Privatisation Processes and Firm Performance:  
A conceptual Process Model

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Abstract

In the early stage of the privatisation a considerable debate has been generated about the ownership of the firms. In recent years, however, researchers have moved beyond the ownership debate to the more complex discussions of pre-privatisation institutional reforms. This paper reviewed the theoretical and empirical studies in narrative forms and developed descriptive conceptual model for the process of privatisation. It can generally be conceptualised into four stages. One stage occurs before the actual privatisation process started: the feasibility studies. The actual privatisation process contains three stages: preparation, valuation, and a sale stage.

1. Introduction

Since the mid-1980s, there has been a global movement away from state towards private ownership of the companies (Gratton-Lavoie, 2000). An important aspect of this trend has been the privatisation of State-Owned Enterprises (SOEs) with the goal to improve their unsatisfactory performance (Megginson & Netter, 2001). Initially, the prevailing view was in favour of fast privatisation as the only realistic way to combat the problems related to a lack of corporate governance. It was also believed that market institutions could be built later after the private ownership was created. Recently, in response to the disappointing privatisation results in some of the transition economies, policymakers have realised the need to strengthen market institutions prior to privatisation (Wallsten, 2002). This was further supported by growing evidence from the developed countries that privatisation alone has been insufficient to stimulate performance improvement (Zhang, Parker, & Kirkpatrick, 2005). This paper contributes to the recent debate on privatisation and its prerequisite restructurings. It focuses on developing countries, where the institutional infrastructure, includes competition and effective financial markets and corporate governance, is a weak or under developed (Boubkri, Cosset, & Guedhami, 2004). A weak institutional infrastructure could create great challenges for the success of privatisation in general and for the entrepreneurial efforts in particular (Zahra, Ireland, Cutierrez, & Hitt, 2000).

An important and difficult decision that most governments faced early in the privatisation process is how fast should SOEs be privatised, and who should execute the restructuring, the government before privatisation or the buyers afterwards? In addition, how does the restructuring fit into a market reform process? What should the sequences of reform be? Should one privatise before or after market reform, or should both proceed together? In other words, should there be sequencing in privatisation, and if so, what principles should underlie this sequencing (Roland, 1994)? This raise the most challenging question of how to shift a society from an economic mode stressing state ownership and direction to one based on private ownership and free enterprise (Megginson, 2005). The main objective of this paper is to gain insight into the privatisation processes in the context of developing
countries by reviewing the theoretical and empirical privatisation studies.

2. Literature review

This section reviews the theoretical and empirical studies in narrative forms to identify dimensions and variables that need to be studied. The included studies span the period from 1985 to the present. The privatisation studies were categorised into, cross-sectional, time-series analysis and sequencing studies, based on the balance empirical evidence presented in each study.

2.1. Static comparisons

In fact, in the early stage of the privatisation a considerable debate has been generated about whether privatisation led to improve the firm performance (Andrews & Dowling, 1998). To the extent that numerous of empirical studies focused on the ownership debate and relied on cross-sectional compressions of privatised or private to the state firms. In order to prove or refute the idea that privatively-owned firms are more efficient than state-owned firms. Early work compared public and private firms in the same industry, was conducted by Färe, Grosskopf and Logan (1985). They found that publicly and privately owned utilities were not significantly different in terms of the overall allocative and overall technical efficiency measures. They also found that publicly owned utilities have better ratings in terms of purely technical efficiency but are worse than privately owned utilities in terms of congestion and scale efficiency. The major source of inefficiency is the lack of allocative (price) efficiency. In a comprehensive study, Megginson, Nash, and van Randenborgh (1994) documented very strong performance improvement following privatisation. The results remain unchanged when the authors compared competitive to non-competitive firms. Greater performance improvements were documented for the group of firms that experienced a larger turnover in directors than the group of firms with fewer turnovers in directors after privatisation. They ruled that price increases were a frequent source of profit increase. The involvement of a private investor in a firm’s ownership critically affected a firm performance. Another study carried out by Galal, Jones, Tandon, and Vogelsang (1994) found that net welfare gains occurred in 11 out of 12 firms, on average equalling 26 percent of each firm’s pre-divestiture sale. The welfare gains varied from firms to another. But it came primarily from investment, improved productivity, product diversification, more appropriate pricing, and better resource allocation. The results were also explained by market condition, institutional factors and the way in which the firms were privatised.

In contrast to Megginson, Nash, and van Randenborgh (1994), Bhaskar and Khan (1995) came to the opposite conclusion. They found that privatisation had a negative effect on aggregate output, but this effect was not statistically significant. The results on employment were more reliable and showed that privatisation had a large negative effect on the managers, employees, and manual workers. Another opposite conclusion was reached by Martin and Parker (1997) who indicated that privatisation had mixed results in the UK. Most of the firms recorded increased productivity growth after privatisation, while the result was disappointing in some cases. Another study which concentrated on mixed privatisation results was carried out by Andrews and Dowling (1998). They found a strong association between performance improvement and leadership restructuring and
financial restructuring, while operation restructuring was not related.

Boubkri and Cosset (1998) conducted a study complementing that of Megginson, Nash, and van Randenborgh (1994). They narrowed the sample to include only developing countries and considered the possible impacts of economy-wide factors. The authors documented strong performance improvement was noted for firms from upper-middle-income countries, competitive and non-competitive firms, and control and revenue privatisation. This was attributed to ownership only, while the market structure turned out to be unrelated. However, weak performance gain was presented for firms from low-income and lower-middle-income countries. Along a similar line, the study of D’Souza and Megginson (1999) documented large performance improvement for the full sample of firms as well as for every sub-sample.

It can be concluded that the analysis of cross-sectional studies shows that privatisation yielded mixed results. Most of the studies were decisively in favour of privatisation and suggested that privatisation improved the firm performance in developed and developing countries. A few others have been more sceptical and suggested that privatisation does not guarantee performance improvement and that efficiency may be related to alternative reforms, including competition and regulation. It is not clear why and how privatisation led to differences in performance, and little progress has been made in describing the separate effects of privatisation, competition and regulation. The following section reviews studies that were designed to investigate further whether privatisation, regulation, and competition resulted in efficiency improvements.

