

**POST-PRIVATIZATION PERFORMANCE OF STATE-OWNED ENTERPRISES  
IN EMERGING ECONOMIES: A TRANSFORMATIONAL LEADERSHIP  
FRAMEWORK**

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**ABSTRACT**

Although privatization has been considered as a strategy for improving the performance of state-owned enterprises in emerging economies, the simple transfer of ownership from public to private hands per se will not necessarily reduce costs nor will it enhance the quality of goods and services. Rather, the pros and cons of privatization in emerging economies should be measured against the standards of good managerial practices. Drawing from the literature on organizational leadership, the present article suggests that transformational leadership would successfully contribute to the transition from state-owned enterprises to private enterprises. Implications for research and practice are discussed.

## **POST-PRIVATIZATION PERFORMANCE OF STATE-OWNED ENTERPRISES IN EMERGING ECONOMIES: A TRANSFORMATIONAL LEADERSHIP FRAMEWORK**

Research on privatization in emerging economies (e.g., De Castro & Uhlenbruck, 1997; Laban & Wolf, 1993; Nellis & Kikeri, 1989; Ramamurti, 1992) has not considered post-privatization management practices of state-owned enterprises (SOEs), nor have researchers examined the relationship between leadership and performance of newly privatized firms. “Most work on privatization either takes the macro public view, usually aiming to demonstrate the benefits of privatization to the public, or consists of how-to explorations lacking a strong theoretical basis” (De Castro & Uhlenbruck, 1997: 139).

The transition from state-owned to private enterprise is a dramatic change. As Goodman & Loveman (1991) put it, like the takeovers of public corporations, the privatization of government assets or services is a radical change. Managing such a radical change requires the presence of a catalyst, having the vision and stamina to bring the transformation needed for the success of the new organization. Bass (1998: 53) notes that “inspirational leaders may reframe opportunities so that the environment is transformed from a situation of threat into a situation of opportunity into which the leader is followed.” Astonishingly, few studies today, have focused on the role of leadership, and especially transformational leadership, on the performance of a newly privatized firm.

The present article attempts to develop a framework explaining the effectiveness of privatization in emerging economies by building on the growing literature on transformational leadership. Nadler & Tushman (1990) contend that leaders are essential in bringing change in organizations because they provide a psychological focal point for the energies, hopes, and aspirations of people in the organization and serve as powerful role models.

In discussing the role of transformational leadership in the performance of newly privatized firms, the present article limits itself to emerging economies for two reasons. First, most emerging economies are moving from state-controlled economies to free-market economies and consider privatization as a means to salvage their staggering economies. Second, these countries lack previous experience of free market economies and modern management practices to spur the benefits of privatization. Although most emerging economies have turned to privatization, the success has been mixed. To the extent that emerging economies represent the major growth opportunity in the evolving new economic order (Arnold & Quelch, 1998; Garten, 1997), it is important that their experience with free market economy be successful.

Studying the impact of transformational leadership on the performance of newly privatized enterprises in emerging economies may present both theoretical and practical advantages. From the theoretical standpoint, researchers on privatization may develop theories and models of the role of leadership in facilitating the transition from state-owned enterprises to private ones. From the practical standpoint, governments and

investors in emerging economies may focus more on choosing effective leaders to successfully manage newly privatized enterprises.

## PRIVATIZATION IN EMERGING ECONOMIES

Recent decades have witnessed a significant trend toward entrepreneurial capitalism in both developed and emerging economies. “One of the most important and visible aspect of this trend has been the enthusiasm with which governments of all political persuasions have sold their state-owned enterprises to private investors in hopes that the generally unsatisfactory economic performance of these firms can be improved by the discipline of private ownership” (Megginson, Nash, & Van Randenborgh, 1994: 403). Privatization refers to the process by which state-owned businesses are sold to the private sector (Andrews & Dowling, 1998). Emerging economies have undertaken massive restructuring programs to strengthen their private sector and dismantle their inefficient state-owned enterprises.

Three characteristics (absolute level of economic development, relative pace of economic development usually indicated by the Gross Domestic Product (GDP) growth rate, and the system of market governance) are used to define emerging economies (Arnold & Quelch, 1998). Emerging economies are also defined as those countries enjoying growth rates attractive to an investor (Arnold & Quelch, 1998; Garten, 1997). “Emerging economies’ attractiveness is partly explained by their ‘emergence’ and a number of economic liberalization measures prompted, in some cases, by the end of the Cold War and the consequent reduced aid from the superpowers and, in many cases, by the demise of communist governments” (Arnold & Quelch, 1998: 8).

