finance issues);
- Redefinition of where and how the affected employees work and their stake in the privatization decision (human resources issues);
- Management of the privatization process and/or specific privatization actions (management issues).

I liken the preparatory work for a privatization initiative to doing one's homework for a difficult course in school. If done in a systematic and timely fashion, it yields a big dividend at the final examination. The final examination in privatization is one's understanding and responsiveness to the problems and needs of the major interest groups which can make or break a privatization program. The groups are:

Political -- The executive and legislative (parliamentary) political leadership of a government.

Public -- The people who receive public services.

Government Employees & Managers -- The group outside the political leadership; typically the civil service cadre of professional and other unskilled workers and supervisors performing government functions and the group most directly impacted by privatization.

Business Community -- The local or expatriate commercial interests who are willing and able to acquire, lease or manage a government-owned and operated activity.

Preparing for privatization consists of determining how to educate, organize, and mobilize these groups to plan and work together, in making certain they understand the existing costs, productivity, capitalization and other issues facing state-owned and -operated enterprises. Most important, these groups must understand the obligations, risks and opportunities of privatization.

III. Preparing for a Privatization Program

By way of background, I have had experience with privatization projects that have operated with and without defined ground rules. Most recently, I have had the opportunity to participate in the development of a comprehensive privatization program for American Samoa, a U.S. territorial government in the South Pacific. This bird's-eye view of the practical issues involved in managing privatization initiatives has led me to this conclusion: privatization without policy, procedures, and a competent and committed staff is privatization doomed to failure.

What I am describing is reflective of the actual experiences I have had in privatizing a number of programs over the past several years. These experiences indicate that privatization can be conducted in four phases (Exhibit 1) which include:

- Institutional Development
- Target Selection
- Privatization Transfer
- Monitoring of End Results

I have further defined the process by including 14 logical decision points (Exhibit 2), all of which will have to be taken into account at some point in time in planning for and implementing a government-wide privatization program.

The privatization process described here is certainly not etched in stone. It is drawn from limited research and empirical work in the U.S. Although it would be premature to describe it as a certifiable privatization tool, it has served me well in planning and managing privatization work. Most important, it serves as a checklist of key questions likely to be raised at different points in the deliberations about privatization.

I think one would find many of these steps in a well-thought out government program dedicated to the objectives of: cost containment and increased productivity of government program; and, dependence upon private sector alternatives and involvement in the conduct of these programs. What does this mean and how is it accomplished? As we shall learn momentarily, the process is designed to encourage business, government, employee and investment groups and other private sector interests, to compete in an open and impartial manner for the production and delivery of public services. That is, the process helps to decide which sector and group(s) can provide the public with a product or service in the most economical and efficient way.

PRIVATIZATION PROCESS -- FOUR PHASES

Four Phases

- I. Institutional Development
- II. Selecting Targets
- III. Privatization Transfer
- IV. Monitoring End Results

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. . . AND 14 STEPS

Phase I – Institutional Development

1. Organize for privatization
2. Assess political situation
3. Create private sector coalitions
4. Develop strategies and guidelines

Phase II – Selecting Targets

5. Policy review
6. Organizational survey
7. Business Evaluation
8. Strategic analysis

Phase III – Privatization Transfer

9. Estimate value
10. Issue conditions and solicitation for transfer
11. Evaluate and select successful bidder
12. Negotiate and execute transfer

Phase IV – Monitoring End Results

13. Establish regulatory and oversight mechanism
14. Monitor performance

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What follows is a brief description of a most critical phase in the privatization process:

Institutional Development

There are four steps that lay the policy and procedural groundwork for and begin the implementation of a privatization program (Exhibit 3). The first step, organization, begins with the definition of what the government plans to accomplish. Is the plan one of research and review aimed at determining the feasibility of privatization or is there a sufficient body of knowledge and expertise within the government to develop implementable program objectives, including specific privatization opportunities. At an early stage in the formalization of the program objectives, the government should designate a policy-level official to provide policy and program directives. The fact that this person should be well-placed within the political hierarchy of the government is worth emphasizing, since privatization is inherently a very political process.

Next, you should allocate sufficient budgetary resources to the process, and select qualified personnel. Staff size and composition will, of course, depend upon the timing and content of the government objectives. You will find yourself competing constantly for financial and staff resources with other more established government programs so it is essential that you carefully plan for, justify, and use available resources. Along with the core government staff, you should plan to create and use an advisory group, preferably people from the local business community or other private sector groups as well as other organizations of government which could help shape the structure and implementation of the privatization program.

