

Privatization—A Cure for all Ills?

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Before a troubled State-owned company can be privatized, the management dimension must be examined. The privatization strategy must be closely linked with the overall business strategy to ensure that the opportunities afforded by the operation provide for long-term profit enhancement. The logic behind the state-owned enterprise is described and the objectives of privatization, the pros and cons, are analysed.

With Veba, Viag, Volkswagen *et al.*, the state's retreat from business is booming. But privatization is not a cure for all that ails troubled public enterprises. After all, the mere selling of shares in state-owned industries cannot create new, powerful management, nor can it guarantee a company's survival. For this reason, any discussion of privatization should be broadened to include business management issues:

- ☆ In many cases full or partial privatization increases the complexity of day to day management and thus the demands made on managers.
- ☆ The prerequisites for privatization are a fundamental new management 'vision' and a new corporate strategy.
- ☆ Management strategies and policies have to be developed, businesses have to be reorganized and key executive personnel, who will fit into the company culture, carefully selected.
- ☆ Management has to concentrate on building such a stable and successful long term business that renationalization becomes unlikely or even politically impossible.
- ☆ It is the job of government, not management, to define the social and economic goals of a state-owned company and to meet the cost of achieving them. However, managers should ensure that they make their views known to the decision makers in government.

In England, France, Italy and Austria alone, more than 30 separate state-owned industrial and service organizations have been fully or partially sold to private investors since 1979. In addition, there have been more than 10 other privatizations in other countries and there are over 65 known candidates awaiting sell-off.

The present wave of privatization, which originated in the U.K. but is now spreading to all western industrial countries and even some less developed ones, has been causing heated political debate in the academic world, in trade associations and in business. In many circles, privatization is considered a panacea—a good means of easing strain on national budgets, of promoting popular capitalism formation and wide share ownership to employees and the general (voting) population, of increasing the efficiency of markets, and of supporting the restructuring of organizations into self-supporting and long term employers (see Figure 1).

The Logic Behind State-owned Business

Although business management is a permanent fixture of government in mixed economies, such as Italy, France, Austria and Spain, it is increasingly coming under fire. State-owned businesses that compete with private companies serve political not financial goals. These political goals are best defined by government and not by the management of the state-run companies. After all, the top executives of public businesses are best employed in improving long term profitability; they cannot be expected to transform themselves into a new type of civil servant deciding case by case whether public well-being is best served by reducing prices, maintaining employment levels or by setting up new plants in depressed regions which private industry has shunned.

To keep inefficiency, injustice and corruption at a minimum, division of responsibilities must take place in the public sector:

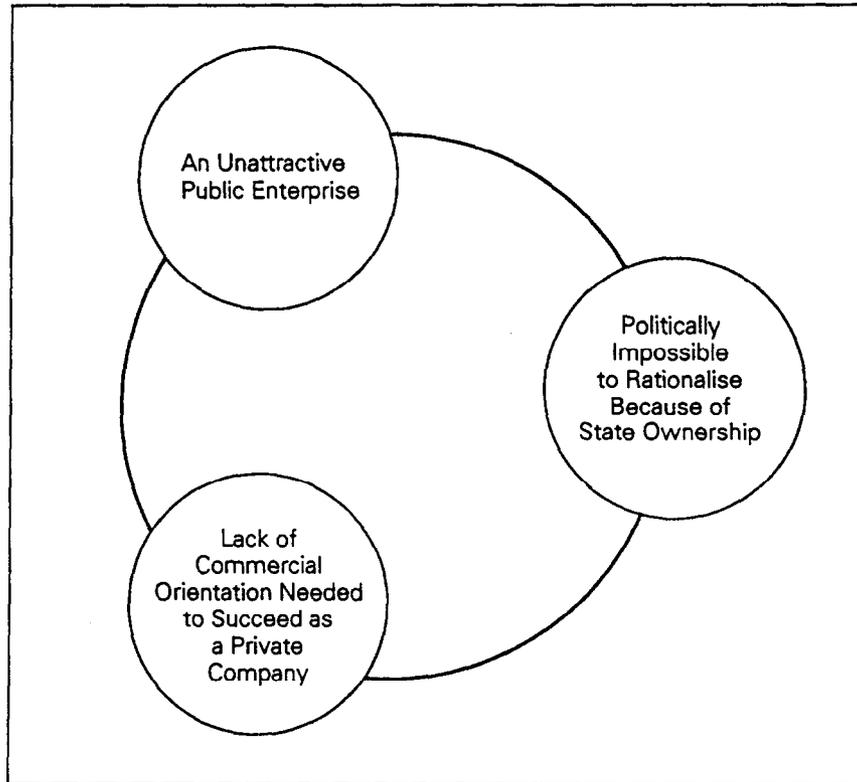


Figure 1. The vicious circle of regulation

- (1) It is the duty of the government to determine the objectives of state-owned industries and to weigh up the cost to the exchequer of meeting these. Politicians must decide whether to keep a loss-making state business operating in a depressed region, even though any private businessman would have closed it down long ago. They should also include the full opportunity cost of continuing operations in their analysis.
- (2) The role of public sector management, like that in the private sector, is to maximize long term profitability. However, managers in the public sector face one additional constraint—they must promote the government's objectives for their industry.

The social and economic costs associated with these additional political objectives are met from the public purse and are not carried by the state-owned company. Thus, there is no difference in the decision-making models of the two types of business: state-owned operations pursue loosely defined objectives of public interest, but, just like private companies, they operate with a view to long-term profits (albeit under additional constraints).

Therefore, in a mixed economy the state must:

- (1) Determine the social and economic goals of the state-owned companies.
- (2) Meet the costs incurred in meeting these goals.