2.2. Dynamic comparisons

To provide a further analysis of the privatisation literature, this section is concerned with studies that dynamically analysed the post-privatisation performance. The aim of these studies was to describe the interaction between privatisation and other market-opening initiatives that are often launched simultaneously with or after privatisation. Ramamurti (2000) proposed comprehensive, dynamic, and multilevel model explains the causes and consequences of privatisation in several emerging economies. He concluded that the firm-level argument needs to be complemented by industry- and country-level arguments to explain the cause of privatisation. In addition, changes in firm governance resulting from privatisation are not the only determinants of post-privatisation performance. Changes in industry structure, regulation, and country-level variables are important as well. Cuervo and Villalonga (2000) developed a dynamic model complements agency, public choice, and organisational perspectives with related variables to explain the variance in the post-privatisation performance. The model showed that strategic and organisational changes increased the post-privatisation performance. Management replacement, by enabling such changes, is a crucial determinant of post-privatisation performance increases. Replacing the management, however, is likely to be contingent on the method of privatisation which determines who the new owners are and the degree of political interference that remains after privatisation. The deregulation and liberalisation of the economic environment can affect management replacement.

Bortolotti, D’Souza, Fantini and Megginson (2002) concluded that the financial and operating performance of 31 telecom companies, from 25 countries (14 industrialised and
11 non-industrialised), improved significantly after privatisation. However, a significant fraction of the improvement resulted from regulatory changes (alone or in combination with ownership change) rather than from privatisation alone. Aussenegg and Jelic (2002) documented no increase in profitability and a significant decrease in efficiency and output in 153 firms from Poland, 28 Hungary, and Czech Republic that were privatised during 1990-1998. This was attributed to the market-oriented framework, which has not been readily available in these countries, as well as to the government continued to own a large percentage of shares after privatisation. Loh, Kam and Jackson (2003) concluded that operating efficiency of plantation sector in Sri Lanka improved after privatisation. However, privatisation itself did not bring about these gains. Rather, it was suspected that changes in management practices and work organisation after privatisation were the key influences. Bear in mind that changes in the environment policies including subsidies, land and labour reform after privatisation may also have affected plantation performance. Li and Xu (2004) found that both privatisation and competition contributed substantially to improved performance of telecoms sector in 177 countries between 1990 and 2001. Countries that implemented full privatisation and more aggressive reform policies moved more aggressively to rationalise input and speed up output growth, network expansion, and improvement in both labour and productivity than countries that implemented partial privatisation with less aggressive reform policies. They concluded that optimal reform policies required the bundling of competition policy with privatisation.

Omran, (2004) concluded that privatised and state firms both experienced significant improvement in most of the performance measures in Egypt. This means in competitive environment, both public and private ownership achieved a similar performance level. This result was partly attributed to the economic reform program that was adopted by the Egyptian government. It was also attributed to the SOE restructuring that was undertaken by the government prior to the privatisation. Boubkri, Cosset, and Guedhami (2005) concluded that the macro-economic reform, environmental and the corporate governance variables were the key determinants of performance improvement after privatisation of 230 firms from 32 developing countries. In similar study D'Souza, Megginson, and Robert (2005) concluded that micro-level factors, especially government and foreign ownership, were the most influential factors on the post-privatisation performance of 129 privatised firms from 23 developed countries that were privatised during 1961-1999. Institutional factors, especially trade and stock market liberalisation, were more significant determinants of post-privatisation improvement in developing countries.

It can be concluded that the review of time series analysis studies suggests that the majority of the empirical studies indicate that privatively owned firms are more efficient than state-owned firms. However, privatisation alone is insufficient to stimulate performance improvement. This is especially true in countries where the institutional framework for regulation is considered weak and underdeveloped. The time-series analysis studies uncovered a set of factors and circumstances that interact together to influence the post-privatisation performance. Macro-level and institutional factors, such as market development and liberalisation, are likely to be the key determinants of post-privatisation performance in developing countries. Due to a variety of reasons, particularly the lack of high-quality data, the experience in developing countries is much less well researched (Parker & Kirkpatrick 2007; Megginson & Sutter 2006). These
findings imply the need to examine the importance of institutional factors and their interactions with endowments and policies.

2.3. Sequencing issues

Issue of sequencing had been debated since the late of 1980s when former communist countries began their transition to market economies (Zhang, Paker, and Kirkpatrick, 2005). Key questions are: should one privatisise before or after restructuring, or should both proceed simultaneously? Should there be a fixed sequence in the privatisation process? If so, what principles should underlie this sequencing? Many transition economies have favoured fast privatisation, with no definite sequencing, as the only realistic method to combat the inevitable problems associated with the lack of corporate governance. It was believed that restructuring is best left to the new owners and that market institutions would be built after the firms were controlled by the new owners (Roland, 1994; Wallsten, 2002). In recent years, however, researchers have argued for the importance of restructuring before the sale of the company. First, an institutional infrastructure that is favourable to market exchange (including a competitive industrial structure and an appropriate regulatory system) should be established. This was influenced by growing evidence from the industrialised economies, such as the UK, that privatisation alone was insufficient to stimulate performance improvement (Zhang, Paker, and Kirkpatrick, 2005). The importance of the institutional infrastructure was also influenced by disappointing results from privatisation in some transition economies such as Russia and the Czech Republic (Shirley & Walsh, 2000).

Wallsten (2002) examined the effects of sequencing of reform in the telecoms sector by using panel data from 200 countries for 1985-1999. He found that countries that created separate regulatory authorities prior to privatisation saw increased telecommunications investment, fixed telephone penetration, and cellular penetration compared with countries that did not. Moreover, the investors were willing to pay more for telecom firms if the regulatory reform had taken place prior to the privatisation, since the established regulatory environment was expected to prevent the future administrative and legal uncertainty of regulation. Zhang, Paker, and Kirkpatrick, (2005) examined the effect of the sequencing between privatisation, competition and regulation reforms in the electricity generation sector from 25 developing countries for the period of 1985-2001. They found that establishing an independent regulatory authority before privatisation is associated with higher electricity availability and more generating capacity. Introducing competition before privatisation appears to bring about favourable effects in terms of service penetration, capacity expansion, capacity utilisation and capital productivity. The results confirm that single reforms, in particular privatisation alone, may well disappoint.

