

**Strategic Privatization:
An assessment of Ownership Transformation
in the Global Telecommunications Industry**

Theodora Welch* and Rick Molz
Concordia University
Montreal, Canada

Abstract: Strategic decision-makers in national telecoms face two options for survival in an industry context of increasing technological change, globalization, and deregulation: merge or ally with a larger multinational player or consortium, and, or acquire a broad investor base among domestic and international investors. Privatization through combination strategic investor and share issue responds strategically to these forces. We view the privatization as ownership management and ask whether it provides for an efficient ownership structure, one that fosters corporate governance and organizational capabilities. We advance strategic privatization to offer some understanding, and present a transaction framework to examine six telecom privatizations in developing countries.

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*Please address correspondence to:
Theodora Welch, Ph.D. candidate in Business Administration
Department of Management, Strategic Management Area
Faculty of Business and Administration
Concordia University
1455 de Maisonneuve Blvd. West, Suite GM 503-33
Montreal, Quebec, Canada H3G 1M8
Telephone: 514-848-2738 Fax.: 514-848-4292
twelch@vax2.concordia.ca

1. Introduction

Three key forces are driving the transformation of the telecommunications sector: advances in information and communications technology; industry globalization as evidenced by increased cross-border investment and inter-organizational alliances; and public policy initiatives such as privatization and deregulation. The focus of this paper is on the latter two, and we view these phenomena significantly as organizational and financial innovation.

Both Schumpeter (1934) and Chandler (1962; 1992) recognized the transformational character of organizational and financial innovation in large business enterprise as central to economic growth, with development gradually emerging from a path-dependent process of corporate learning and increasing specialization of functional activities. Here creative destruction is a result of entrepreneurial activity, technological advances and industrial and corporate re-combinations. Recent corporate financial historians identify three primary agents as instrumental in this evolutionary process: government, finance, and business enterprise (Baskin and Miranti, 1997).

Importantly, Chandler conceives transformation as taking place at certain enterprise levels. At the highest level strategic planning shapes the organization and its environment by determining how a pool of enterprise resources may be optimally allocated in order to take advantage of anticipated changes in the business environment. Since Bower (1970), the commitment of corporate resources has been of vital concern in strategic decision-making. In this paper, we present the allocation of ownership in and of itself as a strategic commitment. In other words, we consider ownership as a strategic choice variable and ownership transformation a transformational strategy. Certainly, Berle and Means (1932) offered early evidence of the impact of ownership structure on the economic performance and strategic behaviour of organizations.

Yet, how on the face of it does privatization or ownership transformation initiate transformation of state-owned enterprise¹ (SOE) and assets? In many network industries a privatization initiative does so by 1) placing these productive resources under what is often a private (or mixed public and private) multinational corporate form (frequently a consortia of multinationals is involved). As Hedlund (1993) reminds us, "the very *raison d'être* of the MNC is constantly to rearrange jobs and transactions, utilizing its infrastructural advantages of globality".

Furthermore, these interorganizational networks may be in the guise of intermediate organizational forms, as in the case of strategic alliances and joint equity investment between telecom providers in developed countries and emerging markets. Privatization also spurs transformation by 2) launching the share issuing process of

going public, wherein a SOE acquires a broad investor base among domestic and international, retail and institutional investors.

For developing countries ownership transformation is likely an initial but critical step for introducing much needed financial, technical, and managerial capabilities. In developed countries, this process of corporate restructuring is well underway.

Both Chandler and Schumpeter denote the broad scope of historical analysis as most appropriate to capture such higher-order economic transformation. Yet some perspective may be gained through the narrow lens of enterprise-level ownership transformation. Indeed we argue that ownership choice – or ownership management is one dimension through which industry and organizational transformation process is achieved. For these reasons and others privatization transactions provide an appropriate unit of action to examine important recombinant agents at work. Here large business enterprise and multinationals, governments and investors are actively re-shaping or re-allocating a strategic resource, ownership.

The remainder of this paper is organized as follows. In the section below we provide an overview of privatization trends, in section 3 we discuss privatization as a construct, in section 4 we elaborate the theory, and in section 5 the research propositions and model are drawn. Six telecom privatization transactions are examined in Section 6, and a final section concludes.

2. Recent Trends in Privatization

Certain transaction patterns may be discerned when observing ownership transformation of SOEs; those importantly related to capital market activity include method of ownership transfer and type of capital flows.

Method of Ownership Transfer

Generally SOE sales may proceed through the stock market or in a private placement, through a series of incremental divestitures or be transferred all at once (or nearly in the case of partial divestiture). In this way ownership is transformed either through sales to a dispersed shareholding public, through a more pointed sale as in the case of a strategic investor, or in a direct or trade sale. Indeed the process of corporate securities issuance is not unlike public financing activity common in the private enterprise sector, similarly corporate recombination is not unlike merger and acquisition activity. Yet in the case privatization government is a key transacting agent, implementing privatization through the markets for firms, partners (joint venture or alliance partners), or shares.

With these forms of transformation in mind the following patterns may be discerned. According to Bel (1998), selling SOEs on the stock market has been and remains the most characteristic feature of privatization in developed countries. Yet despite the overall importance of share issue privatization (SIPs, as Jones, Megginson, Nash, and Netter (forthcoming) coin the term), sales to strategic investors have just recently surpassed SIPs in annual transaction value. In lesser developed regions where capital market conditions remain weak (thinness and volatility of the local stock market), privatization on the stock market has had less relevance. Nevertheless, SIPs are being used increasingly in countries where nascent capital markets are becoming more stable. Indeed, share issue privatization is considered both to facilitate and be facilitated by capital market development. Nevertheless, in emerging market and transitional economies the mixed sale (or combination SIP and strategic investor) and straight trade sale predominate (Lieberman and Kirkness, 1998). These trends are captured in table 1 below.

*****place table 1 trends in privatization transactions here*****

Type of Capital Flows

In developing countries privatization patterns are distinguished through external capital flows as well; we use figures presented by the International Finance Corporation (1998) to assess changes to aggregate movements. The data show a dramatic change taking place during the 1990s in the pattern of external capital flows to emerging markets. Indicated is that: 1) private capital now replaces official flows (bilateral and multilateral development financing from national and international aid agencies) as the main source of external funds, 2) private equity now outpaces debt, 3) and while portfolio stock has increased steadily FDI has undergone explosive growth.²

*****place table 2 waves of capital here*****

The changes in capital flows suggests MNCs are leading a wave³ of private equity surging toward emerging market shores while the tide of official sources ebbs. Furthermore this change in capital forms part of an overall historical pattern observed in many developing countries (see Baer and Hargis (1997) for instance for an examination of flows as applied to Latin America). The emerging trend is one of private flows supplanting public flows in the form of international investment by large business enterprise and new portfolio investors; this shift is highlighted in table 2 above. We recognize this change to capital formation as driven importantly by privatization. It is a pattern shaped in part by the recent trend toward privatization or organizational transformation of state-owned enterprise through combination share issue and strategic investor. Moreover we

can observe this evolutionary process when government, multinationals, and investors come together to implement privatization.

3. Construct Development in Privatization

Though initiatives have varied over the past decade the general trend toward privatization is not a recent one. Since the early 1980s, in more than seventy countries in both developed and developing nations alike, privatization has occurred in infrastructure, financial services, and primary industry, among others. In terms of transaction revenues Lieberman and Kirkness (1998) report that more than US\$155 billion has been raised through privatization during 1990-96.⁴ Yet, despite nearly twenty years of initiatives, worldwide momentum, and transactions valued in the hundreds of billions of dollars, privatization as a research phenomenon and public policy programme remains problematic. The difficulties may be briefly stated and include: an indeterminate conceptualization of privatization itself, mixed empirical results in terms of privatization outcomes and a preoccupation with organizational-level performance as outcome. These issues are not unrelated, of course. However our focus here is to direct conceptual development and incorporate higher-level phenomenon, namely capital market activity. These issues are developed more fully below.

Mixed Empirical Results on Privatization

With regard to mixed empirical results the critique of Megginson (1998) and Claessens and Djankov (1998) may be summarized as follows. The challenges to empirical research on privatization include: 1) *confounding effects* (difficulties in separating out the effects of related policy co-initiatives such as liberalization and deregulation, as well as institutional variation across industries and countries in general), 2) *small sample size* (where industry and institutional variation can be controlled, the problem remains that many former SOEs have operated as natural monopolies with few extant firms as competitors or possible exemplars) 3) *small population effects* (despite a global trend privatization has been implemented in a piecemeal fashion often through gradual divestiture of government holdings over a period of years. An exception to this has been the mass (voucher) privatization in Russia and various Central Eastern European (CEE) countries (transition economies), yet here the lack of acceptable firm-level performance measures are recognized as the significant obstacle to empirical work). These challenges point to another line of inquiry, one that extends outcomes to include welfare effects for certain groups in society and measures post-privatization effects using econometrics. This approach has been criticized for lacking validity (unsuitable for theory-building outside of normative or logical positivist

traditions and, though prescriptive in nature, presents an overly abstract guide for practitioners lacking economic training).