The question of privatization always arises when these social and economic goals are no longer relevant or when they can be better achieved in a different way.

The Missing Business Management View

Three different standpoints are taken in discussing privatization (see Figure 2):

- ☆ the ideological stand-point (to reduce state presence in the economy)
- ☆ the economic stand-point (privatization to reduce costs and increase efficiency)
- ☆ the pragmatic stand-point (privatization on a case by case basis).

Privatization has been driven by domestic political and economic forces whilst business management aims have taken a back seat. However, the reason for selling shares to the public should above all be to improve the performance of the organization being sold.

The basis for this must be a detailed analysis of the business and management opportunities that privatization of a state-owned company presents (see Figure 3). A clear division of duties between government and management allows the former to

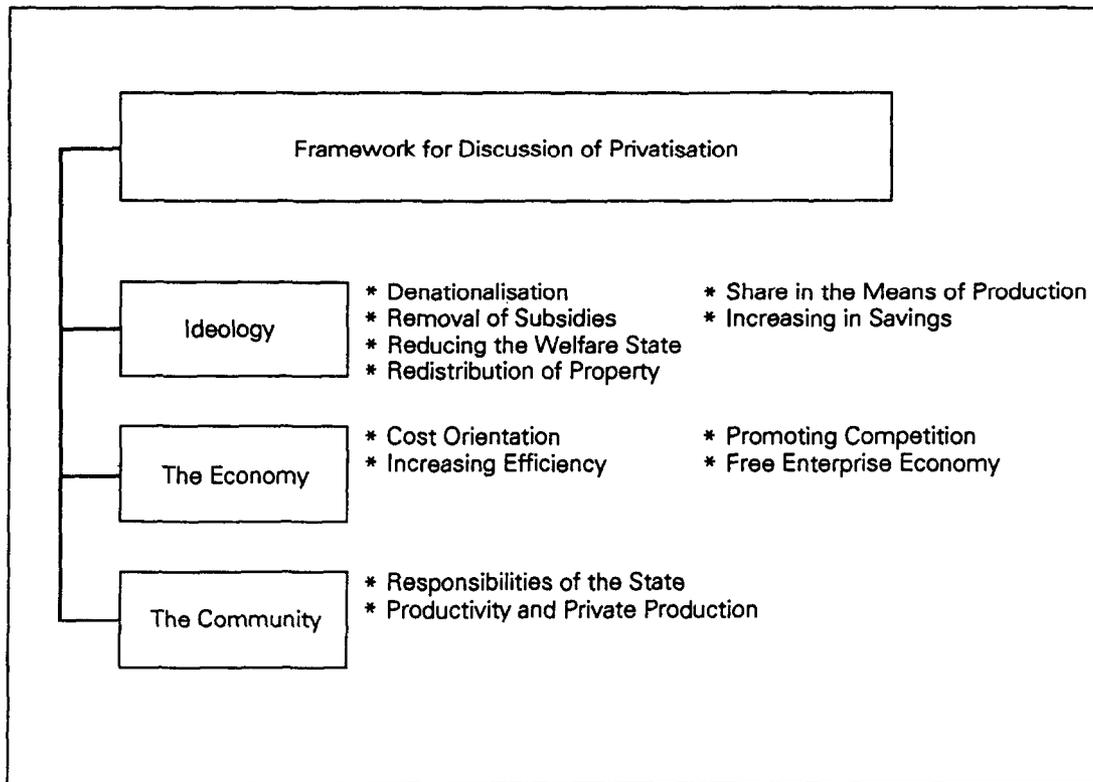


Figure 2. The missing management dimension

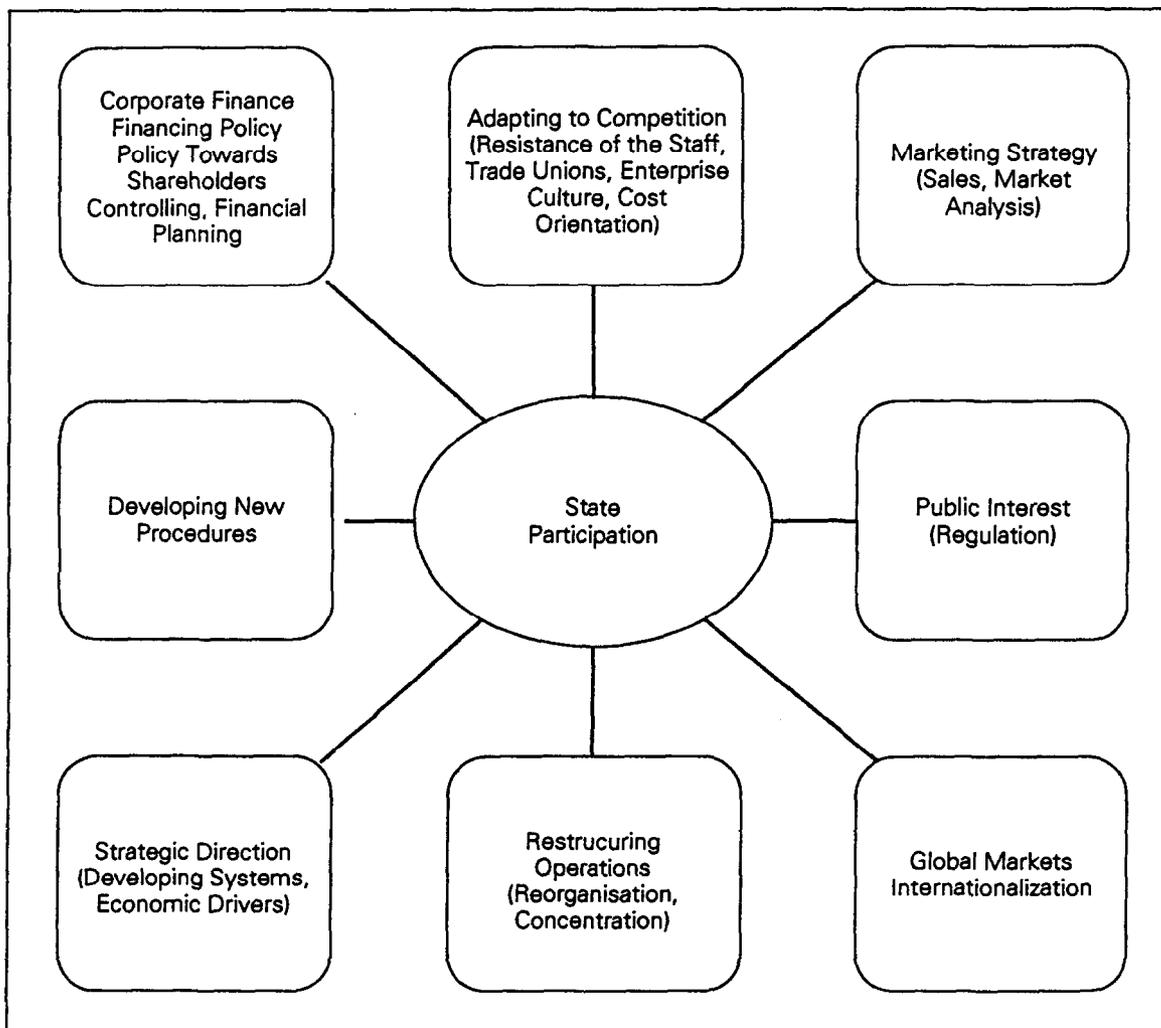


Figure 3. The managerial problems involved in privatization

pursue its political or economic objectives and allows the latter to concentrate on ensuring the successful future of the company.

The Pros and Cons

Privatization is taken here to mean the complete or majority sale by the state of a public, industrial enterprise to various types of investors. These enterprises are often state-owned companies operating in competition with private companies.

The following forms of capital privatization are segmented by scope and by whether or not they are first-time privatizations (see Figure 4):

☆ full privatization—sale of the entire stockholding;

☆ partial privatization—sale of controlling interest (sale of minority stake is not included since, unless there is a hands-off agreement with government, this does not make the new owners autonomous).

☆ re-privatization—full or partial privatization of a formerly private but currently state-owned business.

A great deal has been written on the economic arguments for (and against) privatization, and there have been detailed quantitative comparisons of the efficiency of operations in the private vs the public sector. However, little has been published on the softer management issues such as managing the change of an organization from the public to the private sector.