The review of sequencing studies suggests that the field still deserves additional research, and findings on some issues are limited and inconclusive. In particular, there is much work to be done on the details of how privatisation, competition, and regulation are related and how their combination impacts the key success factors in particular industries. It is also unclear to what extent the pace of these reforms matters. Several authors have pointed out this need for further research in this field: Ramamurti (2000); Aussenegg and Jelic (2002); Wallsten (2002) and Zhang, Parker and Kirkpatrick (2005). The debate on the sequencing issues has drawn attention to the importance of appropriate sequencing.
within reform programs.

3. Developing conceptual model for the privatisation process

Privatisation is not a single event but a process that occurs in stages (Ramamurti 2000). It is combined with a variety of organisational changes, such as setting up competitive industrial structure and appropriate regulatory system (Boubkri, Cosset, & Guedhami, 2005). It may be expected that the impact of privatisation and its institutional infrastructures in developing countries will be affected by why and how these policies are introduced (Parker & Kirkpatrick 2007). This paper develops a conceptual model that explains the process of privatisation regarding the SOEs restructuring, regulation, and competition as the main requirements for the successful program. Thus, following subsections discuss conceptual issues including basis, steps, activities, and influential factors of the model.

3.1. Basis of the conceptual model for the privatisation process

The basic assumption is that privatisation occurs because of the poor performance of SOEs which led to rising deficits for nations (Dewenter & Malatesta, 2001). To improve the SOEs’ performance, and in turn to lessen a nation’s fiscal burden, many of the SOEs were switched to the private sector through the process of privatisation (Ilori, Nasser, Okolofo, & Akarakiri, 2003). Another assumption is therefore that privatisation will improve the poor performance of these firms and also improve a nation’s financial situation. The poorly performing SOE can therefore be viewed as the input to the process of privatisation, see figure 1.1 (Ramamurti, 2000).

The privatised firms can be viewed as the output of the privatisation process. There are two characteristics of this output. One is that the ownership of the firm has changed. Compared to the SOEs, the privatised firms are owned by private investors and controlled by skilled managers who own little or none of the company (Denis & McConnell, 2003). The second characteristic relates to firm performance, which is the ultimate goal of the privatisation (Megginson, Nash, & van Randenborgh, 1994). As shown in the previous discussion, a number of studies showed the effectiveness of privatisation in improving the firm performance, while other studies came to opposite conclusions (Megginson & Sutter, 2006). It is not sufficient to view the transfer of ownership from public to private sector as an end in itself. The key is that firm performance after privatisation must be measured and compared to the performance of the original SOE in order to find any

Figure 1.1 Basis of the conceptual research model
evidence of performance improvement or decline after privatisation. The model therefore includes a comparison of firm performance during the pre- and post-privatisation periods.

3.2. Phases in privatisation

To gain insight into the different phases of the privatisation processes, successful privatisation experiences in four different countries, include the UK, Mexico, Zambia and Morocco, are discussed.

3.2.1. British experience

The British experience is considered the first large privatisation program, and its perceived success has caused governments around the world to model their own policies after it. The shareholders of the firms that were sold, the employees, most of the customers and the whole nation benefitted from it. That is why it has been considered a success (Moore, 1986). According to Moore (1986), who played a significant part in the British privatisation, and Ramanadham (1988), who discussed the UK experience to gain some lessons for developing countries, the process of the British privatisation can be divided into four steps, see table (1.1).

Table 1.1: British privatisation process

<table>
<thead>
<tr>
<th>Step</th>
<th>Activity</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Conduct studies to identify possible SOEs for privatisation</td>
</tr>
<tr>
<td>2</td>
<td>Restructure the SOEs, legislation, and regulation and prepare the SOEs and their market for privatisation</td>
</tr>
<tr>
<td>3</td>
<td>Valuation of the SOEs</td>
</tr>
<tr>
<td>4</td>
<td>Final decision of sale</td>
</tr>
</tbody>
</table>

3.2.2. Mexican experience

The second privatisation success story is the Mexican experience. The most important aspect of the Mexican story was the comprehensive reform program covering liberalisation, relaxation of rules governing foreign and domestic investments, and deregulation (Galal, Jones, Tandon, & Vogelsang, 1994). Another key aspect was the process of learning from earlier mistakes (Kikeri, Nellis, & Shirley, 1992). In a study of the privatisation of 361 Mexican companies, Lopez-de-Silanes (1997) undertook a detailed evaluation of restructuring activities that were completed by the Mexican government prior to privatisation. Although the author does not provide a full list of the relevant procedural aspects, as he places emphasis on one aspect of the privatisation process: a firm restructuring before the change in ownership. But he provides detailed restructuring activities that might be taken before the sale of the firm, see table (1.2).

Table 1.2: Mexican process dealing with restructuring before privatisation

<table>
<thead>
<tr>
<th>Step</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Management shake-up</td>
</tr>
<tr>
<td>2</td>
<td>Labor cutback and worker contract renegotiated</td>
</tr>
<tr>
<td>3</td>
<td>Absorption of outsiders’ debt</td>
</tr>
<tr>
<td>4</td>
<td>Efficiency program to improve performance of SOEs before privatisation</td>
</tr>
<tr>
<td>5</td>
<td>Investment measures</td>
</tr>
<tr>
<td>6</td>
<td>De-investment measures</td>
</tr>
</tbody>
</table>
3.2.3. Zambian experience

The third privatisation success experience comes from Africa, namely Zambia. By 1996, the World Bank considered the Zambian privatisation process as the most successful program in sub-Saharan Africa. It was driven from strong political goodwill and support. Zambia has also attracted a large number of foreign investors; include previous owners of the firms (Musambachime, 1999). The process was supported by appropriate legislations, and the private sector took a leading role in the process. The Zambian Privatisation Agency (ZPA) had the legal permission to execute its function, it had sufficient resources, and it was able to undertake its work with minimum political interference. The process was transparent and well supported by donors that coordinated their assistance (White & Bhatia 1998). Based on Fundanga and Mwaba (1997), who examined the major tools and mechanisms applied in privatising the Zambian public sector, five steps can be identified for the Zambian privatisation process, see table (1.3).