Despite the challenges two studies are noteworthy and overcome certain of these obstacles, though other relevant works occupy the literature as well. Megginson, Nash and van Radenborgh (1994) examine firm-level performance while Galal, Jones, Tandon and Vogelsang (1994) investigate net welfare effects; both demonstrate improved outcomes as a result of privatization.⁵

An Indeterminate Conceptualization of Privatization

Conceived importantly as a public policy initiative construct development in the privatization literature has been shaped first and foremost by researchers in the field of public administration and public sector economics. Not surprisingly the public policy approach conceives privatization as the antipode of government growth, as denationalization in effect. From this perspective research often proceeds toward an assessment of a veritable toolbox of techniques or methods used to decrease the size and scope of the public sector. The approach is understandable as theory-building here is directed toward the growth and development of the modern state (Feigenbaum and Henig, 1997). Yet conceived along a basic public (sector)-private (sector) ownership continuum these researchers examine privatization using a coarse scale. Guided by such a broad construct studies might include decreases in the size or scope of the public sector, or alternatively an increase in private participation in what, where, and how to produce goods and services. In fact an indeterminate conceptualization tends to lump together such diverse phenomena as deregulation, management contracts, public floatation of shares, and the growth of new private firms, to name just a few. Empirically, the effect serves to blur the analytical gaze and with it attenuate any true relationship between privatization and observed outcomes. Certainly, further refinement of the privatization construct is needed, and is proceeding, albeit slowly.

Some Useful Typologies

Two classifications offer some helpful delineation. The first is a taxonomy developed by Savas (1991) and advanced in Bennett (1997); it draws from economic-oriented approaches and presents a more focused account. Here the boundaries of privatization are conceived as either a reduction in government ownership and/or control over public enterprise or assets; the retreat of the public sector is considered the broadest development. These features are defined as government divestment, delegation, and displacement and are presented below.

Divestment is the transfer of state-owned enterprise or assets to private ownership through sale, restitution, give-away, or liquidation. This form of divestment would also include sales to strategic investors, trade or direct sales, as well as public share offering or SIPs. *Delegation* is the transfer of management and control of state assets or activities to agents operating in accord with market indicators or the infusion of private sector managerial autonomy and incentives. This non-divestment option includes leases, (monopoly) concessions, operating franchises, and management contracts. *Displacement* is the promotion of private sector development or involvement in former public activities. Contracting out and private financing or provision of former public outputs through variants of build-operate-transfer offers a third modality.

Where enterprise ownership transfer is the salient feature, as in the divestment concept, privatization is termed 'P1'; it is termed 'P2' where it includes both divestment (P1) and the transfer of (asset management) control, or delegation. The authors identify 'P3' as the combination of divestment, delegation, and displacement: this all-inclusive view conceives privatization as the marketization of economic activity or the assignment of microeconomic decision-making to market forces rather than to political-bureaucratic direction.⁶

From this taxonomy alternative theoretical frameworks and measures may be conceived. Importantly, we note that although the framework partitions methods which transfer ownership from those which transfer (management) control of resources, there is a well-developed literature that considers this form a separation *the* problematic for economic organization. From this line of inquiry ownership structure dictates management control of resources. Thus for our purposes the identification of P2 or divestment/ownership-delegation/control would suggest an agency perspective to certain privatization phenomenon. In particular, the agency-based corporate governance approach offers a certain understanding of corporate behaviour in the context of ownership change. In directing the analytical focus along these conceptual lines we attempt to present a more refined concept of ownership change may be elaborated.

Construct refinement and empirical research may be guided by an additional classification. Feigenbaum and Henig (1994; 1997) present a typology which integrates administrative, economic, and political perspectives and attempts to go beyond the normative techniques-based approach to theory building prevalent in the literature. However their conceptual starting point remains privatization as the opposite of state growth. In their typology the authors distinguish privatization as pragmatic, tactical or systematic, each of which differs in terms of motives (among principal initiators) and outcomes (for government, interest groups, and social classes). The types are presented below.

Pragmatic privatization is carried out by bureaucratic units and is an ad-hoc technical solution to an immediate functional problem (social, administrative, or organizational) and takes place in a context both specific and de-politicized. Examples drawn include user fees for entering parkland, contracting out garbage collection, and others. *Tactical* privatization is sought by political actors, entities, or special interest groups to achieve short-term political goals and is a process which includes appealing to allies, rewarding supporters and punishing opponents. Here SIPs and private sales predominate. Examples include 'discounted' share offerings for utilities or direct sale complete with monopoly concession, as well as employee and management buyouts or preference at sale, and others. *Systemic* privatization is sought to reshape an entire society by fundamentally altering economic and political institutions and interests; it is sweeping in scope, ideological in nature and represents privatization as a grand political project. Examples include the sale of substantial state assets and enterprises, shrinking the state sector, reducing government bureaucracy and social welfare responsibility.

Like the previous framework the classification by Feigenbaum and Henig presents a useful starting point for sorting in a meaningful way the variety which exists across government privatization initiatives. Of particular interest is tactical privatization involving share issues and direct sales. Lacking however is suitable treatment of the behaviour of the firm. The oversight is not incidental as the authors' focus is directed elsewhere. Viewed as the antipode of government growth the authors consider privatization from a rich variety of theory in political science, including liberal, Marxist and neo-institutional approaches. Yet, despite this assortment their perspective remains rooted in a conflict premise: perceived outcomes arise from the exercise of power and domination between classes, interest groups, and institutions. Generally speaking this account precludes a 'positive' theory of private sector growth and conceives private economic exchange and transactions as necessarily problematic phenomena. Indeed, an understanding of corporate behaviour in general appears unfamiliar to these authors. Granted their argument does imply macro- and micro-economic reasoning yet these approaches are themselves limited in important ways. For instance, when examining SIPs, trade sales and concessions, once micro- or macroeconomic outcomes are sought and not found (no efficiency gains, cuts to bureaucracy, or fiscal relief for the welfare state), alternative value creation accounts are left unexplored. Tactical privatization is resolved, then, as direct sales of nationalized firms and share issues to benefit financial and industrial interests as well as enterprise insiders. Though not necessarily incorrect this understanding presents complex and fundamental relationships between government, financial and organizational phenomena as unduly simplified.

Introducing Strategic Privatization

Needed is an improved conception where direct sales, share issues, and capital market activity figure predominantly. To do so requires that privatization be conceived alongside the behaviour of the firm; this requires a distinctly enterprise-level of analysis. The strategic management literature offers considerable opportunity here. More specifically, a well-established and growing body of literature exists in related fields of strategy and corporate finance. The corporate governance approach for instance (which is rooted in the agency dilemma and can be found in both these fields) understands firm behaviour in a context of legitimate action *and* wealth creation.

In this paper an understanding of the behaviour of the firm is advanced through the seminal contributions of Berle and Means (1932) and Chandler (1962, 1977). Theory-building from this perspective represents the general inquiry into the growth and development of modern capitalism. The focus directs attention toward organizational and financial innovation in large business enterprise, in particular that associated with strategies of (vertical and horizontal) mergers and acquisitions, diversification, and national and international expansion. For privatization initiatives that involve the sale of large public enterprise, 'strategic' investors, multinational corporations, as well as the creation of new (capital market) instruments and institutions the scope for conceptual development is evident. In fact, from this literature a portrait of *strategic privatization* rather than tactical privatization may be drawn.

The remainder of this paper presents and then applies an agency-based model to examine privatization transactions and expected outcomes. The focal point is ownership change in the context of capital market developments and participants. Thus the framework directs research attention in a meaningful way beyond the preoccupation with organizational-level outcomes.

4. A Corporate Governance Approach to Privatization

Since Berle and Means (1932), separation of ownership and control is one of the traditional starting points in the theory of the firm; this separation is viewed as negative for allocative efficiency though likely intrinsic to the growth of large enterprise (Jensen and Meckling, 1976). With respect to the discourse on privatization, Martin and Parker (1997) offer an understanding of this dilemma. Their argument is drawn from a line of inquiry which extends from Berle and Means to include Coase (1937), Alchian and Demsetz (1972), and, to some extent, transaction costs theory (Williamson, 1975). This body of work presents opportunistic behaviour and incomplete

information as a joint problematic for business enterprise. In particular, the focus is information asymmetry, incomplete contracting, and the cost of monitoring contract compliance between agent and principal.

Divestment, as Martin and Parker indicate, often results in the replacement of public enterprise by public joint-stock companies (i.e. corporatization). Firms as such raise capital from the investing public in the form of equity and financial institutions in terms of both equity and loans, while control or management (of assets) remains in the hands of professional managers. These managers act as agents for shareholders' interests (or utility). Shareholder interest is advanced by maximizing profits (or net present value of the firm's current and future profits), which in turn increases dividends and promotes growth in share value. Yet organizational goals may not be intended to increase the utility of resource owners as corporate decisions are taken by professional managers whose payoffs will essentially but not exclusively be dependent upon profit flows. Additional management payoff may result from objectives other than maximizing shareholder profit: adapting firm goals to the pursuit of growth, increases in power and prestige and other perquisites.

Shleifer and Vasiliev (1996) remind us that the benefits of control may be distinguished. The cost of consuming perquisites is not all that great when compared to the costs associated with the pursuit of corporate projects or strategies, which may shape the company according to managerial preferences. Shareholder wealth is impacted significantly where projects include excessive growth, diversification or expansion of the line of business when managers have a personal interest or stake. Staying in control when the manager is no longer the person to run the firm is also a benefit of control.

The pursuit of managerial self-interest as such is possible because of information asymmetries and incomplete contracting between management and shareholders. Generally speaking, shareholders lack the information to know whether profits are being maximized, and contracts, which heavily constrain managerial discretion, would restrict the ability of management to react to unforeseeable contingencies on behalf of shareholders.

Agency problems exist for most forms of ownership, both public and private. Yet, ownership transfer through a competitive capital market in the private sector is thought to alleviate agency problems. A substantial literature presents several interrelated discipline mechanisms⁷; ownership structure and the market for shares provide a conceptual focus from which to explore these.

The Market for Shares

This discussion considers the performance effects of increasing ownership concentration, in particular the effects of proceeding along the ownership continuum of going public to going private.