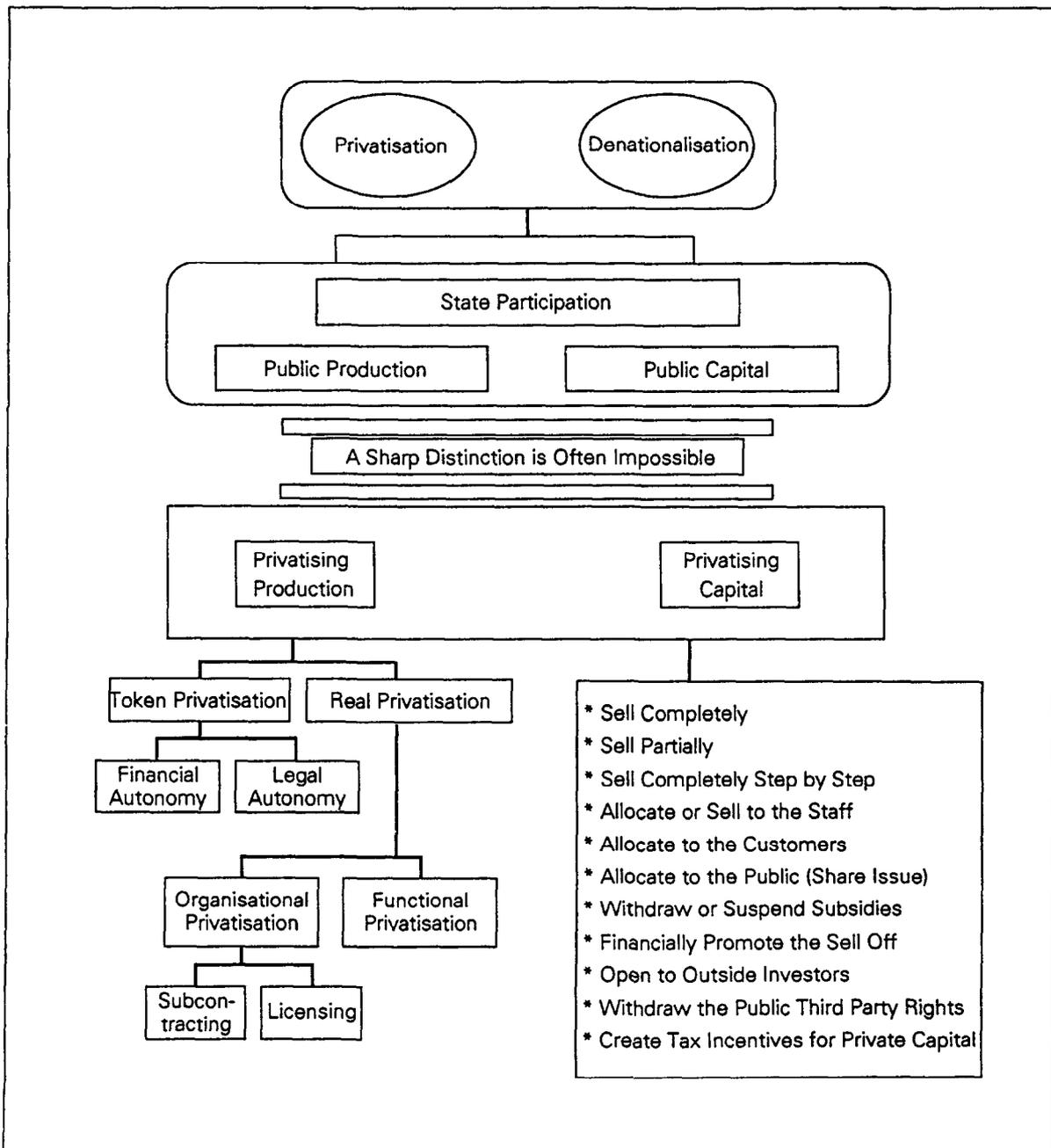


Figure 4. The types of privatization

Seen from this perspective, the pros and cons of privatization can be segmented according to how much scope there is for managing their impact on the success of the privatization—as measured by the net income to the state (sales value, future tax revenue, saved subsidies etc.).

The arguments in favour include: privatization presents a unique opportunity to 'revolutionize' the company's strategic, organizational and cultural direction; cost efficiencies in production (i.e. scale and experience effects) become more important; there is increased consistency in allocating and exploiting available resources (including dis-investment, when necessary); the company becomes more market oriented; there is less or no need for subsidies; there is increased company independence and freedom; better access to capital markets and finance; cost consciousness becomes a necessity in all strategic sectors of the company; international expansion becomes possible; pricing becomes more market-sensitive and efficient control systems become a necessity.

The arguments against include: a state-owned company does not have to make a profit; whereas a

privatized company has to get by without deficit guarantees, state orders or similar survival aids from the public sector; after privatization, public relations obligations increase (depending on the size and legal status of the company); depending on the particular branch of industry, economic activity has to be regulated after privatization in order to ensure continuity of production, meaning that management freedom and operational autonomy will only be partial.

It goes without saying that a privatized and healthy business will also be able to meet long-term domestic economic objectives. Moreover, re-nationalization is hardly likely if privatization proves to be successful.

Prerequisites and Environmental Conditions

The strategic prerequisites for privatization include: observation of the capital markets in the countries concerned; formation of a long-range and forward-looking business plan; development of strategies for the entire company and for the strategic subsidiaries;