As the advisory group is an important asset, its role should be determined early on. Having worked with skilled and dedicated groups, I can note that some of its jobs can be: fact finding; recommendations on policy frameworks; definition of administrative

EXHIBIT 3

PHASE I: INSTITUTIONAL DEVELOPMENT

Steps

- Organize for Privatization Initiatives

- Assess Political Situation

- Create Private Sector Coalitions

- Develop Program Strategies and Guidelines

Issues

- Government vs. non-government
- Define policy and program roles
- Inter-governmental relations

- Legal barriers
- Economic constraints
- Employment dislocations
- Other political costs/benefits
- Strengths/weaknesses of coalitions

- Educating the public
- Create/strengthen privatization coalitions
- Develop tactics to blunt opposition
- Incremental vs. wholesale approach
- Increase incentives (taxes, loans)
- Reduce disincentives (deregulation)

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processes; establishment of criteria and identification of privatization targets; and oversight of privatization initiatives. You can no doubt think of others relevant to your specific governmental situation.

To carry out the second step of Phase I, that of assessing the political context, you must determine whether privatization will enable the executive and legislative leaders to better manage and oversee the production and delivery of the services. Will they be able to maintain local control, or will outside (e.g., foreign) interests gain undue or monopolistic control to the detriment of the local social and economic interests?

The effect on the public must also be of paramount concern. What assurances can be given to the public that the quality and price of services will be reasonable? That all groups will have continued, or better, access to the services or products. That there will be no precipitous termination of a service without some of the guarantees one would find in a government operation, such as: alternative sources to provide services and products, compensation for disrupted services, and so on.

You should also consider how the privatization will impact on government employees. What provision can be made to protect employee rights, benefits, and employment opportunities? Will employees remain with the government or have preferential rights to jobs with a private firm? These questions are important for both the welfare of present government employees and the prevention of lawsuits against the government.

Finally, political assessment must include impacts of the program on the local business community. Basically, the issue turns on how much business will be available for local firms versus non-local or foreign entities. What sort of work (e.g.,

management vs. labor, skilled vs. unskilled) will go to each? Have companies made long-term investments based on a given relationship with the government? Will there be real or imagined unfair competition in the wake of government divestment to one or more firms?

In the third step of the first phase, your goal is to create private sector coalitions to support your privatization project. The first requirement in doing this is to make the business community aware of both the nature of privatization, and its positive results for them individually and as a community. Another way of describing this need is to say that there should be a well conceived program of public education through which the true facts about privatization are deduced and the misleading and incorrect statements of less informed parties are rebutted.

Once there is genuine knowledge and understanding about privatization programs and their effects, you should create and strengthen private sector coalitions. Since it is unlikely that you will be able to mobilize the entire population around a single issue, try to work with special interest groupings, but ensure that they do not work at cross purposes. You will be pleasantly surprised by the degree to which these coalitions can generate positive pressure on local decision-makers, and can be responsible for either the avoidance or solution of numerous problems as the program evolves.

Related to this is the manner in which you deal with groups threatened by privatization, especially government employees and others who control or benefit directly from a government subsidized operation. You must make certain that they, too, understand what can be accomplished with privatization, the steps that are being taken to address their concerns of adverse effect, and the safeguards being considered to protect the public interest.

The final step of Phase I is the development of program strategies and guidelines, which among other, involves the content and form of the administrative guidelines. As you to put these in place, think about a number of relevant issues. Should you proceed on an incremental or a wholesale approach? In other words, should your program contemplate all potential privatization actions, or just selected ones? And what factors and criteria should be used in the selection of privatization targets of opportunity? What incentives, if any, should be considered to induce local business involvement in the privatization program? Are there to be changes in the tax system, financial assistance, or the enforcement of social or economic regulations (e.g., anti-trust)? Overall, you will discover that the balancing of incentives and disincentives will have a profound effect on the degree of success attained in privatizing.

When you have completed the foregoing steps of the first phase of privatization planning, you and the government are well prepared to move into the task of selecting a privatization target and carrying out an action.

IV. Preparing for a Specific Privatization Action

Turning now to the preparation for a specific privatization action, such as the privatization of a government power plant, garbage service, or motor pool. This involves four steps: Policy Review, Organizational Survey, Business Evaluation, and Strategic Analysis. First, you must determine whether the government activity has been the subject of a privatization policy review. If there has been such a review, determine whether the analysis and background data would be of use to you in your planning.