In many ways share issue privatization resembles the initial step of an entrepreneurial private sector firm issuing its first shares in the process of "going public". Yet Jones, Megginson, Nash and Netter (forthcoming) describe some important differences between share issue privatization or SIP and the private sector counterpart, the IPO. Most notably, the first tranche in share issue privatization does not represent a smaller entrepreneurial firm going public to raise external capital. Rather a SIP often represents the sale of existing shares (held by the state) of a larger enterprise where the proceeds go to the government rather than the firm. Yet this is not always the case.⁸ To be sure, share issue privatization often presents a joint process of ownership transfer and corporate and government financing.

Notwithstanding the differences between SIPs and IPOs, certain parallels may be drawn. Mello and Parsons (1998) explain the process of going public as a complex and often extended process incorporating many transactions over time. Most importantly, this process presents ownership as a choice, with share issuance to be managed with an ultimate ownership structure in mind. Investor heterogeneity permits at least two distinct segments in the market for shares: dispersed shares held by small, passive investors and controlling blocks (or pools of small investors or 'funds') held by active shareholders prepared to shape firm management either as monitors of current management or as proponents of an alternative strategy or management team. Simply put, financing through public offerings is designed for a widely-held structure and not suitable for selling control.

The importance of blockholders for corporate governance is recognized (see, for instance Shleifer and Vishny, 1986; Zajac and Westphal, 1994; and Boycko, Shleifer and Vishny, 1996). Indeed, the basic premise of Berle and Means is that some degree of shareholder concentration would seem necessary, if not a sufficient condition for substantial influence over management. Institutional investors (as a specialized class of owners) may be particularly influential in this regard, strengthening corporate governance in view of expertise (i.e. building up information on industries and key firms), visibility, and significant ownership positions in many firms (McConnell and Servaes, 1995). Nevertheless, the evidence remains mixed as to whether institutional investors can influence the behaviour of management. To the extent that institutional holdings preclude "exit" (through the market), long-standing relationships developed with firm management may transform "voice" into advocacy (co-optation). Likewise, the presence of institutional shareholdings is not associated with 'radical' organizational restructuring (i.e. layoffs, plant closures), management turnover, or preventing growth (though it is associated with more appropriate diversification) (Allen and Cebenoyan, 1991). Large (external) shareholdings appear necessary in these cases.

Despite the advantages of large blockholdings ownership is not without drawbacks: too much can result in owner 'domination'. At the extreme, ownership concentration may become complete and result in a publicly-held corporation "going private" (de-listing from the stock exchange is often the result). Closely-held or family dominated ownership structures are found here and may be characterized by wealth protection rather than shareholder wealth maximization (Gedajlovic, 1993). Though ownership by insiders (i.e. managers) in general may act as a substitute for other types of monitoring (such as board monitoring, and render incentive compensation less necessary), significant insider ownership may promote management entrenchment and insulate incumbents from external control and scrutiny of the financial or operational situation of the firm (Shleifer and Vishny, 1989). The owner-managed structure presents a limited internal labour pool from which to groom future owner-managers; the general succession problem hinders the growth of a professional management core and places a limit on developing (upgrading) managerial capabilities.

The Market for Partners and Firms

Berle and Means presented early evidence of the impact of ownership and control on the economic performance and strategic behaviour of organizations. Implied here is that ownership in itself is a strategic variable. Indeed, the basic premise of Williamson's (1975, 1985) transaction-cost paradigm is that the choice of ownership is the most important strategic consideration for business enterprise, both national and multinational. Firms are to adopt a governance structure that best suits a particular exchange relationship; the options included were to integrate vertically or to rely on market exchanges (the market versus hierarchy decision, to buy or to 'own'). Studies indicate the advantages of vertical integration or ownership to include: superior cost control and efficient use of inputs; protection of proprietary technology; and the creation of barriers to entry that limit competition, to name just a few. Recent theory development from this perspective underscores the value of hybrid or intermediate structures such as joint-equity partnerships (joint ventures), alliances, and other collaborative forms that exist somewhere in between the market and wholly-owned extremes. Strategic partnering seeks to gain the benefits of expanding business operations (growth) while minimizing some of the drawback of buying or internally developing the means to expand.

Recognizing the value in intermediate forms and collaboration, the importance of both corporate 'control' (through ownership) and 'learning' is now generally understood. The field of strategy is particularly well positioned to appreciate this dual imperative.⁹ An understanding of the advantage of ownership from this perspective is captured nicely by Kogut (1996), who underscores the conceptual distinction of more 'pointed'

ownership in general. The author states the implication in the context of foreign direct investment, yet the inference may be extended to include controlling blocks in general: "the distinguishing feature of direct, as opposed to portfolio, investment is control over economic assets across borders..." (p.298). Specifically, equity-based control across borders influences the evolution of both organizational capabilities and corporate governance in the following way:

1. Organizational capabilities: The investing firm has superior methods in the form of knowledge of operations and in their control through supervision, authority, and incentives.
2. Organizational form and institutional governance: The foreign firm implements a superior method of organizing and external control, wither indirectly through the form of financing (e.g. debt and equity structure) or directly through the re-creation of oversight institutions.
3. Competitive externalities: By in creasing competition in the host country, the foreign firm generates information on the x-inefficiency of competitors in the local country and generates incentives for imitation (p.313).

The author maintains that technology transfer (or technological innovation) accompanies this infusion of organizational, managerial, and financial know-how. Direct investment is preferred as the firm specializes in the creation and transfer of particular kinds of knowledge that are better replicated inside the firm than through market mediated exchange.

The conceptual distinction between portfolio and more 'pointed' investment may be drawn further. Direct investment offers the advantages of both control and learning in the case of firm to firm investment. The 'overlap' of two firms in this way holds the promise of synergy or combination benefits; when these enterprise operate in similar industry domains recombination is felt along the primary business activity chain. In this way sales to strategic investors that involves industry partnering is likely to offer organizational innovations and physical restructuring outcomes; this brings to mind the literature on corporate growth strategies, as well as takeover and merger and acquisition activity in general¹⁰. In contrast, investment companies or institutional investor capabilities are not built on real (productive) sector capabilities, but derive from financial sector innovations and (financial) restructuring. Knowledge transfer is probable along these lines.

Clearly when considering divestiture through trade sales to strategic investors the issue of 'synergy' and combination between firms is key. More to the point, ownership re-combination between firms in the context of privatization may be assessed in terms of net contribution to organizational capabilities and corporate

governance.

The following table encapsulates the discussion above, distinguishing amongst the transaction types and expected value-creation.

*****place table 3 transaction types & expected value-creation here*****

5. Research Propositions and Model

From the discussion above some conclusions may be drawn. Simply put, the relationship between ownership concentration and performance (be it capabilities or corporate governance induced) is not a linear one, but follows an (inverted) U-shape: better performance is expected when concentration is neither too little nor too great (maximization of shareholder wealth is found here). For privatization the implications are presented with the following research question and propositions.

Research Propositions

The general research question is whether privatization transactions provide for an efficient ownership structure, one that fosters corporate governance and the development of organizational capabilities? The query falls within a broader research programme which asks whether firms have substantial owners.

Proposition 1. The sale of SOEs for cash via share issue privatization only presents an opportunity for improved (financial and operational) monitoring (where institutional investors or funds are present). Share issue privatization only is characterized by financial innovation, and termed a financial transaction.

Corollary 1a. The sale of SOEs via share issue privatization that creates a class of equity which separates residual cash flow rights from control rights in the form of non-voting shares models a financial transaction.

Corollary 1b. The sale of SOEs involving share issue privatization is conditioned upon capital market development. Capital market development provides (internal) financing for a country; underdevelopment suggests that foreign capital market participation will be required to implement national privatization. The character of foreign demand will condition the speed and timing of privatization implementation.

Proposition 2. The sale of SOEs via mixed sales to 'strategic investors' and follow on share issues present an opportunity for improved monitoring, organizational restructuring and the development of managerial and technological capabilities. Significant strategic investor participation is termed a control transaction and is characteristic of strategic privatization.

Proposition 3. The sale of SOEs via direct sales only present an opportunity for organizational restructuring and the development of managerial and technological capabilities, as well as improved managerial incentives,

but little outside scrutiny (of financial or operational position) and possible management entrenchment (a limit on upgrading management know-how). Trade sales only are characterized by 'privacy' (and financial innovation in the case of leveraged management or employee buyouts), and termed private transactions.

Other corollaries may be given regarding equity classifications and indigenous entrepreneurship.¹¹

The Models

The discussion above is captured in the framework below; included is a two-dimensional landscape upon which privatization transactions are mapped. The x-axis presents private ownership as a continuum of stock concentration, extending the range going public to private. It is difficult to identify specific threshold levels of stock concentration yet the literature offers certain delineation points¹² (see table below). Share concentration is measured by the percentage of common stock ownership held by the largest stockholder. A more complex model might theorize interactions between shareholders of various concentrations; no attempt is made here to do so.

*****place table 4 ownership continuum here*****

Going strategic occupies the intermediate range and is indicated by the presence of effective control and the absence of owner domination; this includes controlling shareholders, strategic and high strategic owners. This area accounts for ownership structures ill-fitted to a dichotomized variable of manager/owner-controlled. The y-axis presents state ownership (residual) holdings as a dichotomized measure; included is a minority and majority range. The locations of financial, control, and private transactions are mapped as well. When private and state ownership dimensions are considered jointly *strategic privatization* presents where effective control short of domination combines with minority state holdings: in other words, strategic privatization is marked by private control *and* ownership.

*****Place diagram 1 types of privatization transactions here*****

This model seeks to refine the government-private ownership continuum in separating out private ownership concentration (share concentration) in the context government ownership change; yet some caveats are in order. First, no attempt is made to distinguish further ownership effects. For instance, the model does not partition 'foreign' (MNC) ownership effects from simply 'private' share concentration effects. Second, this approach seeks only to examine first level ownership and does not look for the ultimate owners of capital in these firms. Thus where another enterprise, and another own shares in a privatized firm, the ultimate owner within such a pyramid form is left unexplored.