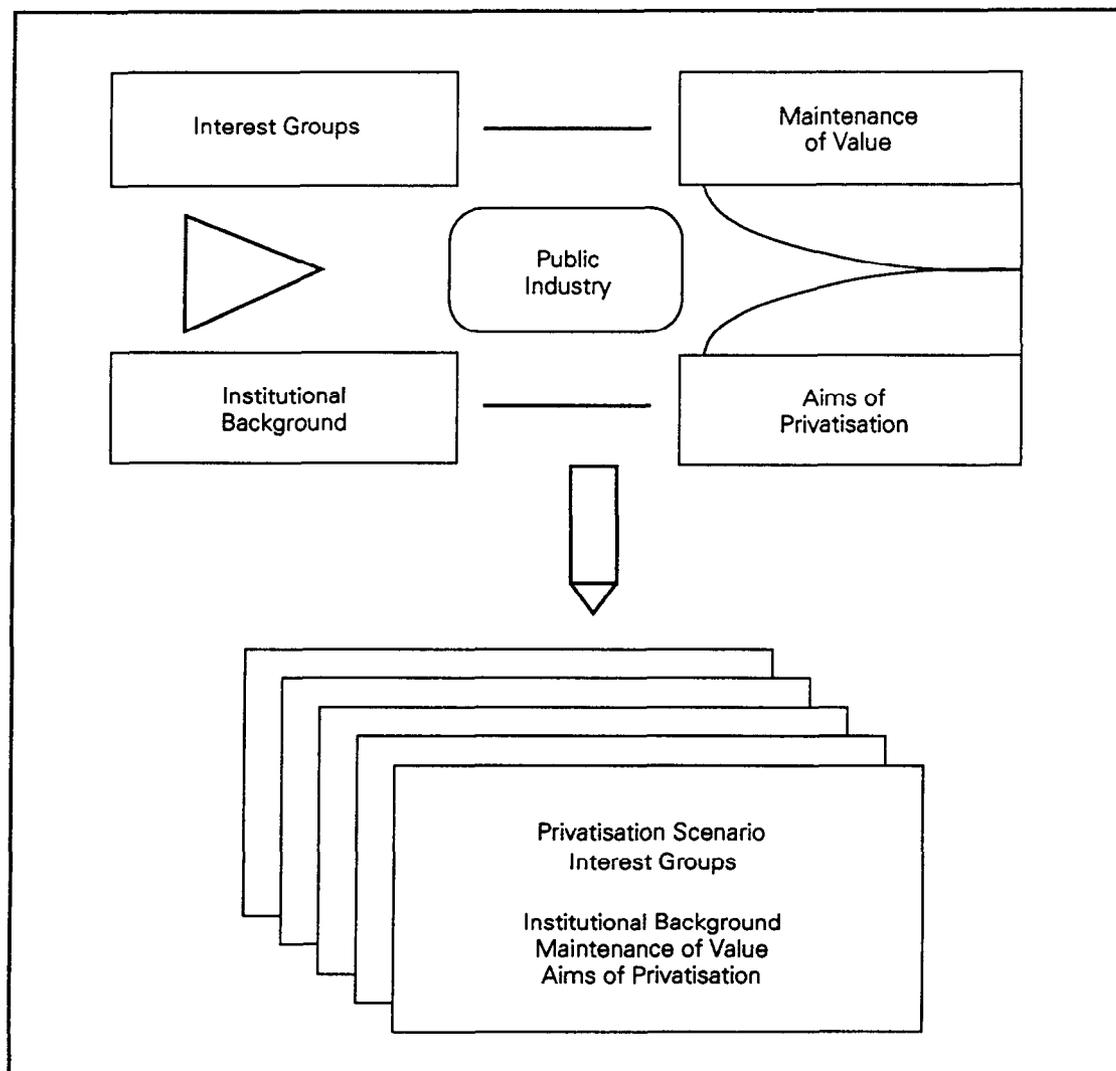


Figure 5. Basic conditions for privatization

ensuring long term management and overall stability as well as product quality; maintaining a minimum of issued capital; publicizing privatization to the desired circle of investors. These prerequisites show privatization's close relationship with business strategy and the company's prospects. Privatization can be considered successful when all the objectives of sellers and purchasers are satisfactorily met. Other fundamental prerequisites for success include:

- (1) maintaining the production demanded by society at an acceptable and competitive price
- (2) maintaining profitability so that taxes paid by the privatized company will flow into the exchequer and prevent the privatization from looking like a 'winding-up sale'.

The course and success of privatization depends to a large degree on the conditions in which it is