### **Reasons for Privatization in Emerging Economies**

The key to privatization is the unsatisfactory economic performance of public enterprises (Uhlenbruck & Decastro, 1998). “Almost every government that decides to follow the privatization route regardless of its ideological basis, expresses similar objectives. All are ultimately based on disappointment with the actual performance of SOEs, and all perceive that the lure of financial incentives and the discipline of the capital markets will spur greater efficiency” (Megginson et al., 1994: 407). According to Andrews & Dowling (1998), Megginson et al. (1994), privatization increases the financial performance of newly privatized firms.

In emerging economies, one of the prime drivers of privatization has been the need for fresh capital and new investments from firms in developed countries (Ramamurti, 1992). Faced with poor performance of SOEs and their burden on public expenditures, governments in most emerging economies were forced to privatize their public sector by donor institutions such as the World Bank and the International Monetary Fund (IMF). Because of their chronic inefficiencies, state-owned enterprises (SOEs) in emerging economies may be considered as examples of permanently failing organizations (Meyer & Zucker, 1989). Privatization is therefore, considered as a means to remedy this state of permanent failures.

Moore (1992, a former minister in Margaret Thatcher's Conservative Government) noted that privatization improved the performance of SOEs and encouraged the more efficient use of resources throughout the British economy. The author indicated that privatization led to 20% increase in productivity in British Airways and British Gas. Goodman & Loveman (1991) and Jensen (1989) also point out that enhanced management accountability resulting from the transfer to capital market funding and competitive product markets are expected to improve performance.

However, the positive effects of privatization are far from automatic (McDonald, 1993). Factors related to management of the newly privatized firm do matter. The simple transfer of ownership from public to private hands will not necessarily reduce the cost nor will it enhance the quality of services (Goodman & Loveman, 1991). "The determinants of a firm's success or failure are not who owns it. Rather, the firm's success or failure is a function of to what extent, and in what direction, its owners exercise the authority that comes with ownership and its managers carry out their jobs" (Wortzel & Wortzel, 1989: 634).

By focusing on the role of transformational leadership on post-privatization performance of state-owned enterprises, the present article suggests that the effective management of an organization is more important than who owns its capital. As stated by Goodman & Loveman (1991), ownership of a good or service, whether it is public or private is far less important than the dynamics of the market or institution that produces it. To the extent that privatization implies a dramatic reorientation of the firm's mission, objectives, and strategies, a transformational leader is needed to carry out this task.

## **THE ROLE OF TRANSFORMATIONAL LEADERSHIP IN PRIVATIZATION**

### **Transformational Leadership**

Transformational leadership (e.g., Avolio & Bass, 1988, Bass, 1998; Bass & Avolio, 1994; Bass, Avolio, & Goodheim, 1987; Bennis & Nanus, 1985; Burns, 1978; Pawar & Eastman, 1997; Yukl, 1989) refers to leadership in which leaders possess charisma and provide intellectual stimulation, individualized consideration, and inspirational motivation to followers. "Transformational leaders create a dynamic organizational vision that often necessitates a metamorphosis in cultural values to reflect greater innovation" (Pawar & Eastman, 1997: 83). Transformational leadership also seeks a bonding between individual and collective interests allowing subordinates to work for transcendental goals (Bass, 1985, 1998; Pawar & Eastman, 1997).

The four elements of transformational leadership, *charisma*, *intellectual stimulation*, *individualized consideration*, and *inspirational motivation* (see Table 1, for more details) are important in successfully leading change.

Table 1. Characteristics of Transformational Leadership\*

<i>Charisma:</i>	Provides vision and sense of mission, instills pride, gains respect and trust.
<i>Inspiration:</i>	Communicates high expectations, uses symbols to focus efforts, expresses important purposes in simple ways.
<i>Intellectual stimulation:</i>	Promotes intelligence, rationality, and careful problem solving.
<i>Individualized consideration:</i>	Gives personal attention, treats each employee individually, coaches, and advises.

*Charisma.* Charisma involves not only the possession of personal characteristics but also the capacity to envision a future for the organization. Envisioning “involves the creation of a picture of the future, of a desired future state with which people can identify and which can generate excitement. By creating vision, the leader provides a vehicle for people to develop commitment, a common goal around which people can rally, and a way for people to feel successful” (Nadler & Tushman, 1990: 82).

*Intellectual stimulation.* “Intellectually stimulating leaders are willing and able to show their employees new ways of looking at old problems, to teach them to see difficulties as problems to be solved, and to emphasize rational solutions” (Bass, 1990: 21).

*Individualized consideration.* Individualized consideration implies that the leader treats followers with respect and dignity and serves as a mentor to subordinates. “The leader psychologically helps people act or perform in the face of challenging goals” (Nadler & Tushman, 1990: 83).

*Inspirational motivation.* Inspirational motivation requires that the leader energize members of the organization. Transformational leaders communicate clearly the importance of the company’s mission and objectives to employees. Such clear communication allows employees to strive beyond their prescribed duties.