6. Ownership Management during Privatization

Recall that our primary aim is a further refinement of the privatization construct. In doing so we model privatization as an independent variable and develop a framework that may be used to distinguish in a meaningful way amongst a variety of transaction types. We then apply this scale to assess expected outcomes of six recent and/or ongoing telecom privatization transactions. In effect we examine the structure of privatization transactions for strategic qualities according to the framework described. We narrow our focus to transactions which involve trading ownership claims for cash payment or equal consideration (thus, restitution, 'spontaneous' privatization, voucher schemes or mass privatization, and other free transfers are not considered). In other words, we limit our examination to privatization programmes distinguished by case-by-case initiatives (Welch and Frémont, 1998).

Sample and Data

Our transaction sample is drawn from lower and middle income developing countries primarily in the transition economies of Central and Eastern Europe, as well from emerging markets regions of Central Asia and Latin America; the countries include Brazil, Hungary, Lithuania, Pakistan, Poland, and Romania. Transactions are restricted to the telecommunications sector (a utility industry) in order to gain some understanding of transaction patterns across divergent national programmes. In particular, we look at the ongoing privatization of six firms: Telekomunikacja Polska; Romtelecom; Matav; Lietuvos Telekom; Pakistan Telecommunication Corporation; and Companhia Riograndense de Telecomunicacoes.

Secondary data on the transaction 'terms of sale' is culled from investor and industry publications, notably *Euromoney*, *Euroweek*, *Global Finance*, and *Privatization International*. Selected figures on telecom infrastructure capacity and stock market development for various countries were obtained from the World Bank's 1998 World Development Indicators on power and communications and stock markets.

Telecom sector development indicators provide a rough assessment of the provision of infrastructure services in the country; 1996 figures include: the number of households (in thousands) on waiting lists for basic service and waiting time (in years); the number of telephone mainlines per employee in the sector, the revenue per line, and the price for a local call (in US\$). Underdevelopment is inferred by higher values for waiting lists and time and a lower ratio of mainlines per employee. Revenue per line and price per local call are understood as proportionate yet not directly so as the demand curve would suggest (Lower prices lead to lower revenues overall yet stimulate higher demand and perhaps higher revenues as a result; infrastructure supply caps

demand, of course). A stakeholder analysis of the tradeoff between consumer prices and enterprise revenues falls outside the scope of this paper. Suffice to say, paired values outside the general trend line suggest either great demand for current services (i.e. relatively high revenue given price) or high receivables (i.e. relatively low revenue given price); both infer sub-optimum performance.

Capital market development indicators provide a rough assessment of internal financing capability of a country and will condition the privatization implementation. Share issue privatization that is characterized by domestic listings will require local capital market development, while foreign SIP will not. Figures for 1990 and 1996 (or 1997) include: market capitalization (as a % of GDP) or the size of the stock market relative to the economy; the turnover ratio (the value of shares traded as a % of capitalization) or turnover relative to market size; and the number of listed companies on the domestic exchange. Lower market capitalization, turnover ratio, and domestic listings infer underdevelopment.

Background information on privatization policy was compiled from exploratory (and unstructured) interviews¹³ conducted at The World Bank in November 1998: primary sources include private and financial sector development specialists, both consultants and staff.

The primary aim is to examine recent and ongoing transactions for expected outcomes with the prospect of drawing implications for privatization in-the-making. This focus provides currency in particular for practitioners, both policy makers and international managers who may at present be actively involved with the phenomenon of privatization. Though not generalizable, theory-building through (mini) case analysis offers certain academic value. Specifically, such methodology is appropriate when directed at 'unfolding' phenomena, as is the case here. Still, implications may not extend beyond telecom privatization.

The Telecom Sector

Nowhere perhaps is change more evident than in the telecom sector, an industry regarded at the forefront of the new economy, the transformation toward a post-industrial stage. Rapid change includes advances to information communications technology effecting data, voice and video transfer; the growth of Internet and business data networks, e-commerce, and wireless communication in general. Indeed, both technology and deregulation have spurred an intensely competitive market, in the areas of international and mobile telephony. Yet in areas once considered natural monopolies such as fixed line services, competition is emerging as well. Technology is driving down the advantage of scale economies and large potential competitors such as cable TV operators are positioning as viable voice, data and video transfer alternatives. Likewise regulatory concerns

have shifted. Price-related issues now appear as secondary matters for most sectors of the industry while questions of interconnection, standardization and third party access are placed foremost in the minds of regulators.

A trend in corporate transformations is identified also. Generally speaking, former telco monopolies are breaking free of regional alliances and national markets and joining global telecom consortiums to enter international markets. As well, these firms are going beyond traditional voice communication capabilities to build data-networking expertise for a growing customer segment, other large enterprise with multinational needs for the transfer of data to far flung places. Many players are transforming into super-carriers to serve the needs of these large customers. Telecoms are developing full service provision offering customers access to advanced end-to-end national networks for any-distance and any-bandwidth, and to a global network and services.

Large enterprises in general, telecom or otherwise, are directly involved in performing value-added activity that is both capital- and knowledge-intensive. Indirectly, this activity produces “externalities” within the country of operations that helps develop and maintain indigenous resources and capabilities. These two advantages prompt a virtuous circle: the wealth-creating assets of these firms help develop local systems of innovation which in turn increases the locational attractiveness to investors to conduct high-value-adding activity. This process is critical for private sector development and economic growth. Yet, in the case of telecommunications this process speaks to the development of basic endowments necessary for the information age, a post-industrial stage of economic development. The telecom sector will help to build this infrastructure yet so to will other large enterprise that will use these information endowments to establish a competitive advantage. In this way, an underdeveloped telecom sector may present a significant bottleneck for sustainable growth in developing countries.

Most governments agree on the need to intervene to improve and sustain created assets yet there exists a variety of methods to do so as well as considerable variety among countries who pursue some degree of intervention. Privatization (and nationalization before that) represents a public choice in this regard.

The implications for many developing countries are several. Most are burdened with severely underdeveloped telecommunications infrastructure. There is large unmet demand for basic service (i.e. hundreds of thousands of households remain on waiting lists and will remain there for years) and voice and data business networks are

near absent; in many countries regulatory reform has just begun. Telecom sectors require huge financial investment for upgrading or replacing whole networks; billions of U.S. dollars in financing is required.

Broadly, privatization and access to international capital markets has set in motion increased industry restructuring, creating several global, competitive firms out of formerly inefficient state monopolies. What's more, privatization itself serves to increase the momentum for globalization in the industry, putting further pressure on state-owned enterprise and governments to privatize and allow for competition. Still, how certain developing countries are facing these industry and competitive challenges is still to be determined. Yet, the structure of the following transactions may give some indication.

Telecom Transactions

The diagram below maps the six telecom privatizations examined here; for discussion purposes four developed country transactions are mapped as well, they include British Telecom, France Telecom, Deutsche Telekom, and Sonera, formerly Finland Telecom.¹⁴

*****Place diagram 2 ownership Management during telecom privatization here*****

Telekomunikacja Polska (TPSA)

Telekomunikacja Polska is the dominant state telecom operator in Poland yet maintains an antiquated national telephone system when compared with other CEE countries; only Romania's sector figures indicate a worse state of affairs. For instance, in 1996 approximately 2.3 million households were waiting for basic services (the longest list, of the countries considered); the average delay was over 3 years, despite reasonably high levels of staffing per line (for instance, Canada maintains 2.75 more mainline infrastructure per worker) (see table*). Clearly, the national system shows certain inadequacies.

*****Place table 5 telephone mainlines here*****

Early in 1998, the Polish Government announced its intent to raise US\$2 billion from a 25% divestment of TPSA to international and domestic retail investors. There is some indication that workers will be allotted 15% as well, as well as reference to a strategic investor being sought in the future. Yet, in all, the government's intent is to retain 50% ownership, leaving little stake for any strategic buyer. This TPSA structure suggests a financial transaction combined with continued majority state holdings thus does not conform to strategic privatization.

Much is riding on the stock exchange as a market for privatization where sales depend importantly on SIP and difficulties are immediate. Notably, the Asian financial crisis (in banking, currency and the stock markets) has been felt throughout emerging markets, including those in the CEE and Latin America. As U.K. and U.S.

institutional investors retreat to safer shores, ongoing volatility weakens conditions for privatization in Poland. Capital markets have been so unfavorable that the Polish Treasury has slashed the asking price for TPSA by 25%.

Despite the drop in share price foreign portfolio investors may be scarce. Specifically, the TPSA SIP risked being crowded out as a host of telecom share issues went to market in late 1998 and 1999, including Telecom India, Greece OTE, Belgium Mobistar, Swisscom, and Japan's mobile telecom operator, DoCoMo. Portfolio demand may become satiated with a supply of world-class share issues before the Polish government has the opportunity to implement the TPSA privatization. Thus, market timing is crucial when governments rely on SIP only.

Share issue privatization must consider capital market development as well. Though Poland sought to establish nascent capital market institutions, such as the Warsaw Stock Exchange (WSE), and then proceed with privatization (while the Czech Republic initiated mass (voucher) privatization and expected institutional development to follow, for instance), equity markets remains relatively underdeveloped. Poland ranks near the bottom middle of the cases examined here. Without significant foreign participation a telecom issue of this size will be difficult to place domestically given the relatively small size of the WSE in terms of market capitalization. Absorption capacity is good however when market turnover is considered (actual shares traded, or liquidity).