conducted. The management of state-owned company acts—just as any other company's management body—within a given set of influences. These influences change during privatization and their affect on operational decisions and the decision making process will also alter.

The following systematic classification is helpful in analysing the impact of these conditions (see Figure 5):

- (1) interest groups
- (2) sets of values
- (3) aims of privatization
- (4) framework of institutions surrounding the state-owned enterprise.

Interest groups (see Figure 6) are taken to mean all the groups, directly or indirectly participating in the

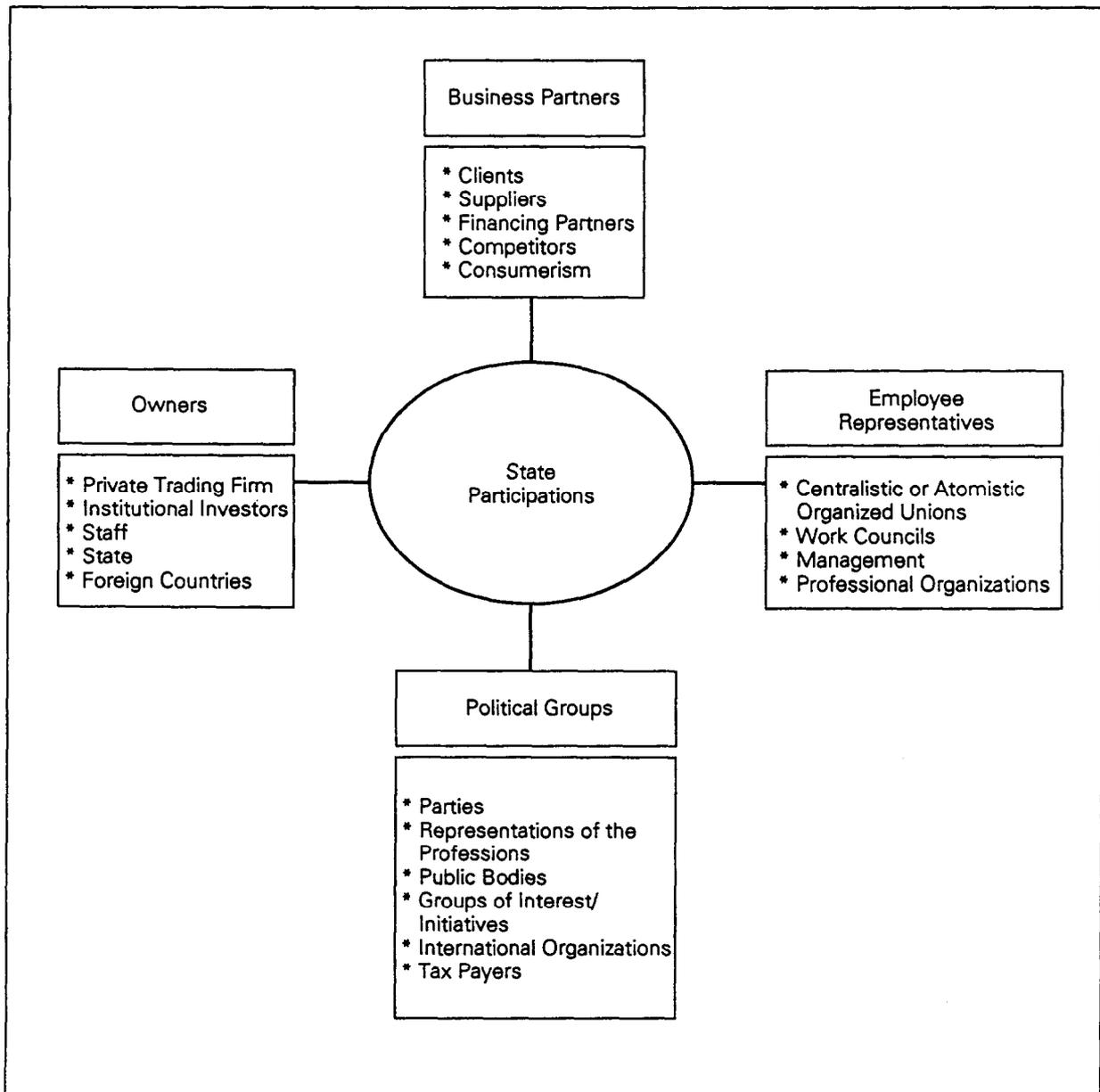


Figure 6. Influence groups involved in privatization

privatization, which (on the basis of their sets of values) can influence the course or even the success of privatization. These are the new owner(s), the unions, political parties and groupings and business partners.