Table 1.3: Zambian privatisation process

<table>
<thead>
<tr>
<th>Step</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Announcement</td>
</tr>
<tr>
<td>2</td>
<td>Identifying candidates</td>
</tr>
<tr>
<td>3</td>
<td>Creation of privatisation agency for managing the sale of SOEs</td>
</tr>
<tr>
<td>4</td>
<td>Evaluation activities to fix the price and suggest the sale method</td>
</tr>
<tr>
<td>5</td>
<td>Final decision of sale</td>
</tr>
</tbody>
</table>

3.2.4. Moroccan experience

The fourth privatisation success story comes from North Africa, Morocco. It is regarded as a successful program in terms of scope and performance. It was implemented by relying on outside consultants to prepare the process. This method was expensive, but it was quick and resulted in a high-quality work (Ernst, Edwards, Gladstone, & Hitt, 1999). The US Agency for International Development (USAID) sponsored a study conducted by Ernst, Edwards, Gladstone, & Hitt, (1999) to assess Morocco’s privatisation process, its impact and its influential factors. USAID saw Morocco as an ideal testing ground for an appraisal of the impact of case-by-case privatisation in a mixed economy. Accordingly, as shown in table 1.4, Moroccan privatisation can be conceptualised into four steps.

Table 1.4: Moroccan privatisation process

<table>
<thead>
<tr>
<th>Step</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Identify candidates</td>
</tr>
<tr>
<td>2</td>
<td>Preparing candidates for the sale through auditing, valuing and finalising the conditions for sale</td>
</tr>
<tr>
<td>3</td>
<td>Advertising campaign and bid valuation</td>
</tr>
<tr>
<td>4</td>
<td>Sale announcement and closure</td>
</tr>
</tbody>
</table>

3.2.5. Conclusion about phases

On the basis of the experiences discussed, the process of privatisation can generally be conceptualised into four stages. One stage occurs before the actual privatisation process: the feasibility studies that are necessary before the process of privatisation can be started. The privatisation process contains three stages: preparation, valuation, and a sale stage. Figure 1.2 illustrates these stages and their sequence. This information will be used and further developed in section 4 where the conceptual research model is developed.
Feasibility phase: this initial stage usually starts after the announcement and before the beginning of the actual privatisation (Ramanadham, 1994). It involves a study that is typically undertaken by merchant banks, consultant teams, or even civil servants to investigate the SOEs and provide feedback on the possibilities, options, and prerequisites of any sale (Moore, 1986). This feasibility stage can therefore be viewed as necessary to assist the government to determine which SOEs should be privatised and how (Nellis & Kikeri, 1989). The feasibility stage ends with the granting of parliamentary authority for both the choice of options and the creation of a privatisation agency (Kayizzi-Mugerwa, 2002). This can be considered as the start of privatisation.

Preparation phase: following the establishment of a parliamentary authority, the first stage of the actual privatisation process begins. This stage includes restructuring activities that are intended by governments to prepare the SOEs for sale and to create an effective market environment for privatisation. The SOEs usually have excess employees and large fiscal debt, and they suffer from a lack of sufficient entrepreneurial capabilities. Thus, their preparation prior to sale is necessary to ensure that they can operate effectively in a market-oriented economy without state support and to make them more attractive for private investors (Moore, 1986). The restructuring of the SOEs is also seen as necessary in order to command a higher price for the firm (Cuervo & Villalonga 2000). The market in which the SOEs operate must also be restructured to protect investors from arbitrary political actions and to protect the consumers from the abuses of monopoly power (Kikeri & Nellis, 2004). Market restructuring is a task of ending the monopoly regime to ensure successful privatisation (Parker & Kirkpatrick, 2007). This stage ends when the market and the SOE candidates are prepared for privatisation.

Valuation phase: once the candidates become eligible for privatisation, the second stage begins. It is about assets valuation to determine the market value of the SOE that will be used as a benchmark against market values that are submitted by potential buyers (Fundanga & Mwaba, 1997). The market value is the present value of future cash flow discounted at an appropriate risk-adjusted rate (Buchanan & Bowman, 1990). This stage ends once the market values of the privatised SOE candidates are established.
Sale phase: once the market value of the SOE candidates is determined, the third and final stage of the process starts. It is about the decision for the SOEs divestiture (Megginson & Netter, 2001). This step starts with advertising SOEs that are ready for privatisation to attract investors. It ends with the signing of the sale of the firm (Fundanga & Mwaba, 1997). This results in a new privatised firm that marks end of the privatisation.

3.3. Influencing factors

The steps in the privatisation process are influenced by a number of factors. To structure the discussion, they are classified as economic, political, and additional factors. The following sections briefly discussed these factors.

3.3.1. Economic factors

Privatisation is largely considered a response to the economic crisis and the poor performance of SOEs (Gratton-Lavoie, 2000). The economic factors are separated into macroeconomic factors, institutional factors and microeconomic factors.

Macroeconomic factors:
Financial pressures: the financial deficit and foreign debt are the most important motives for privatisation in most developing countries (Seock, 2005). As a result of the oil crisis in the 1980s, the governments of both rich and poor countries found themselves with large budget deficits. It was difficult for those countries to squeeze money out of taxpayers and investors at home and from lenders abroad. This turned privatisation into a serious option to improve their short-term cash flow (Ramamurti, 1992). The fiscal condition of the country can also influence the pace of the privatisation process (Boehmer, Nash & Netter, 2005). The lack of budgetary resources to pay for laid-off workers slowed down a privatisation process (Karatas, 2001). International pressures: privatisation has also been associated with international pressures applied by international lending agencies. Most of the developing countries approached these agencies to finance their external debts (Manzetti, 1994) and therefore grew more dependent on those donors. The international lending agencies made their credit dependent upon the adoption of an economic transition from a command to a market economy (Boorsma, 1994).