*****Place table 6 developing country stock markets here*****

As a financial transaction, the failure to adequately place the SIP may leave TPSA without the capital to launch technological upgrading and restructuring needed to satisfy pent-up demand for basic services (certainly, debt may be issued as an alternative). As a result, the telecom operator may find it difficult to position the firm for increased competition as industry deregulation proceeds and new markets open up within the European Union. Matav of Hungary (as well as Ceska Radiokomunikace in the Czech Republic), which has undergone extensive restructuring since 1993, may be much better placed regionally in terms of technological and managerial skills than TPSA.

Moreover, in the context of chronic underinvestment and underperforming assets, a stalled privatization process may translate into an enduring infrastructure deficit, which may present a significant bottleneck for sustainable growth in Poland.

In relying on SIPs first and foremost, TPSA might forego indefinitely the capital, equipment, and management skills that a strategic investor might bring, and Poland's telecom and entrepreneurial sectors may suffer the

basic endowments necessary for the information age. Certainly the data-networking expertise demanded by multinational enterprise is lacking. Developed country infrastructure is not faced with these deficiencies. Thus SIPs as financial transactions pose less of a risk in the case of British Telecom, France Telecom, and Deutsche Telekom.

Romtelecom (RT)

Similar to Poland, Romania's national telecom system requires significant overhaul. In 1996 approximately 1.3 million households were waiting for basic services, about 60% the number on Poland's roster; yet the average delay was 7 years, twice that of its northern neighbor and staffing (per line) higher as well.

Yet, in contrast to the case above, Romanian officials are seeking a strategic buyer first and foremost for the privatization of Romtelecom, the nation's public telecom operator. In June 1998, the government announced the aim to divest a 35% stake to a consortium of buyers; initial reports present Telecom Italia/Dutch KPN, OTE of Greece/Southwestern Bell, and a Canadian firm as three possible bidders. (Interestingly, of those bidding groups identified, each contains partially privatized entities themselves.) Selling effective control to a telecom consortium of global operators would likely improve Romtel's system and help build Romania's telecom sector. Unlike a purely financial transaction, a control transaction of this nature presents a capabilities-building opportunity.

Other shareholders are to include Romtel workers, who will receive 5% equity, and the European Bank for Reconstruction and Development (EBRD), an international financial institution along the lines of The World Bank yet with an CEE regional focus. The EBRD will invest US\$100 million. These investors present official backing which may facilitate this privatization deal. The EBRD stake may encourage strategic investors to come on board despite Romtel's unknown quality and Romania's country risk. Indeed, an important aim of this international financial institution is to direct investment capital to transition economies, which suffer seriously underdeveloped capital markets, as is the case here. Romanian equity markets are effectively nonexistent when market capitalization, turnover and number of listed companies are used as indicators. The government hopes to launch a public issue at some later date yet a severely underdeveloped local capital market sector will make this difficult; international portfolio investors would likely dominate any SIP in the near future. Indeed, in 1997 not one Romanian SOE was privatized despite a substantial target list.

In sum, the Romanian government will divest a controlling stake to strategic investors yet a majority residual is likely to remain with the state. At present, then, the Romtelecom structure suggests a control transaction

combined with continued majority state holdings thus does not yet conform to the notion of strategic privatization as presented here.

Matav (M)

Matav, the Hungarian telecom monopoly (whose monopoly status ends in 2002) boasts a relatively modern telephone network, and demonstrates continued improved firm performance since initiating privatization six years ago; in 1998, market capitalization stood at over US\$6 billion. Not surprisingly, Hungary's telephone infrastructure does not present the severe inadequacies of other CEE telecom sectors. Though households waiting for basic service numbered 250,000 in 1996, the delay for hookup is just over seven months, yet the price of a local call is relatively high; overstaffing (per line) is amongst the lowest of the countries examined.

The satisfactory infrastructure capabilities are not unassociated with privatization. In 1993, close to 30% of the state's holding in Matav was divested to MagyarCom, a joint venture established by Ameritech, a U.S. multi-service telecom provider and Deutsche Telekom, the German state operator; in 1995, the joint venture partners increased their stake to 37%; together these sales raised over US\$1.7 billion in revenue. Another initial shareholder was the EBRD, with a \$US 57million contribution to equity. At the time, a majority stake remained in the state holding company.

What MagyarCom brought to the Matav deal is this: American marketing and financial capabilities and German technology; though a German-Hungarian partnership does point to an earlier historical relationship as well (Austro-Hungarian Empire). Together these strategic partners updated Matav's technical equipment in a cost effective manner (the entire system was not refurbished as was the case for Eastern Germany under Deutsche Telekom's leadership), and improved organizational efficiencies through the development of financial reporting skills.

Yet, Matav was able to source local marketing and sales skills as well. Hungarian staff was hired from multinationals such as Unilever, Philips, and CocaCola, who have operations in Hungary. Thus, these global consumer products firms provide a skilled marketing force from which Matav can draw and use to grow. Yet these same MNC also have sophisticated telecommunications needs, and their continued expansion or new entry into Hungary serves to increase demand for various infrastructure services in the country. This modest example offers an indication of the many ways in which the relationship between private sector development and infrastructure growth can be viewed to co-evolve over time.

Matav's successful restructuring and improved performance made it a prime candidate for a public offering. In late 1997, the state divested a further 30% through a SIP. The government sought a foreign listing as the local equity market lacked the absorption capacity to support the US\$1.2 billion float. In November, Matav was listed on both the Budapest Stock Exchange (BSE) and New York Stock Exchange (NYSE). As a result of SIP and further ownership restructuring, Matav's equity holders now comprised of the following: just under 60% is held by the MagyarCom consortium; 30% equity is dispersed over 156,000 other shareholders; and small blocks are retained by the state holding company and the international financial institutions. This structure shows an initial control transaction and follow-on share issue which in the end results in high strategic ownership and a (small) minority state holding. Overall, then, the Matav transaction represents a mixed sale and a form of strategic privatization.

*****Place table 7 Matav ownership structure here*****

Matav was the first company from the CEE to be listed on the NYSE, and the largest ever equity issue from that region. The significance of the float has been felt on the BSE and capital markets have grown substantially in Hungary in the last decade. Yet, equity markets remain only moderately developed and dominated by a few dozen large enterprise. In fact, in 1998 Matav stock represented 20% of the entire stock capitalization of the Budapest exchange.

The impact of telecom SIPs is not limited to Hungary, however. The public offering of Nippon Telegraph and Telephone (NTT), the Japanese state telecom operator, is the largest equity issue to date (1998 market capitalization of the firm is valued at over \$US 122 billion), and the massive size of the Deutsche Telecom SIP changed the composition of the German index, DAX (market cap for DT in 1998 was over \$US 75 billion). Often the size of these offerings constitute a large portion of the indices and investors seeking to maintain their former market weighing must increase their positions on these privatization stocks.

Still, the high-profile nature of telecom issues does not shield emerging market share value when trading becomes volatile. In the case of Matav on the day of the November 1997 issue the Budapest exchange tumbled. In a similar fashion the value of Telebras, the Brazilian national telecom, plunged following divestiture, though the shares remain one of the few liquid stocks in the Latin American region. In general, telecom SIPs have fared better than most as emerging market investors seek out bellwether shares as a hedge against region or country risk as a whole. In which case telecom liquidity may indicate proxy interest rather than true investment in the firm.

To the extent that investor fear of secondary market adjustments tempers demand for subsequent SIPs, the question for developing governments becomes how low will prices fall before suspension of future sales. Once privatization is stalled, it may be tough for some of these governments to come back and access the market anytime soon. Brazil has a list of more than a half dozen SOEs waiting to be privatized that will be delayed as the markets attempt to regain a certain level of stability.

Persistently weak market conditions may prompt developing countries to shift away from an over reliance on public issues and toward more significant strategic sales component, particularly for non-telecom divestiture.

Bad timing due to ongoing price volatility has effectively stalled privatization initiatives in developed countries as well. For instance, shares issues for both France Telecom (FT) and Korean Telecom have been postponed. Yet, as some initiatives stall, opportunities open up for others. Specifically, the FT delay has freed up market demand for a 22% stake in Sonera (So), the Finnish national telecom; the structure of the deal is expected to include a significant portfolio investor component and raise US\$600 million. Formerly Finland Telecom, Sonera operates state-of-the-art data and voice technology, offering both telephone and Internet service. Like many utility privatizations, the partially divested Sonera is itself participating in the divestiture of other SOEs.

Lietuvos Telekom (LT)

The national telephone system in Lithuania is need of capital investment. Yet, compared with the Romanian telecom sector fewer households in Lithuania are waiting for basic service; but for those that do, these potential customers face a comparable delay in service hookup. Overstaffing (per line) is slightly lower here than in Poland.

Conditions in the Lithuanian sector will likely improve however. In 1998, the Scandinavian consortium of Sonera of Finland and Telia of Sweden bought a 60% stake in Lietuvos Telekom, the national telephone operator. The joint venture partners paid \$US 731 million (\$US 510m in cash and committed to \$US 221million in capital investment over the next 2 years. Furthermore, as a result of this privatization transaction Telia and Sonera are now positioned in all three Baltic states (Estonia, Latvia, Lithuania); these telecom firms also have strategic stakes in Russia and Poland (investment in a cellular network in St. Petersburg and 25% ownership in Netia, the Polish operator).

Indeed, with world-class Swedish and Finnish telecommunications equipment suppliers such as Ericsson and Nokia in addition to advanced infrastructure, Scandinavia may be positioned as a critical region for the development of post-industrial economies. Historically speaking, the joining of Sweden's, Finland's, and

Lithuania's telecom sectors may offer more than technological or capabilities transfer. Linkages of this sort may help to reestablish an earlier, perhaps deeper socio-economic relationship between these regions, severed during Soviet rule. Notwithstanding socio-economic transformation, aspiring global competitors, which have evolved in a Northern Europe context, are the likely (cultural) allies for enterprise sector development in certain post-socialist economies.