These interest groups (excluding the new owners), will have already exerted an influence on company management prior to privatization. However, privatization also affects the scope of their influence. For example, privatization can greatly weaken the influence wielded by a union: in England, labour representatives only need to come to terms with new management objectives (although even this has to be considered a loss in influence because of cost squeezes that follow privatization), while, on the other hand, in countries where unions are organized by industry (W. Germany, Italy, Austria and France) the original union federation can be weakened.

The concept of sets of values can be broken down into business-related values (for example, willingness to take risks, dividend policy, growth, consideration of personnel objectives etc.) and the objectives and values of society.

Over and above the groups of influence, there are other participants in the privatization process (see Figure 7), whose assessment of the future and whose values have to be taken into account.

All changes in sets of values (i.e. society's expectations) have significant consequences for management's view of the privatization process, because taken together with other external influences they form the basis for restructuring a company's image, policy and strategy when privatized.

Objectives of Privatization

Different groups of interest have different objectives from privatization (see Figure 8). All these interest groups (except owners) will make day to day demands on the privatized company in order to fulfil their social objectives.

Investors and future owners have a wide diversity of tactical goals from privatization (as diverse as the broader strategic goals of privatization itself). For example buyers/investors may be looking for: a long-term or short-term investment; elimination of

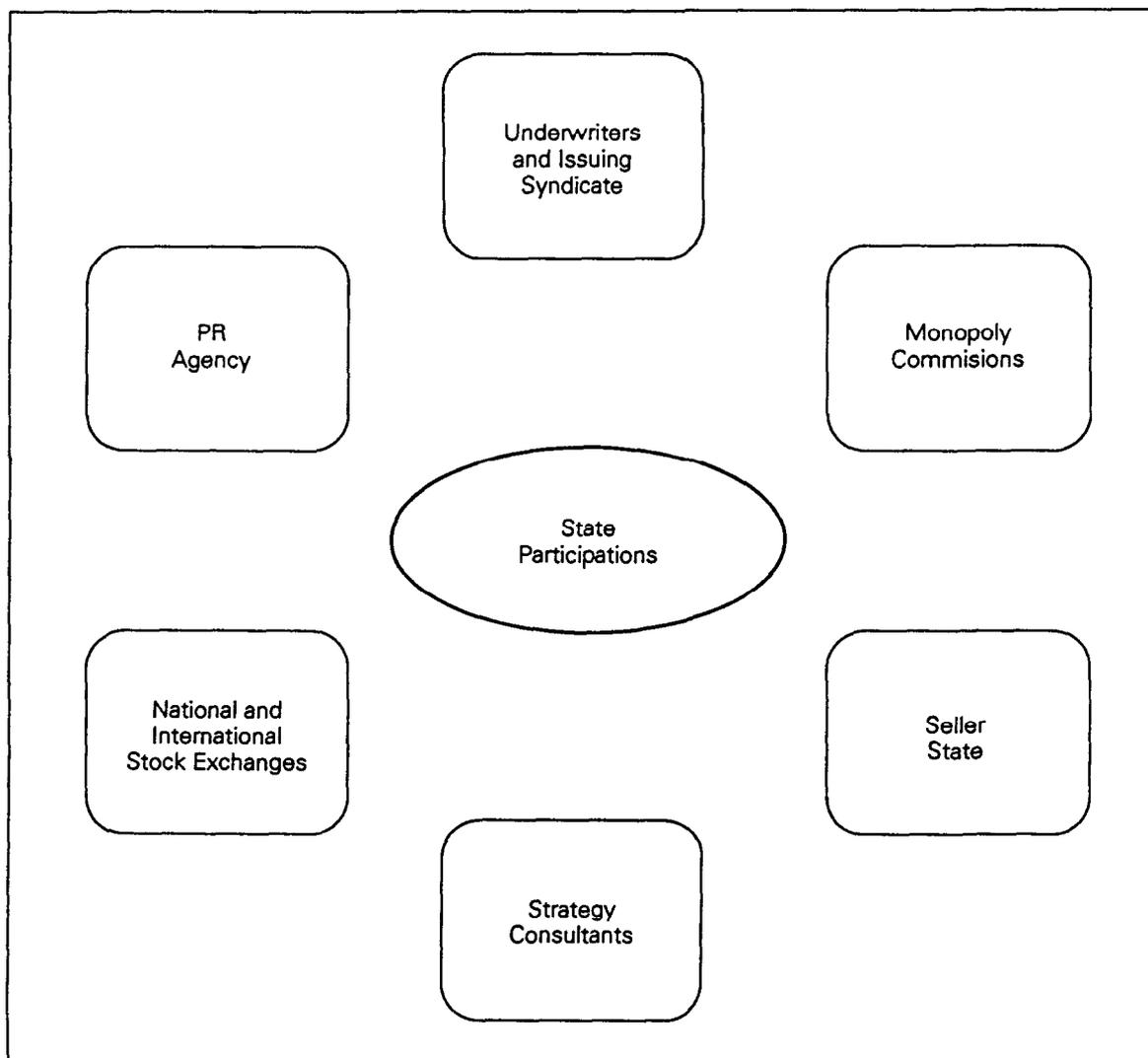


Figure 7. Groups involved in the privatization process

competition; strengthening of competitive position; capacity extension; horizontal and vertical integration; broadening a product line; gaining better access to markets; securing supply of raw materials/procurement; guaranteed sales; gaining know-how, and research and development capability and patents; gaining key personnel. Clearly it is important to understand the identity and motivations of potential purchasers/investors before a privatization is announced.

