Non-Technical Summary

Marko Simoneti, Jože P. Damijan, Matija Rojec, Boris Majcen*

"Efficiency of mass privatization vs. gradual privatization: Owner and seller effects on performance of companies in Slovenia"

According to the recent World Bank comprehensive report[1] on lessons learnt in the first ten years of economic transition from plan to market, the ideal privatization strategy is to transfer assets as rapidly as possible to concentrated owners through open, fair and transparent methods. However, the report admits that is difficult to achieve on a large scale in a short period as the privatization to diffuse owners and insiders is appealing on equity grounds, and in several countries this was the only way to make private ownership politically acceptable. The main issue then is whether these intermediate ways of privatization accelerate or retard the eventual takeover of the enterprise by the "right" kind of investors. Might it not have been preferable to keep the assets in state hands, waiting to identify and than sell the enterprises to viable strategic investors? The World Bank report goes further by saying "Navigating between continued state ownership with eroding control rights and a transfer to ineffective new private owners with an inadequate institutional framework is possibly one of the most difficult challenges confronting policymakers in charge of privatization."

Table 1:
Quality of privatization in terms of company performance on the scale from 0 to 3

	Initial period	Owner effects	Seller effects	Long run
Gradual case-by-case privatization	**0**	**0**	**3**	**3**
Rapid mass privatization	**0**	**1**	**2**	**3**

The key policy choice in privatization for countries in transition is schematically presented in Table 1, where privatization can improve company performance from

* Marko Simoneti, Central & Eastern European Privatization Network (CEEPN), Ljubljana and Law School, University of Ljubljana ; Jože P. Damijan, IER-Institute of Economic Research, 1000 Ljubljana and Facultcy of Economics, University of Ljubljana; Matija Rojec, Faculty of Social Sciences, University of Ljubljana; Boris Majcen, IER-Institute of Economic Research, Ljubljana.

[1] Transition – The first ten years: analysis and lessons for Eastern Europe and former Soviet Union, The World Bank; 2002 (pages 72-73).

0 to 3 in one, two or more steps. A rapid case-by-case privatization, which would improve performance of all companies to be privatized in one single step, is not a realistic policy choice for countries in transition. Given a large number of companies to be privatized, a case-by-case approach is by definition gradual in transitional economies: while some companies get privatized (with seller effects on performance 3), many stay in continued state ownership (with owner effects on performance 0). Alternatively, mass privatization transfer ownership quickly and free of charge to new ineffective private owners (with limited initial positive owner effects on performance 1), while further improvements are expected only after the secondary sales by mass privatization institutions (with seller effects on performance 2).

It is expected that the temporary owner effects on performance are stronger in mass privatization (performance 1 vs. 0), while the seller effects on performance are stronger in gradual case-by-case privatization (performance 3 vs. 2). In selling companies, mass privatization institutions are considering only the purchase price. On the other side, the selling governments can take into account the restructuring needs of an individual enterprise in selecting the appropriate new private owner, which is expected to assure better post privatization performance. Therefore, the advantage of mass privatization is the speed of privatization captured by the temporary owner effects, while the advantage of gradual privatization is the quality of privatization captured by the seller effects. The overall effects of rapid private sector led mass privatization versus gradual government led privatization then depends on the relative importance of the owner and seller effects. When the temporary owner effects are dominating, mass privatization should be better (at the beginning of the process and if “temporary” ownership last for many years). When the seller effects are dominating, gradual privatization should be better.

It is clearly presented in Table 1 that a relevant comparison of the two privatization methods can be done only by taking into account all companies initially included in both programs. The standard research approach, comparing performance of companies temporary owned by mass privatization institutions (with performance 1) and companies sold by the government in gradual privatization (with performance 3) is not appropriate. The effects of gradual privatization are overvalued as non-privatized companies are excluded, while the effects of mass privatization are undervalued as companies sold by mass privatization institutions are excluded. It is further proposed that companies temporary owned by mass privatization institutions should be compared with non-privatized companies and companies privatized by the government in a standard way with companies sold by mass privatization institutions.

There are two additional important conditions presented in Table 1 that are necessary for a meaningful empirical analysis of the two policy choices. First, the initial performance of companies selected for gradual and mass privatization should be the same (with initial performance 0). In real life this is almost never the case and the issue of selection bias or simultaneity between company performance and chosen privatization method should be explicitly dealt with in the empirical analysis of company level data. Second, the selection of the time period is crucial for comparative analysis of the various effects of the two privatization methods on performance of companies. In the functioning market economy all privatized companies should eventually find the appropriate owners in the long run and they should be equally efficient irrespective of the initial privatization method (with performance 3). Therefore, the time horizon is crucial not only to analyze the temporary owner and final seller effects within each method, but to compare overall effects on performance between the two methods as well.

For Slovenia, we compared mass privatization programs for listed and non-listed companies with government led pre-privatization restructuring program using TFP model. We find out that mass privatization with listing is superior to mass privatization without listing and government restructuring. In addition, we show that mass privatization institutions are better temporary owners in listed than in non-listed companies, and better temporary owners than the government and its institutions. The last result was confirmed when dynamic versions of the model were studied, with simultaneity and heterogeneity problems explicitly controlled for using Sys-GMM approach to panel data. The strong bias in the construction of our samples of data, since the survival of companies in the period 1995-2001 and preselection of different privatization methods by companies are affected by their past performance, was explicitly controlled for using the Heckman two-step method.