In the next few years the government intends to divest a further 35% through a SIP. Like the Matav transaction structure, the LT sale is to proceed in a two-step fashion. First, sell a controlling stake to a strategic investor, who will bring cash, equipment and management skills; allow the company to become fully commercialized. Second, launch a public share issue with the increased value reflected in the share price. Workers are to receive a 5% holding; there will be no state residual.

Like the Matav share issue, the Lietuvos SIP may require foreign listing as equity market capitalization for the two countries is effectively the same. Indeed, foreign equity participation may be necessary for secondary trading to continue in any way post-sale. Despite hundreds of firms being listed domestically, turnover in Lithuania is almost nonexistent.

This structure shows a control transaction and a planned share issue (and allocation of equity to workers) that would result in a full transfer of state holdings. Provided the ongoing transaction is implemented as planned the Lietuvos Telekomas sale would represent a form of strategic privatization.

Pakistan Telecommunication Corporation (PTCL)

Generally speaking, Pakistan's telecom sector is on par with Lithuania's and Hungary's yet shows more overstaffing, not surprising given overall population levels in Pakistan. Certainly some restructuring and capital investment will be required.

The government has made some progress on the privatization of Pakistan Telecommunication Corporation. To date, approximately 12% of PTCL equity has been divested to domestic and international investors; notably the second tranche involved a global depository receipt (GDR). Depository receipts are certificates denote portfolio equity or foreign investment in domestic stocks listed abroad, on major international exchanges. For instance, GDRs are often issued in the United Kingdom on the London Stock Exchange, while American depository receipts are listed in the United States on the New York Stock Exchange.

These receipts are considered a recent financial innovation which allows large companies to issue equity in better-capitalized foreign markets. Yet, depository receipts can stifle local capital market development if capital

raising activities remain offshore. Important in addition, unlike foreign direct investment where investors are likely to insist on control rights, depository receipts allow managers to attract foreign capital without relinquishing control. These certificates rarely carry voting rights. Still, international listing requirements do demand more stringent financial reporting from management than might be expected by local market participation, which does result in improved monitoring.

The government has announced it will seek a third share issue once a strategic buyer is found: a 26% stake has been allotted for the direct sale and 11% of equity is to be transferred via public offering. The remaining 51% will remain in state hands.

*****Place table 8 Pakistan Telecommunication Corporation ownership structure here*****

This structure offers majority state holdings along with a mixed sale, yet with less than effective control to any prospective strategic buyer. Thus, the PTCL transaction, if implemented as planned, represents importantly a financial transaction, and does not conform to strategic privatization.

Despite these intentions Pakistan's privatization programme remains at a standstill. In the case of PTCL the sale to a strategic buyer has been pending since 1996. The government might go ahead with further SIPs without a strategic buyer, taking advantage of the Karachi Stock Exchange's relatively good performance. For instance, Pakistan's capital markets were the best performing in Asia in 1997; figures suggest overall equity market development throughout the 1990s. In addition, ongoing privatization of PTCL will likely have a significant effect on the stock exchange, where it already accounts for half the turnover and close to one-third of total market capitalization.

Yet continued financial transactions by themselves are unlikely to bring both the equipment and management skills that might add value to the Pakistani telecom: the government has succeeded only in throwing a lot of paper at the capital markets, rather than bringing in much-needed know-how. In contrast to the Matav and Lietuvos Telekomas transactions, the PTCL privatization structure is designed to bring in strategic know-how quite late in the sales process, once half the public share offerings have been made. Only a third tranche holds any promise of reflecting improved technical or managerial capabilities as a result of strategic investor behaviour; the initial tranches, though offering a widened capital base for the telecom firm, forfeit strategic value-added.

Telecom restructuring does not appear imminent however. Pakistan's privatization programme has been at a standstill in view of ongoing political indecision linked to recent coalition governments. Besides, given the

significant percentage of productive assets that remain in state hands and the acute need for industrial restructuring, the government's case-by-case approach to privatization will prove to be a lengthy process anyway. Unfortunately, the resultant opportunity cost for the telecom industry and enterprise sectors dependent on basic infrastructure will serve only to hinder sustainable growth in the country.

Companhia Riograndense de Telecomunicacoes (CRT)

Though figures are lacking, the indicators do suggest Brazil's telecom sector to be one of the better underdeveloped cases. For instance, similar to Hungary and Lithuania, lines per worker imply much less overstaffing in Brazil than in Poland, Romania, or Pakistan. Yet, insufficient telecom capacity is hinted at as well. Notably, Brazil shows the highest revenue (per line) relative to local call prices, which may warn of current network capacity straining under demand. Fortunately, business and retail customers in the state of Rio Grande do Sul may look forward to increased sector development. In December 1996, the Brazilian government initiated privatization in the telecom sector with the partial divestiture of Companhia Riograndense de Telecomunicacoes. This firm currently operates a monopoly, providing local telephone, cellular, data transmission and other services in the Brazilian state.

A consortium led by Telefonica of Spain, and industry partners CTC of Chile and Telefonica affiliate Telefonica de Argentina submitted the winning bid of US\$654.8 million for a 35% stake in CRT; the buyer group also comprised banking partners, RBS and Citicorp. Eighteen months later, in June 1998, the government sold an additional 50.1% voting stake for US\$1.02 billion. The buyer in this second direct sale was the Telefonica do Brazil holding consortium, led by Telefonica of Spain and Rede Brazil Sur of Brazil. The consortium now holds 85.1% of CRT voting stock. Soon after, another industry player, Portugal Telecom, and an additional financial institution, Banco Bilboa Vizcaya, joined the consortium.

This structure shows two control transactions: the first transferring voting rights to a controlling shareholder consortium, the second consolidating ownership further, in that most voting stock is now privately held. This current ownership suggests a sale characterized by a private transaction thus does not conform to the notion of strategic privatization.

From a corporate governance perspective this private transaction suggest the CRT privatization may result a general restriction on outside scrutiny. However, the presence of financial institutions as consortium partners may suggest some scope for "bank-led" monitoring.

Most notable is the capability-building opportunity shaped by the privatization transaction. In fact, the results of

the 1998 auction are considered recognition of Telefonica management value enhancement of CRT since gaining control in 1996.

The transaction denotes value-added from a positioning point of view as well. In particular, Telefonica of Spain expects to make Latin America a key element in its strategy to become one of the most important global players in the industry. For instance, winning the CRT bid has allowed the Telefonica consortium to leap past rival bidders led by Stet, the Italian telecom holding company, itself seeking a an improved position in the region (Stet has strategic stakes in Cuba, Argentina, Bolivia); emerging markets in Latin American may present a particular opportunity for both these telecom operators. Telefonica and Stet are likely to have firm-specific cultural assets other European and North American telecoms lack. Knowledge of Latinate norms and values may provide insight into associated consumption patterns and work practices, where they exist.

Yet, enterprise opportunities exist for the economic region in general. Increased economic growth is a prevailing feature as regional common markets such as Mercosur/Mercosul (grouping Brazil, Argentina, Uruguay and Paraguay) become more established. The prospects for private sector development in Brazil stand out in particular with multinational activity a salient feature. For instance, in 1996, 115 multinationals announced new investment in the Sao Paulo state alone, firms such as Colgate Palmolive, Compaq, Ford, General Motors, GoldStar Electronics, Honda, and Philips, to name just a few. These large enterprises are expected to invest billions of dollars in capital and equipment; expanded manufacturing facilities in turn will increase the demand for various types of infrastructure services.

Of particular interest to telecom firms will be the increased demand for telecommunications services as private sector development and regional business transactions grow. Furthermore, given the significant presence of multinationals the demand is likely to be quite sophisticated, involving business networks transferring voice and data. The Telefonica consortium's strategic intent may be to position their operations for this imminent growth in private sector demand. In particular, the telecom alliance might use CRT as a platform for managing regional investment in Latin America in an effort to provide end-to-end voice and data links for the entire Mercosur/Mercosul regional market. This region may evolve into Latin America's business-telecommunications corridor.

Discussion

The salient features of the transactions discussed above are presented in the summary table below.

*****Place table 9 case summary of ownership management during privatization here*****

Of the six sales examined only Matav and Lietuvos Telekomas demonstrate strategic privatization wherein a control transaction combines with minority state holdings. Strategic privatization is also characterized by the mixed sale.

Here telecoms were offered new investors whose high strategic ownership suggests an infusion of capabilities and governance. In transition economies in particular there may be a premium on corporate governance arrangements that can remove unsuitable management and attract active investor who contributes to the firm's financial and accounting experience, provides direction where it is lacking, as well modern technology and equipment. Moreover, outsiders in the form of new foreign controlling ownership are likely necessary to enact painful restructuring (asset sales, layoffs).

Access to new markets and business partners figure prominently in these large global multi-market privatization transactions. Strategic consortia were comprised of both industry and banking participants that may seek to mitigate business and technological risk as well as financial risk when competing in the in an increasingly globalized telecom industry. This risk management showed a cultural component too. The Matav, LT, and of Companhia Riograndense de Telecomunicacoes transactions show cultural and industry positioning as strategic investors pursue avenues for new growth through older socio-economic ties.

The sheer size of these sales entails significant financial risk. With enterprise sales in the billions of dollars -- not uncommon in the telecom (and utilities) sector, the formation of a buyer consortium of multinational or international firms may be necessary. Certainly, the financial strength of large industry players combined with banking partners would present a buyer advantage. As well, significant new capital is needed to bring the sector up to date, to expand to meet the needs of a growing economy. The magnitude of this risk is captured in the two-tiered financial quality that intertwines many privatization transactions: initial financing for privatizing the assets and subsequent financing to fund capital expenditure.