Institutional factors:
Market development: the practice reveals that a wide variety of methods has been used to privatise the SOEs (Cook & Kirkpatrick, 1995). The choice of an appropriate method depends on the market development (Zahra, Ireland, Cutierrez, & Hitt, 2000). Public share offerings often require a well-developed market, such as the UK, where the British Gas shares were offered on the stock market (Mahoobi, 2003; Pirie, 1988). Mass privatisation has been preferred by countries such as the Czech Republic and Poland where the market was not well-developed. Market Liberalisation: the most important aspect behind the success of Mexican privatisation was the comprehensive reform programs including trade liberalisation (Galal, Jones, Tandon, & Vogelsang, 1994). The success of privatisation of Kenya Airways was ascribed to the partner Royal Dutch Airlines (KLM). The significant performance improvements of public and private Egyptian firms were also attributed to the economic reform program that was adopted by the government (Omran, 2004). Competition: several studies argued that competition is a
more important determinant of allocative efficiency than whether a firm is state or privately owned. Omran, (2004) concluded that in a competitive environment, both state and private Egyptian firms had achieved similar performance levels. Li and Xu (2004) concluded that countries executed a full privatisation and competition experienced significant performance gains compared with countries that implemented less aggressive reform policies. Regulation: Bortolotti, D’Souza, Fantini and Megginson (2002) documented that price regulation significantly increased the profitability of 31 telecom companies that were privatised over the 1981-98 time period.

Microeconomic factors:

*Performance of the SOEs:* according to the international financing institutions, the SOEs are inefficient, and privatisation is one of the most important policies to improve their performance (Seock, 2005). In 2005, Boubkri, Cosset, and Guedhami, stated that privatisation led to a significant increase in profitability, efficiency, investment, output and, thus, improved the economic efficiency. In contrast, Aussenegg and Jelic (2002) documented a significant decrease in efficiency and output after privatisation. *Nature of the SOEs:* many African countries embarked on privatisation with a list of firms that remained state-owned. Some SOEs were considered strategic for national sovereignty, while others were considered economically important (Kayizzi-Mugerwa, 2002). In the process of learning from earlier mistakes, the Mexican government and some African countries started their privatisation with small and competitive firms that were relatively easy, before moving to more complex firms where important regulatory issues and mistakes would be more costly (Shafik, 1996; Kayizzi-Mugerwa, 2002). *Ownership:* the result of Oswald and Jahera (1991) indicated differences in the performance of manager-controlled and owner-controlled firms. Frydman, Gray, Hessel, and Rapaczynski (1997) found that outside owners performed better than inside owners on most performance measures, and the impact of foreign investors appears to be no stronger than that of domestic outsiders. Kocenda and Svejnar (2003) showed that foreign ownership leads to superior economic performance relative to domestic private and state ownership.

*Organisational structure and restructuring:* significant performance improvements of both public and private Egyptian firms were partly attributed to the restructuring of SOEs undertaken by the government prior to privatisation (Omran, 2004). Organisational restructuring also depended on how the firm was privatised and who the new owners were (Ramaswamy & Glinow, 2000). *Organisational chart:* the SOEs are commonly highly structured by political concerns and tend to be associated with a strict hierarchy of accountability and centralisation plans (Parker, 1995a). This means that there is a high level of centralised top-down decision-making, involving long chains of command (Anderson, 1995). These structures are likely to be detrimental to survival in a new economic environment. Privatisation, therefore, is expected to lead to restructuring of the firm by reducing the centralisation and bureaucratic rules in order to ensure faster decision-making (Parker, 1995b). *Top management replacement:* the government of Kenya dismissed the entire board of directors and appointed a new board by choosing the best and most able people in the country to manage the company (Debrah & Toroitich, 2005). Andrews and Dowling (1998) found a strong relation between performance improvement and management restructuring after privatisation. Management replacement is likely to be contingent on privatisation methods that determine who the new owners are
and degree of political interference that remains after privatisation. In several Eastern European countries, control was left in the hands of managers who were mainly motivated to protect their own positions (Cuervo & Villalonga 2000).

Employee decline: SOEs tend to be overstaffed for social and political reasons (Kranton, 1990). D’Souza and Megginson (1999) documented a significant decline in employment after privatisation. In contrast, Boubkri and Cosset (1998) documented a significant increase in employment after privatisation. Incentives policies: major efficiency gains of 31 telecom firms resulted from better incentives and productivity rather than from the extensive firing of labour (Bortolotti, D’Souza, Fantini & Megginson 2002). Megginson, Nash, and van Randenborgh (1994) stated that change in the compensation policies may provide incentives for the firm’s workers to be more productive.

3.3.2. Political factors

Privatisation is an intensely political process as politicians determine not only whether privatisation goes forwards, but also how it is handled. It needs political initiation, support, and sustainable commitment (Ebeid, 1996). In addition to the economic factors, political factors also influence the process and outcome of privatisation (Boorsma, 1994). Debrah and Toroitch (2005) attributed the success of privatisation of Kenya Airways to the government’s purpose not only to privatise but also to ensure a successful privatisation. Boehmer, Nash and Netter (2005) found that political factors significantly affect the decisions of bank privatisation in the developing economies. The following factors were identified as political factors that may influence the process and outcome of privatisation. Government ideology: privatisation is not totally rational as governments may have interests other than enhancing the efficiency gains. These interests are influenced by their ideological view (Börner, 2004). Privatisation might be a consistent policy for right-wing governments if the SOEs’ shares are used for democratisation. Privatisation might also be consistent policy for left-wing governments if revenues are used for re-distribution (Bortolotti & Pinotti, 2003).