(intending to keep it on a long term basis) must be regarded as a special case for management.

Secondly, government control over the management of a partially privatized company can have significant implications for investors. For example if a company of key importance to society is privatized, the goal of maximizing profit may be subordinated to the maintenance of investment levels or employment. This diminution of the interest of shareholders can be anticipated by setting the issue price for the offer at a level which compensates for the reduction of future profit potential. There is also a general problem of valuing the assets of a public utility. If government seeks to promote wider share ownership and 'a share owning democracy' it may set a low offer price. However, even if loyalty bonuses are included in the offer, the share price will find the correct market level and the initially large number of small

Conflicts of Interests in the Case of Partial Privatization

There are two potential sources of conflict. Firstly, the percentage of equity held in the private sector determines the entrepreneurial autonomy devolved to management. Any privatization in which the state retains a majority share of the company

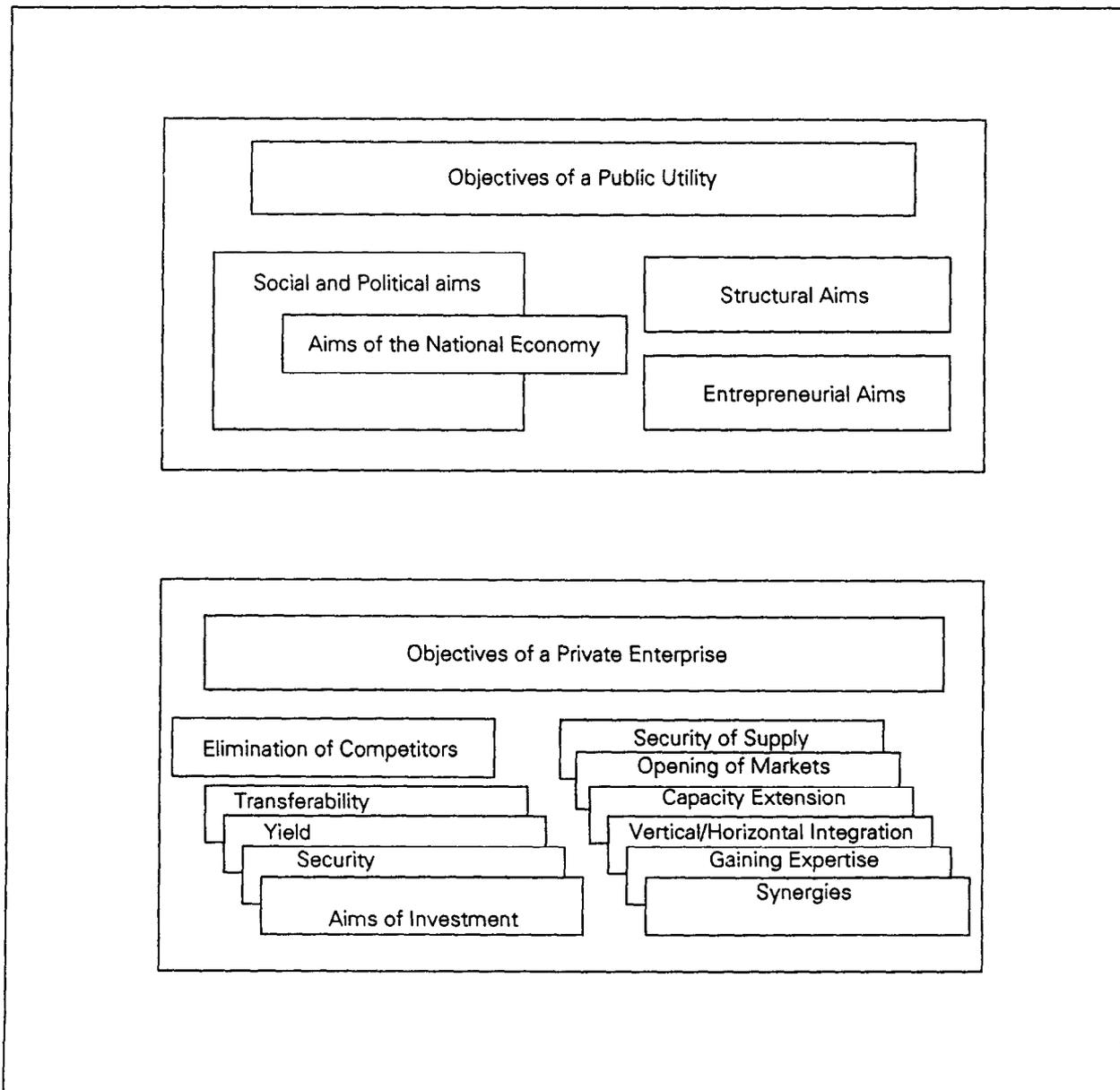


Figure 8. The aims of deregulation

investors will tend to sell out for a quick profit, leaving a large proportion of the shares in the hands of a few institutions. Another consideration of promoting share ownership is maintaining a minimum level of dividends.

This 'dilemmas of partial privatization', for both shareholders and management are temporary phenomena showing the gap between the private interests of the owners and the public interest. If the public interest is poorly defined, this conflict becomes even harder to manage.

Managing the Strategy of the Privatized Enterprise

The prerequisite for any successful stock issue is the creation of value for shareholders in the future. In

most countries public enterprises, as a result of fulfilling political or public aims, managerial problems or a combination of both causes, make losses and require subsidies.