In the case of mixed sales this second stage financing is at least partly achieved by accessing the capital markets through SIPs; government ownership was often diluted to minority standing as share issues progressed. The contingency of capital market development figured prominently here. For Hungary and Lithuania, share issues appear less troublesome as equity markets in these developing countries show moderate capitalization, though weaker turnover (Brazil and Pakistan showed stronger development, and Poland and Romania weaker). A general lack of absorption capacity makes it necessary to access foreign portfolio capital to implement privatization of these telecoms.

The transaction structures of Telekomunikacja Polska and Pakistan Telecommunication Corporation demonstrate a government penchant for treating privatization as a financial transaction primarily, while regarding the infusion of much-needed know-how as secondary. Privatization as such is most dependent on capital market conditions. In the case of PTCL capital market conditions sustained privatization initially. Depository receipts to foreign portfolio investors launched the telecom sale and an active local market likely supports some secondary trading. The problem here is attracting a strategic investor so share issues may resume. The PTCL sale is stalled as the search goes on for an investor to buy less than effective control and partner with a majority state owner of an unstable regime. The difficulties for Poland's Privatization Ministry are weak capital market conditions as well as a reluctance to part with majority ownership when privatizing telecom firms.

There is a danger for public policy makers in relying on SIPs principally. The road to market is crowded, and continuing emerging market volatility serves only to make matters worse, threatening to delay some initiatives indefinitely while reducing government proceeds for others. Where portfolio capital drains away strategic investor may offer the only viable market for privatization in some developing countries.

To adhere to SIPs initially in a mixed sale is hazardous as well; both the TPSA and PTCL privatizations have it backwards so to speak. At the very least, to eschew early strategic ownership and the value-added that comes with commercialization may reduce overall proceeds from share issues. At most, holding back strategic ownership in the telecom sector may result in a serious deterioration of national endowments and threaten sustainable development in the longer term.

Non-strategic sales show a government reluctance to divest majority state ownership as well. This tendency is not limited to developing country governments and the privatization of TPSA, Romtelecom, and PTCL however. A statist tradition has evolved in many industrialized nations in the post-war period. In these countries repeated financial transactions and significant state ownership typify telecom privatization. For instance, when the British, French, German, and Finish telecom privatizations are mapped each falls inside the financial transaction area, and in all but the British Telecom sale are majority state holdings retained (indeed, transaction patterns in the British programme may be the exception and not the rule for industrialized countries.) Still, telecom firms, which have evolved in OECD countries, are not likely to suffer the corporate governance and capabilities deficit counterparts in developing countries do. A significant takeover premium may exist in the latter and not the former. To be sure, capital markets the world over get a boost from telecom SIPs. Yet in developing countries

capital market liquidity is more likely conditioned on these shares as portfolio investors use these issues to spread country risk. For governments it remains to be seen however whether a hot house approach -- telecom SIPs as 'seedcrop' -- will spur sustainable capital market development for these countries.

In closing, one last pattern may be recognized from the non-strategic sub-sample. Set the TPSA and PTCL transactions against that of CRT and we can observe the following. Ownership structure in the former places public financing before private enterprise skills (majority state ownership and financial transactions) while the latter favours private skills over public offerings (private sale despite moderately developed equity markets). To the extent these transactions represent government posture in Poland and Pakistan, and Brazil, respectively, we conclude that a *dirigiste* legacy shapes some privatization transactions importantly while a corporatist tradition others.

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TABLES

Table 1 Trends in Privatization Transactions

	<i>Developed Countries</i>	<i>Developing Countries</i>
SIPs	Most common overall	
Strategic Investors	Predominates now	Combinations predominate
Direct Sale	Less likely	Predominates

Table 2 Waves of Capital	
Official vs. <i>Private Development Flows</i>	
	Debt vs. <i>Equity</i>
	<i>Portfolio vs. FDI</i>

Table 3 Transaction Types and Expected Value-Creation			
<i>Transaction Type</i>	<i>Improved Financial and Operational Monitoring</i>	<i>Infusion of Operational Skills</i>	<i>Net Value-Creation</i>
Financial	Likely, publicly	Unlikely	Sub-Optimal
Strategic	Likely, publicly and privately	Likely	Optimal Range
Private	Likely, privately	Likely	Sub-Optimal

Table 4 Ownership Concentration Continuum (%)	
Dispersed or Widely-held	< 5
Blockholders	5
(Foreign) Direct Investment	10
Large Shareholders	20
Controlling Shareholder (effective control)	30
Strategic Owners	51
High Strategic Ownership	60
Closely-held	80

Table 5 Telephone Mainlines 1996					
	<i>Waiting List (000s)</i>	<i>Waiting Time (yrs)</i>	<i>per Worker</i>	<i>Revenue per line</i>	<i>Price of call (\$ per 3-min.)</i>
Canada	na	0	246	731	na
Brazil	na	na	169	821	.04
Hungary	250.9	.6	164	485	.15
Lithuania	141.6	3.2	100	134	.02
Pakistan	209.5	.7	44	442	.05
Poland	2327.4	3.3	89	389	.06
Romania	1299	7	59	177	.01

Table 6 Developing Country Stock Markets						
	Market Capitalization (%GDP)		Turnover Ratio (value of shares traded as % of capitalization)		Listed Companies (number)	
	1990	1996	1990	1997	1990	1996
Brazil	3.4	29	23.6	85.6	581	551
Pakistan	7.1	16.4	8.7	103.7	487	782
Hungary	1.5	11.8	6.4	73.4	21	45
Lithuania	Na	11.6	Na	8.9	Na	460
Poland	0.2	6.2	89.7	78.4	9	83
Romania	Na	0.2	Na	7.2	Na	17

Shareholders	Shareholdings (%)	
MagyarCom Consortium:		59.58
	Ameritech	30
	Deutsche Telecom	29.58
State Holding Co.		6.47
EBRD and IFC		2.92
Public Investors		30.99
(156,000 shareholders, participation by American and international portfolio investors)		

	Date	Shares equivalent (m)	%
SIP	August 1994	100	1.96
GDR (second tranche)	September 1994	500	9.80
Sale to strategic investor	Pending as of 1996	1,326	26.00
Third tranche	After strategic sale	573	11.24
State residual	N/A	2,601	51.00

	<i>TPSA (Poland)</i>	<i>Romtelecom</i>	<i>Matav (Hungary)</i>	<i>Lietuvos Telecom</i>	<i>PTCL (Pakistan)</i>	<i>CRT (Brazil, State)</i>
Private Ownership	25% SIP 15% Workers	35% Strategic Investor 5% Workers na% EBRD	59.58% Strategic Investors 30% Deutsche Telekom 29.58% Ameritech 2.96% EBRD & IFC 30.99% SIP	60% Strategic Investors na% Sonera (Finland) na% Telia (Sweden) 35% SIP	11.76% SIPs 26% Strategic Investor 11.24% SIP	85% Strategic Investors Telefonica do Brazil Holding Co. led by Telefonica of Spain
Transaction Type	Financial	Control	Control	Control	Financial	Private
Government Residual (voting stock)	(at least) 50% Majority	(at least) 50% Majority	6.47% State Holding Minority	O?	51% Majority	na% Minority
Strategic Privatization?	NO	NO	YES	YES	NO	NO