3.3.3. Additional factors

There are also some factors other than the economic and political factors that influence the privatisation process. Opposition and debate: the Turkish privatisation process has shown slow progress over time due to a strong opposition exerted by senior bureaucrats and the labour union (Karatas, 2001). In most African countries privatisation has been superseded by a serious debate. The local opinion refers to privatisation as a loss of resources to abroad and loss of independence (Kayizzi-Mugerwa, 2002). Transparency of the process: the lack of transparency can lead to a perception, justified or not, of unfair dealings and to a popular outcry. This can threaten not only the privatisation but also the reform in general (Kikeri, Nellis, & Shirley, 1992). In Turkey there has been considerable delay and resistance in the privatisation of some of the SOEs because of doubts about the reliability of asset assessment (Karatas, 2001). In most of the African countries, many of the SOEs were not operating at the time of privatisation, but the public believed that they were worth much more than what the buyers were offering (Kayizzi-Mugerwa, 2002).
4. Conceptual model for the privatisation process

Based on the privatisation literature and different cases in developing economies, a descriptive model for the privatisation process is depicted in figure 2.2.

Figure 2.2: Conceptual Model for the Privatisation Process

4.1. The firm performance before privatisation

Many of the SOEs in many countries have not lived up to the expectations of their governments (Dewenter & Malatesta, 2001). Too many of them cost rather than make money, and too many operate at low efficiency (Nellis & Kikeri, 1989). The critical problems resulted from the ownership, incompetent managers, excess labour, and weak managerial incentives (Parker, 1995b). To counter the negative effect of the SOEs, many of them were switched to the private sector through the process of privatisation (Ilori, Nasser, Okolofo, & Akarakiri, 2003). Influential factors: following the announcement of privatisation, there might be a strong opposition from politicians, members of the civil society, and general public. They are either ideologically opposed to the privatisation or they may feel uncomfortable for the sale of a nation’s assets (Calabrese, 2008).

4.2. Feasibility study

Following the announcement and before the actual privatisation process starts, governments usually conduct a feasibility study to provide feedback on the possibilities, options, and prerequisites of the sale (Moore, 1986). The feasibility study stage ends with a parliamentary decision to create a privatisation agency and to approve the lists of firms in which all of the equity (or part of it) is to be privatised (Ramanadham, 1994). The influential factors: the choice of which SOEs to privatise depends on certain criteria. Some SOEs are considered strategic firms for national sovereignty and identity, while others are considered economically important (Zahra, Ireland, Cutierrez, & Hitt, 2000). The criteria for selecting the SOEs for privatisation might also include their size and nature. Small, medium, and competitive firms might come first, assuming that they are simple and quick to process, involve little pre-restructuring, and are politically low-risk (Kikeri, Nellis, & Shirley, 1992). The choice of how to privatise the SOEs also depends on the government ideology and objectives (Megginson & Netter, 2001). Governments
may privatise the SOEs through public share offerings either to achieve widespread ownership or to develop the market (Mahoobi, 2003). They may also privatise through employee buyouts either to gain employee support or to reduce the adverse impact on the employee (Gupta, Schiller, & Ma, 1999). Governments may also privatise through mass privatisation either to gain political support based on distributing free vouchers to citizens or to avoid the sale of national assets to foreigners (Shafik, 1996).

4.3. The privatisation process

Once the list of candidates is approved and a regulatory agency is created, the process of privatisation can start (Moore, 1986). It is characterised by three steps a preparation stage during which the market and the firm are restructured, a firm valuation stage, and the last stage in which the firm is sold, i.e. ownership of the firm is changed.

4.3.1. The preparation phase

The process of privatisation often begins with restructuring activities to prepare the SOE and its market for privatisation (Moore, 1986).

Market restructuring: the preparation stage includes a market preparation. It consists of revising the existing laws or setting up new laws related to liberalisation, competition, and regulation (Kayizzi-Mugerwa, 2002). These laws can take the form of a general regulation prohibiting uncompetitive behaviour or specific regulations of pricing and other monopolistic aspects (Guislain, 1992). The influential factors: privatisation is a difficult task, particularly for countries where the institutional infrastructures are underdeveloped, the SOEs dominated all markets, and the corporate governance and law system are weak (Zahra, Ireland, Cutierrez, & Hitt, 2000). This why international donors often support privatisation as one part of an overall government program of exchange rate, fiscal, trade, and price reform.

Firm restructuring: aside from market restructuring, the SOEs themselves are also prepared through restructuring activities defined as a change in motivation and operation towards more productive use (Djankov, 1999). These activities can be categorised into organisational and managerial change, cleaning up debts, and making new investments (Binh, 2003). The influential factors: the lack of qualified, competent managerial leaders to oversee the firm’s transformation can make the process of privatisation more challenging (Zahra, Ireland, Cutierrez, & Hitt, 2000). The lack of budgetary resources to finance the preparation activities may also slow down the pace of the privatisation process (Karatas, 2001). The opposition to the privatisation process continues in the preparation stage to cover issues of labour layoff as an inevitable consequence of the privatisation reduction. This might delay the privatisation, or cause the government to postpone it (Kikeri, Nellis, & Shirley, 1992).

4.3.2. The firm valuation phase

This is an activity that concerns valuing and pricing the firm’s asset (Valentiny, Buck, & Wright, 1992). To derive the market value of the firm, several valuation methods are considered as proxies for contestable market value (Davis, 2002). They include the book value; modified value; replacement cost; net present value; and price-to-earnings ratios
(Buchanan & Bowman, 1990). Influential factors: the valuation methods rely heavily on accounting data and influenced by the techniques used in the restructuring stage. The firm valuation is a particularly difficult task for countries where information is weak, market is small, and comparable firms are few (Kikeri, Nellis, & Shirley, 1992). A number of issues including the size of the SOE and the impact of any regulatory control that goes with privatisation have contributed to this difficulty (Karatas, 2001). It is also difficult because the future income streams also need to be evaluated (Wright & Thompson, 1994).