Next, in organizing a privatization assessment, you must have access to expertise in several skill areas. Among the prime requirements are technical expertise in target activity, finance, law -- especially contracting, and policy. Whether you organize a permanent team or retain individuals on call depends on several

factors, namely: the size, complexity, and availability of reliable operational and cost data; and your operating knowledge of and experience in privatization. However you organize the experts, they will play a continuing role in all the phases of the preparatory analysis.

The second step entails an organizational survey which includes a cost analysis. Define clearly what the organization does for the government and the public it serves. How is it organized and staffed? What are its operating procedures, and what facilities and equipment are required to perform the activity? What are the production and performance objectives and has the organization met them? At this point you should be prepared to collect, validate and analyze data (including that collected from interviews), and prepare a written report that encapsulates your view of the strengths and weaknesses of the organization and ideas or recommendations to improve organizational productivity. The report should cover:

- Mission and Objectives
- Organization
- Staffing
- Definition of Service Beneficiaries
- Operating Procedures
- Service Size and Workload Expectations
- Productivity and Performance Achievements
- Equipment and Facilities

When completed, the report will serve your further planning as well as the educational process for the decision-makers and the public, as it will illustrate the organization's needs, problems, and opportunities for improvement. Ultimately, this information will serve as a basis for the privatization work statement and solicitation document.

Following your organizational survey is an important aspect of your feasibility assessment; it will be the identification and description of the performance costs of the activity under review. The reasons for doing this are: the need for a database for discussions; for service improvement cost estimates; and for establishing a cost comparison baseline. With the help of government financial staffs, you can readily chart out a cost assessment. My experience has been that eight elements must be included. They are:

1. Labor
2. Fringe Benefits
3. Materials and Supplies
4. Travel
5. Equipment
6. Capital Expenditures
7. Contractual Services
8. Overhead Costs

If you can gather these different costs accurately from either historic or (better yet) prospective operation, you can identify a good portion of the financial baselines used in further assessment.

This brings you to the third step of Phase II, performing a business evaluation of privatization feasibility. This will be a look at business-related factors which currently and prospectively shape commercial activity. Again, I have set forth here a list of issues that should be evaluated. There are seven that involve business prospects:

- Existing local capacity to perform the function;
- Capitalization burdens on government/private sector;
- Local business interest;
- Improved efficiency;
- Increased local jobs;
- Expanded opportunities for local business; and
- Minimal job displacement.

These first three steps of privatization assessment have been fairly straightforward and factual. The last step entails a comparative strategic analysis and selection of one or more options, and this is much more complex. Now you must begin to think about how to implement a privatization decision, and the consequences of your action. Can your budget support needed capital improvements in the activity? Will a privatization result in the layoff of government employees? Many more questions flow as you begin to think about this.

Among the principal strategic options we can discuss are contracting out, sale of ownership rights (i.e., stock or title), leasing, and abandonment. While this list is far short of Madsen Pirie's list of 22 types of privatization actions, it is adequate for our purposes. As you weigh each of the options, consult with your team of advisors and support staffs. Attempt to quantify the financial, legal, contractual, technical and political implications of each strategy so they can be compared. I think your task will be more simple than this sounds, as some of the privatization options will not be open to your government due to underlying economic, business, political or legal implications or, perhaps more often, due to the nature of the activity.

Once you have completed these steps, you can look back and note that you have gone through a decision tree that looks like this:

Are there compelling reasons for retaining the activity as a government function?  YES (retain in-house)
 NO

Would conversion lead to unacceptable disruption in an essential public service activity?  YES (retain in-house)
 NO

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Are commercial source(s) available
and is private sector competition
likely?

→ NO (retain in-house)

↓
YES

Could service be produced and
delivered by a private sector
group in a more efficient,
cost-effective manner?

→ NO (retain in-house)

↓
YES

Prepare privatization recommendations
and plan for contractual phase of
privatization.

Your final task in the preparation for a privatization action is the reporting of your findings and recommendations to the appropriate decision-maker. Treat this as you would any other extremely important initiative where key decisions hinge on the facts presented in a short amount of time, and you will know the degree of preparation and supporting material you will need.

V. Conclusion

As was noted at the beginning of this paper, there are no basic texts one can go to to learn how to carry out the "perfect" privatization. We are all learning by experience, and I have found that the steps I have described to you have worked well in the field, and they appear to be readily "transferable" to other locations and types of privatization. Each of you will put a local twist on a general procedure, but that is necessary. Perhaps if we meet in several years and compare notes, we will be able to develop a perfect cook book; until then, we learn by trying.