Intended strategy

DIAGRAMS

Diagram 1 Types of Privatization Transactions

Private Ownership Concentration

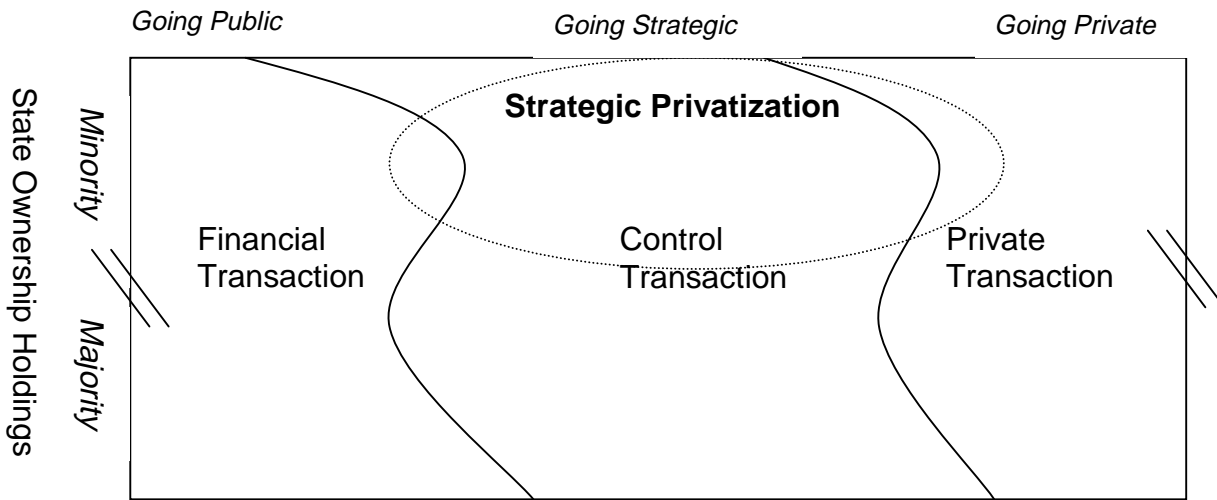
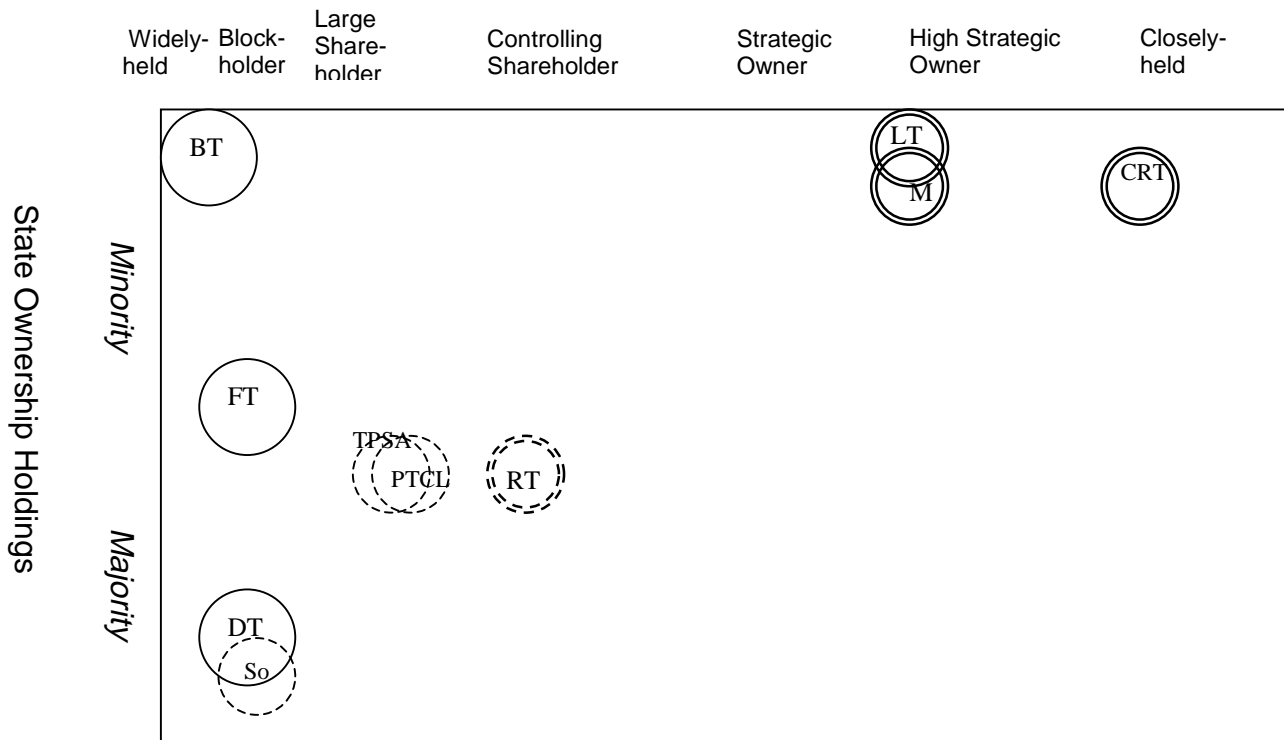


Diagram 2 Ownership Management during Telecom Privatization

Private Ownership Concentration



----- Partially implemented
 _____ Fully implemented
 (double line) Joint venture / consortium

BT - British Telecom
 FT - France Telecom
 DT - Deutsche Telekom
 TPSA - Telekomunikacja Polska
 So - Sonera
 PTCL Pakistan Telecommunications Corporation
 RT - Romtelecom
 M - Matav
 LT - Lietuvos Telekom
 CRT - Companhia Riograndense de Telecomunicacoes

Firms not drawn to scale

¹ We use the World Bank definition: a state owned and/or controlled economic entity generates the bulk of its revenue from selling goods and services.

² The private, public reversal presents in 1993, with private debt and equity outpacing official flows five-fold by 1997; the equity, debt reversal presents in 1997, with equity now surpassing debt by a factor of two, while FDI jumped markedly to now exceed portfolio flows three to one.

³ In the article "Southeast Asian enterprises: Forces and forms" (in review) Carney and Gedajlovic suggest the notion of waves of capital in their examination of how different enterprises were funded since World War II.

⁴ The authors cull these figures from The World Bank privatization database and note the data understate the value of transfers as mass privatization or voucher sales common in the former Soviet block in Central and Eastern Europe are not included.

⁵ From a strictly firm-level perspective, Megginson, Nash and van Radenborgh (1994) overcome certain of these obstacles in their study of the effect of privatization on financial and operational performance. Here they analyze pre- and post- privatization data for 61 firms in 32 industries for 18 countries (12 industrialized (OECD) and 6 developing (non-OECD)) for the period 1961-1990. The results show strong post-sale improvements (increases in real sales, profitability, investment, operating efficiency, and surprisingly, employment). The large sample size facilitates a robust outcome in capturing population effects, though incremental sales limit the time series data to a few years only for each subject (performance for years -3 to -1 (pre-privatization) and +1 to +3 (post-privatization) are examined). As comprehensive as this privatization study is, however, the authors restrict their examination to public share offerings (which represent 20% of the total number of transactions included in the authors' source document, the population frame). In addition, the data set includes only a small sample of developing countries.

From the more analytic perspective, the study by Galal, Jones, Tandon and Vogelsang (1994) is noteworthy. These authors consider the welfare consequences of the sale of 12 public enterprises operating in 6 (mostly non-competitive) industry sectors in 4 countries (Chile, Malaysia, Mexico and the United Kingdom). They examine changes in producer and consumer surplus to identify who won and lost, by how much and why, focusing on government, domestic and foreign purchasers, workers, consumers and competitors. The assessment compares actual pre- and post-sale performance with a counterfactual exemplar (which compares the divested firm with a model of its undivested self) to determine the outcome had the SOEs not been privatized (hypothetical outcomes are subtracted from historical figures to derive a measure of gains and losses due to divestiture). Results show positive net welfare gains for society and improved performance at the level of the firm post-privatization (in 11 of 12 cases). The authors recognize their sample is small and unrepresentative of the population of privatized firms (though the case method offers some depth, lending a comprehensive aspect in and of itself), over generalization should be avoided. As well, the contrived counterfactuals remain open to critique.

⁶ In Western economies this notion captures the general trend from state to market and in transitional economies the move from plan to market.

⁷ For instance, competition in the product market; monitoring by oversight bodies; the incentives of debt; the managerial labour market and managerial incentives in general. There is a complementary literature on the market for corporate control as well; Vickers and Yarrow (1988) describe two equity participants here. 1) Firm shareholders that seek and monitor contractual employment arrangements with management that maximize profit. Here opportunistic behaviour is constrained by an efficiency optimizing incentive structure. With residual rights to income flow, shareholders are considered highly motivated to establish effective management incentive and monitoring systems; these internal mechanisms include: monitoring by a board of directors, executive compensation, and equity ownership by management. 2) Other investors or their agents who may acquire shares as a prelude to establishing a more efficient incentive structure and monitoring system. The availability of private and tradable shares puts pressure on firms for several reasons, the primary reason being that it creates a competitive market in ownership. Here opportunistic behaviour is checked by the takeover constraint. Anticipated effects of current actions are capitalized into the present value of shares. Poor performance drives equity prices down and subjects the firm to the threat of takeover by a new set of owners (who intend to rejuvenate performance). Indeed, liquid securities markets are crucial in order to transmit new financial and operating information quickly into securities prices, without which, takeovers and in particular hostile takeovers, become much less likely. Active markets suggests two efficiency effects: to induce management to strive for superior performance and strong capital values as a pre-empt to takeover, as well as providing a mechanism for a new set of owners to replace incumbent management who fall short in their commitment to shareholder interests.

⁸ This is not true in all cases however. In Canada the sale of certain state enterprise have gone to market with new shares during a first tranche with sales proceeds retained by the firm; the government offered some or all of its remaining shares at a later date (Welch and Frémont, 1998).

⁹ The nature of ownership (the nature of the firm) is of course a running theme in the organizational economics and strategy literatures, among others. In fact the literatures begin to look awfully alike once epistemological approach (in terms of the general relations between subject and object, for instance.) and 'interest theories' are accounted for. The agency-based theories in finance and economics focus on information, control, and competition between firms (i.e. in markets), while a concern with knowledge, learning, and cooperation across firms (a network view) is found in sociological approaches to organization. The field of strategy has control and learning schools and as a field bridges the sociological and economic-related literatures to some extent. The notions of core competence or (organizational) capabilities and strategic alliance (and joint ventures) are central to strategy; the value of corporate learning and 'hybrid' organizational forms is understood. Indeed the value of organization is found importantly here.

¹⁰ Strategy as firm behaviour offers three corporate orientations: growth through mergers and acquisitions or 'partnering', growth through internal development, and shrinkage. In a population of firms this often means one firm's divestment is another enterprise's acquisition (the most obvious form of corporate re-combination).

¹¹ Corollary 1c. The sale of SOEs via share issue privatization that includes new shares presents an opportunity for voluntary restructuring. Corollary 1d. The sale of SOEs via share issue privatization only that place a (maximum) limit on individual and foreign ownership holdings promotes a widely-held structure and blunt the takeover threat (in subsequent share trading) and model financial transactions. Corollary 1e. The sale of SOEs via share issue privatization that creates a class of equity which confers veto power to a special shareholder in the form of 'golden' or special shares these blunt the takeover threat and may restrict the strategic behaviour of new owners. Corollary 3a. The sale of SOEs involving trade sales is conditioned upon entrepreneurial development. Sales to local entrepreneurs require local supply, while foreign trade sales do not.

¹²In some instances effective control is measured at 20% share concentration and closely-held structures at 50%. A lower base case is often implied by U.S. researchers as American corporate ownership structures show a high degree of dispersion across the population of firms.

¹³ These interviews are part of an ongoing research project on privatization.

¹⁴ Share issue privatization has been the dominant sales method in many developed countries, including the British Telecom (BT), France Telecom (FT), and Deutsche Telekom (DT). Shares for BT were floated in 2 tranches, with 50% equity sold each time. In contrast, FT divested 25% and then a further 13%, with 62% now remaining with the state, DT divested 26% to private hands, leaving 74% with the state. Note as well that FT and DT are negotiating a joint equity agreement.