Transformational leadership may facilitate the adjustment of the newly privatized state-owned enterprise to market discipline. Andrews & Dowling (1998) found a strong association between performance improvement of the newly privatized firm and leadership restructuring. “A shift from political to an economic operating environment requires a corresponding shift in the abilities of the CEO” (Andrews & Dowling, 1998: 614). They found that privatized companies that changed their CEOs were likely to perform better than those who did not. They contended that the CEO might not have political ties and cronies whose interests must be protected. Therefore, he or she might be free to undertake the changes needed for better organizational performance. However,

Andrews & Dowling did not specify the different leadership characteristics displayed by these CEOs nor did they try to link particular leadership styles to the performance of the privatized enterprises.

Because transformational leadership deal with influencing major changes in the attitudes and assumptions of organizational members and building commitment for the organization's mission, objectives, and strategies (Yukl, 1989), it is needed to facilitate the transition from a state-owned enterprise to a private one. However, transformational leadership is a shared process (Burns, 1978). As the leader attempts to change the organization, he/she must have the support of followers. Failure to receive such support may undermine the success of the newly privatized firm. Bass, Waldman, Avolio, & Bebb (1987) found that transformational leaders attract strong feelings of identity, excitement, and expectations, by focusing on ideas and creating a vision for their followers.

### **Transformational leadership and Organizational Performance**

A transformational leader inspires change in the entire organization. He/she creates a vision for both managers and employees within the organization. The transformational leader will have to develop a new organizational culture, new compensation and performance appraisal systems, as well as new policies and strategies in hiring and motivating employees.

Empirical research (Hater & Bass, 1988; Howell, & Avolio, 1993; Koh, Steers, & Terborg, 1995) found a positive relationship between transformational leadership and organizational performance. In an empirical study on a sample of 78 managers, Howell & Avolio (1993) found that transformational leadership directly and positively predicted unit-level performance. In a study conducted in a different cultural setting (Singapore), Koh, Steers, & Terborg (1995) reported a high level performance of high school students whose institutions were managed by charismatic leaders. Hater & Bass (1988) found that managers identified independently as top performers were rated higher on transformational leadership than the randomly chosen group of ordinary managers. Transformational leaders' organizations do better financially (Bass, 1990). In light of these empirical findings, it is not premature to anticipate that transformational leadership may have a positive impact on the transition from state-owned to private enterprises in emerging economies.

Transformational leaders are effective for several reasons. They are able both to unite followers and change followers' goals and beliefs (Kuhnert & Lewis, 1987). For Conger & Kanungo (1988), transformational leaders portray vivid representations of a future vision for followers. Because such leaders are able to formulate a clear vision, they are likely to motivate employees in sharing that vision. Transformational leaders motivate subordinates to perform beyond expectations (Bass, 1985; Singer & Singer, 1990). The period following privatization is generally a period of uncertainty for the new shareholders, managers, and employees as well. Therefore, a leader possessing charisma,

inspiration and intellectual stimulation is needed to show followers how their behaviors could contribute to the attainment of the organizational goals.

According to Pawar & Eastman (1997), the effectiveness of a transformational leader is the result of three factors. The organization's position on the continuum of organizational receptivity (openness to change), the correspondence between the transformational process required by the position and the actual transformational leadership process, and the transformational leaders' capabilities required to undertake the appropriate transformational process. If transformational leaders can play an important role in the transition from state-owned enterprises to private ones, then how can emerging economies develop and nurture such leaders? Although there is no easy answer, one may suggest that transformational leadership can be developed in an organization through selective recruitment and training. Garten (1997) notes that how to recruit, develop, and train managers who can operate in emerging market is the key question.

Transformational leaders may be selected by using survey measures, behavior observation, interviews with the applicants (Bass & Avolio, 1989), and through the analysis of information gathered from previous or current peers, subordinates, and superiors. The use of such techniques would help assess the extent to which managers display the attributes of a transformational leader. The Multifactor Leader Questionnaire (MLQ) has been used as a tool to assess the extent to which a leader possesses transformational characteristics. Managers could be trained to display more transformational behavior (Bass & Avolio, 1989).

According to Bass (1998), transformational leadership can be taught and learned. The first step in training managers to lead the transition to private enterprise should start by identifying the appropriate skills and abilities. Transformational leaders can be trained in areas such as critical evaluation and problem detection, envisioning, communication skills for conveying a vision, impression management, and how to empower employees (Bass, 1998). Table 2 illustrates Greenberg & Baron's (1997) suggestions for developing transformational leadership in organizations. A transformational leader should be able to formulate a vision that is both clear and appealing to followers. In addition to formulating the vision, the transformational leader should articulate a strategy for bringing that vision to life. To the extent that a transformational leader is inspirational and sets the guidelines for reaching organizational goals and objectives, he/she can dramatically improve organizational effectiveness.