4.3.3. The privatisation of the firm

This stage involves the decision of divestiture which must be made by governments (Megginson & Netter, 2001). It usually includes activities such as advertising the SOEs ready for privatisation, negotiations with potential buyers, and finally, it ends with signing of the sale by the minister (Fundanga & Mwaba, 1997). The influential factors: the opposition would continue in the sale stage to cover the issue of corruption (Kikeri, Nellis, & Shirley, 1992). Lack of transparency in making specific deals might be the key issue of the decision stage (Kayizzi-Mugerwa, 2002).

4.4. The firm restructuring after privatisation

Following the decision of sale, new privatised firms will be established. These firms might be restructured again after privatisation (Lopez-de-Silanes, 1997). This restructuring involves internal adjustments that influence performance improvement and could be taken in the first few months after the sale (Ramanadham, 1988). The changes include the firm’s goal, labour, management, organisational chart, and the managerial incentives (Ozkaya & Askari, 1999). The influential factors: some of the internal adjustment programs are pursued by the owners and managers because the restructuring before privatisation might not fit their strategy or the government does not carry out an adequate restructuring (Lopez-de-Silanes, 1997). Other restructurings are forced by changes in the market environment (Djankov, 1999). Following privatisation, the firms are no longer financed and protected by the government (Bortolotti, Fantini, & Siniscaloc, 2004). They are, however, subjected to market forces including liberalisation, competition, and regulation (Zahra, Ireland, Cutierrez, & Hitt, 2000). This means that the firms must make a profit to survive; otherwise they will go bankrupt (Megginson, Nash, & van Randenborgh, 1994).

4.5. The firm performance after privatisation

As stated in the introduction, government policies regarding privatisation primarily aim to improve the firm's performance (Megginson, Nash, & van Randenborgh, 1994). The literature review revealed that privatisation is not always successful, and it does not guarantee that the performance will improve. Thus, the firm's performance after privatisation must be measured, and comparisons made between the pre- and post-privatisation periods, in order to assess the impact of privatisation and to determine whether the government's objectives were met.
5. Operationalisation and measurement

In this section the conceptual research model is operationalised, which means that the initial ideas are presented for measurements that can be applied in the real life. It should be realised that privatisation is a very broad process associated with many activities. It is difficult, if not impossible, to study the entire process. For this reason the paper is aimed at exploring the market restructuring stage since the literature reviews highlighted its importance, i.e. to establish institutional infrastructures that are favourable to market exchange. This focus helps to gain a rich understanding and to contribute to the recent debate on privatisation and prerequisite market institutions. The paper also has an explicit focus on the firm restructuring before and after its sale. Accordingly, this section specifies several propositions that can be used as guiding tools for analysing the findings.

5.1. The firm performance before privatisation

Many of the SOEs had generally posted disappointing performances. Although some of them performed very well, many others were particularly inefficient (Guislain, 1997). To counter the negative effect of the SOEs, many of them were switched to the private sector through the privatisation process (Ilori, Nasser, Okolofo, & Akarakiri, 2003). During the development of the conceptual model, a proposition was made that poor performance of the SOE is the main reason for privatisation. Measurement: to assess the performance of SOEs, the criteria profitability, output and operating efficiency should be assessed over several years before privatisation. The profitability is usually calculated by using return on sales: net income to sales (ROS), return on assets: net income to total assets (ROA), and return on equity: net income to equity (ROE). Output is measured by using the real sales: nominal sales adjusted to inflation by using Customer Price Index (CPI). The operating efficiency is calculated by using the sale efficiency, which is real sales per employee (SALEFF), and income efficiency, which is net income per employee (NIEFF) (Megginson, Nash, & van Randenborgh, 1994).

5.2. Feasibility study

The feasibility study looks at performance, aims and, most prominently, external financing limits of the SOEs (Ramanadham, 1988) to determine which SOEs are more likely to be privatised and how (Nellis & Kikeri, 1989). The choice of the SOEs for privatisation depends on their strategic and economic importance as well as on their nature. The choice of privatisation method also depends on the government’s ideology and market development (Zahra, Ireland, Cutierrez, & Hitt, 2000). Measurement: the privatisation database should be analysed. It includes official reports that reveal the initial firm performance evaluated by the government. The database also includes a list of targeted firms that are strategically, economically, and poorly performing firms. The database also reveals the objectives and methods of privatisation that reflect its political economy and, thus, the platform and ideological orientation of the government (Bortolotti, Fantini, & Siniscalco, 2003).
5.3. The privatisation process

As was previously identified, the privatisation process is characterised by three steps: a preparation stage during which the market and the firm are restructured, a firm valuation stage, and the last stage in which the ownership of the firm is changed.

5.3.1. The preparation phase

The market and of the firm restructurings are the two activities that take place during the preparation phase.

*Market restructuring:* restructuring the market is done through three mechanisms: liberalising the market, increasing the competition, and issuing new legislation. Market liberalisation is connected to macroeconomic stabilisation, lowering of tariffs and taxes, deregulation of production, prices, and wages (Khandwalla, 1996). It could broadly bring benefits for the whole economy of the country through access to better technology, input, intermediate goods, and increased competition (Dornbusch, 1992). It is expected that market liberalisation is part of the restructuring activities conducted by the government prior to the sale of the company. Market liberalisation allows foreign investors entry to the market that was previously a state monopoly (Ramamurti, 2000). They are expected to provide the domestic market with capital, technology, managers’ expertise, and an international link (Welch & Frémond, 1998). *Measurement:* the intensity of foreign competition is usually measured with the Trade Openness Index (TOI), deriving from the economic freedom of the world annual report (Gwartney, Lawson, & Easterly, 2006). It reflects the degree to which the government’s policies restrict the freedom to trade with foreigners. Components of the TOI include the prevalence of tariffs, quotas, exchange rate control, and limitations on the international movement of capital (D’Souza, Megginson, & Robert, 2005). Along with TOI, the Economic Freedom Index (EFI) is commonly used to assess the economic freedom of the country (Gwartney, Lawson, & Easterly, 2006). The major determinants of a nation’s EFI are the size of the government, structure of the economy (market vs. central planning), and chances for the exercise of personal choice (D’Souza, Megginson, & Robert, 2005).