Before privatizing an enterprise, the overall long-term prospects of the company itself and its components have to be examined. There should also be a division by division audit of the company. This examination should form the basis for developing any new strategies for the company (Figure 9).

Privatization changes the importance of some of the factors that influence product strategies. In many cases product ranges, prices and even management are re-organized, partially to demonstrate to employees and the outside world that changes are afoot.

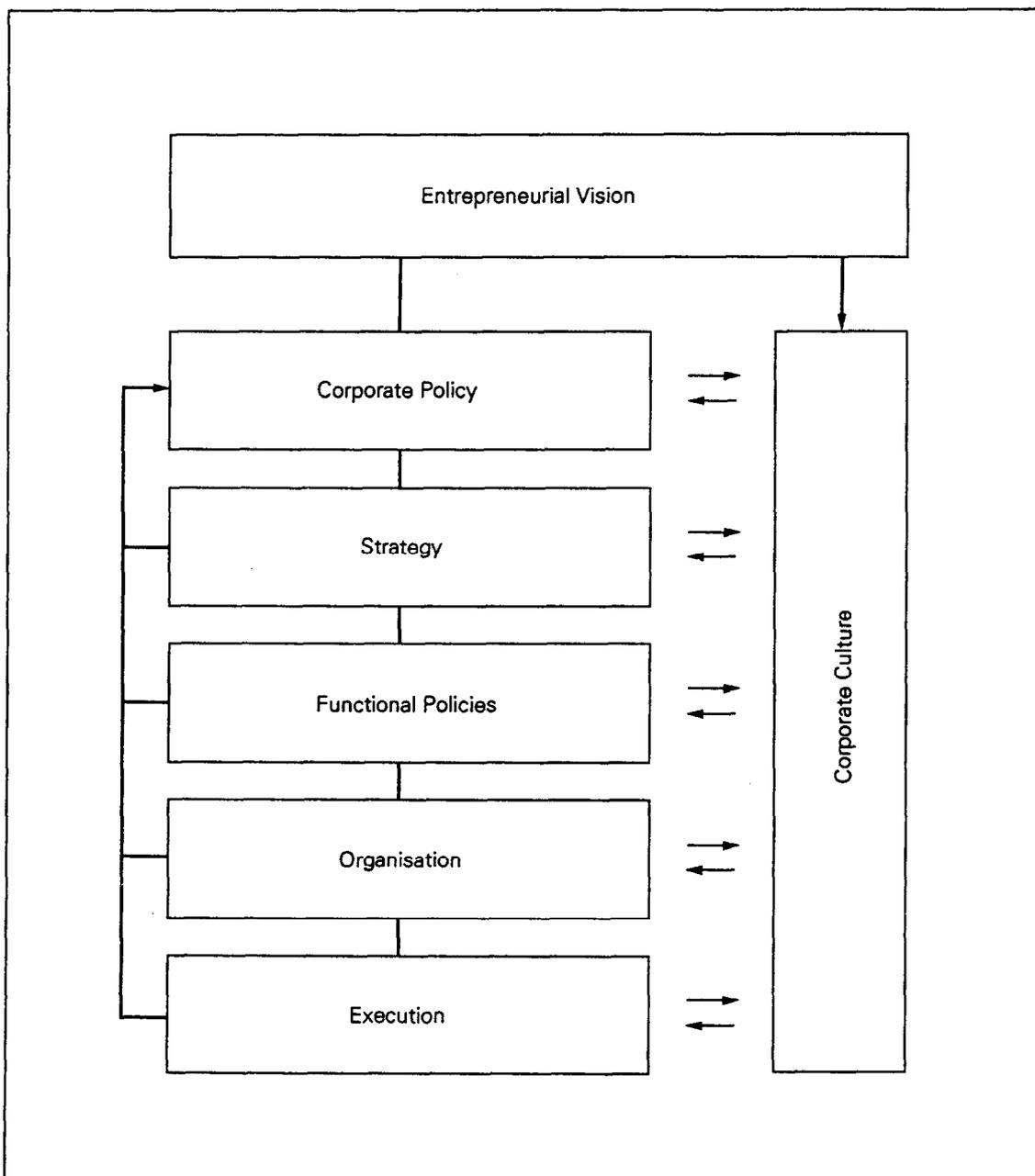


Figure 9. The seven factors of management

When privatized, a company is forced by external influences to re-think its future. A management with long term vision will anticipate this change (whilst still state owned) and prepare strategies for managing it and ensuring the success of the privatization. In developing these strategies the management must address the following areas:

- ☆ entrepreneurial vision
- ☆ management policy
- ☆ strategy formulation
- ☆ functional policies
- ☆ organization development
- ☆ entrepreneurial culture.

These areas are treated iteratively since any one will influence the others. This also assures the ability to react to changing conditions. Controlling this mechanism presents opportunities not only for providing supervision and guidance but for management interference.

Privatization increases the complexity of the business problems faced. It effectively changes the environment and thus increases the demands placed on management in improving long-term profitability.

A strategy for the privatization process, which allows co-ordination of each operational and strategic step as well as the maintenance of executive control, is absolutely essential to ensure that the enterprise achieves its goals in manageable steps.

This strategy should therefore be regarded as a vital accompaniment to privatization as well as a prerequisite for giving direction to the newly privatized company.

The development of a strategy for privatization can follow the same steps as the one of the organization's general strategy development process. The privatization strategy must provide a clear step by step process for: achieving the state's goals, providing a new direction for the company, implementing this vision, and identifying and attracting a suitable group of investors.

The privatization strategy has to be closely linked with the overall business strategy in order to ensure that the demands that the sell off places on management are met and that the opportunities that privatization presents for long-term profit enhancement are exploited.

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