**Table 2. Guidelines for Becoming a Transformational Leader**

<b>Suggestions</b>	<b>Explanation</b>
Develop a vision that is both clear and highly appealing to followers.	A clear vision will guide followers toward achieving organizational goals and make them feel good about doing so.
Articulate a strategy for bringing that vision to life.	Don't present an elaborate plan; rather, state the best path toward achieving the mission.
State your vision clearly and promote it to others.	Visions must not only be clear but made compelling, such as by using anecdotes.
Show confidence and optimism about your vision.	If a leader lacks confidence about success, followers will not try very hard to achieve that vision.
Express confidence in followers' capacity to carry out the strategy.	Followers must believe that they are capable of implementing a leader's vision. Leaders should build followers' confidence.
Build confidence by recognizing small accomplishments toward the goal.	If a group experiences early success, it will be motivated to continue working hard.
Celebrate successes and accomplishments.	Formal or informal ceremonies are useful for celebrating success, thereby building optimism and commitment.
Take dramatic action to symbolize key organizational values.	Visions are reinforced by things leaders do to symbolize them. For example, one leader demonstrated concerns for quality by destroying work that was not up to standards.
Set an example; actions speak louder than words.	Leaders serve as models. If they want followers to make sacrifices, for example, they should do so themselves.

\* Greenberg, J., & Baron, R. A. (1997), p. 449.

## **IMPLICATIONS FOR RESEARCH AND PRACTICE**

This framework bears both theoretical and practical implications.

### **Implications for Research**

The present framework provides a helpful guide for conducting future research on the impact of transformational leadership on the success of newly privatized state-owned enterprises in emerging economies. A transformational leadership framework could help scholars to focus more on the dynamics within the newly privatized firm instead of limiting their analysis to the sole process of transferring capital from the public to the private sector. Areas such as the characteristics and abilities of the transformational leader, the existence of a new management team able and willing to create a culture of quality and competitiveness, and the acceptance of the new mission and goals by

subordinates, are interesting avenues for empirical research. The extent to which such factors influence the performance of newly privatized firms warrant empirical investigations.

As the company moves from its state-owned status to a private status, management and employees must also change their mind-set. Understanding the dynamics of change from employees' perspective could shed light on their adjustment (or resistance) to the new organization. As Andrews & Dowling (1998) put it, a shift from a political to an economic operating environment requires a corresponding shift in the abilities of the CEO. Such shift is not only limited to the CEO but involves all employees within the organization.

Transformational leadership has a following dominoes effect (Bass et al., 1987). Bass et al. (1987) found that the degree of transformational leadership behavior observed at a superior level was also seen at the next lower level of management. A strategy of instilling transformational leadership in an organization is therefore, to provide transformational leadership training to top-level managers who will, in turn serve as role models for their lower-level subordinates. The extent to which such diffusion of transformational leadership skills is possible in an organization should be explored.

Is also important knowledge about the extent to which political pressures undermine the efforts of a transformational leader to implement radical changes in a newly privatized SOE. To what extent do factors such as political constraints, economic conditions, and social influences limit the effectiveness of the transformational leader? Andrews & Dowling (1998) note that after privatization, when the government influence remains strong, the agents of the state will have more power to protect their personal and political interests than when the government has little ownership influence.

Pfeffer (1977) suggests that organizational effectiveness depends on factors beyond the leader's control such as economic conditions, market conditions, government policies, and technological change. When present in emerging economies, such factors may impede the effectiveness of a transformational leader. Gibbons (1992) considered environmental complexity and scarcity as external factors influencing the form of the required transformational leadership. However, even though leaders cannot directly alter such factors, they can take actions to reduce constraints, expand choices, and make the situation more favorable (Yukl, 1981). Researchers may look at the strategies transformational leaders use to reduce the negative impact of external factors and successfully manage newly privatized firms.

### **Implications for Practice**

Understanding the role of transformational leadership in improving the performance of newly privatized enterprises would help governments as well as acquiring firms to train those who will manage the change process. The development and training of local managers to manage the newly privatized enterprises have been neglected in the privatization literature in most emerging economies. Before selling or buying an SOE in

an emerging economy, governments or foreign investors must be assured of having someone to make the turn around. Failure to find a leader capable of leading the transition may result in poor performance.

However, the process of change and development regarding the leader is generally a long-term one that requires continual updating, feedback, and modification (Bass, 1998). Because of their positive impact on organizational re-orientation and performance, transformational leaders should be considered when undertaking privatization efforts in emerging economies. As Bass (1998: 80) points out “where it is in short supply, transformational leadership should be encouraged, for it can make a big difference in the organization’s performance.”

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