Second, competition is seen as a complementary element for the success of the privatisation process because privatisation without the immediate introduction of competition will simply create a private monopoly (Li & Xu, 2004). If the firm does not face direct competition for its products, it is likely to set higher prices and to relate these prices to the intensity of competition and the relative production cost. In a competitive environment, the market rather than the producers themselves controls the price of the product (Smith & Trebilcock, 2001). Increasing competition requires changes in administration, procedure, and controls to liberalise the investment climate and, thus, encourage new private investments to expand further (Behrens, 1996). The introduction of other firms raises the competition and, in turn, the threat of bankruptcy (Hu, Song, & Zhang, 2004). Therefore, competition could affect the privatisation outcome by creating the necessary incentives for privatised firms to make the investments that help to avoid bankruptcy (Boubkri Cosset, & Guedhami, 2005). For the case study, it is expected that market restructuring is associated with increasing competition which is part of the restructuring activities that are conducted by the government before selling the firm.
Measurement: the perceived intensity of competition faced by firms can be measured by using a number of competitors to the firm, evaluated by the firm’s managers, and the potential entry cost for new competitors to compete with the firms. It consists of a number of questions rating the intensity of competition, e.g. the effect of incentives and threat of bankruptcy (Hu, Song, & Zhang, 2004).

Third, where competition cannot be introduced or takes time to develop, regulations must be instituted prior to privatisation. The market regulations must control both the prices and the quality of the output to protect consumers from abuse of a monopoly power (Gibbon, 1996). Meanwhile, the market regulations should encourage efficiency and give investors a chance to earn a reasonable rate of return (Welch & Frémond, 1998). This can be done by revising the laws covering areas such as taxation, bankruptcy, and competition (Kayizzi-Mugerwa, 2002). It can also be done by removing any provisions in laws or regulations creating the monopoly position, preventing or restricting the entry of new businesses into market (Guislain, 1992). Investors are willing to pay more for the firms if the regulatory reform takes place prior to privatisation, as the established regulatory system is expected to prevent the future administrative and legal uncertainty of regulation (Wallsten, 2002). The expectation, which can be checked in the field, is that new legislation is introduced by the government prior to the sale of the company. Measurement: to obtain information on market regulation, privatisation databases should be studied, namely acts, legislation, and regulation reports. The economic orientation of the state (socialist or capitalist) was also considered as proxy for the legal environment (Megginson, Nash, Netter, & Poulsen, 2004).

Firm restructuring: it involves five activities: adjusting the organisational chart, top management replacement, dealing with excess employees, cleaning up debt, and making new investments. The first restructuring activity to prepare the SOEs for privatisation is adjusting their organisational chart to be more reasonable and contain smaller units (Binh, 2003). The SOEs are commonly structured by politician and tend to be associated with a strict hierarchy of accountability and centralisation plans (Parker, 1995b). This means top-down decision-making involving long chains of command (Anderson, 1995). To reduce the centralisation plan and bureaucratic rules, the governments transform large firms into viable and smaller units that may be a better match to specialised bidders (Lopez-de-Silanes, 1997). However, the lack of qualified managerial leaders who can oversee the firm’s transformation can make the process of privatisation more challenging (Zahra, Ireland, Cutierrez, & Hitt, 2000). Adjustment of the organisational chart is expected to be part of the restructuring activities conducted by the government before the sale of the company. Measurement: the organisational chart is considered adjusted if the firm has changed its hierarchy. It is measured by looking at related documents and asking several questions about the organisational chart (Singh, House, & Tucker, 1986).

Second, organisational restructuring might also involve management replacement. The SOEs are run by managers who have a different set of skills than their private counterparts. They were selected for their ability to get along with politicians, not to run the firms efficiently (Barberis, Boycko, Shliefer, & Tsukanova, 1996). To attract private investors and command a higher price, unskilled management might be replaced as part of the firm restructuring (Cuervo & Villalonga, 2000). This involves studying the
experience and qualification of each top management team (Lopez-de-Silanes, 1997).

Replacing top managers is expected to form part of the restructuring activities conducted by the government before the sale of the company. *Measurement:* the management restructuring is considered to have occurred if the firm has replaced its top managers. It is measured by studying the managers’ position before and during privatisation (Barberis, Boycko, Shleifer, & Tsukanova, 1996). Third, restructuring of the SOEs might also involve employee restructuring. The SOEs tend to be overstaffed for social and political reasons as well as pressure from the labour union. For example, creating job opportunities and maximising the probability of re-election (Boycko, Shleifer, & Vishny, 1996). The restructuring of employees is a sensitive issue and generates much heated debate. Excess employees reduce investor interest and invite demands for subsidies to cover their costs. It is, therefore, best for the state to handle the reduction of excess employees prior to privatisation, especially where the employment policies of the state have led to overstaffing (Nellis & Kikeri, 1989). The employee restructuring involves the study of labour scope and size (Lopez-de-Silanes, 1997). However, employee restructuring is likely to incur a large layoff as an inevitable consequence of privatisation, which might delay, or cause the government to postpone, the privatisation (Kikeri, Nellis, & Shirley, 1992). It is expected that the employee base will be reduced as part of the firm restructuring conducted by the government before the sale of the SOE. *Measurement:* the employee reduction is considered to have occurred if the firm has reduced the number of its employees. This is measured by counting the number of employees before and during the privatisation process (Barberis, Boycko, Shleifer, & Tsukanova, 1996).

The fourth firm restructuring activity concerns cleaning up their debt. They often face large financial costs or are in a state of bankruptcy (Lopez-de-Silanes, 1997). They would not be attractive targets with their existing debts and obligations. Cleaning up their debt involves cleaning up the balance sheet by removing the existing debt and cross-liabilities, and deciding on the treatment of state-guaranteed obligations. It may also involve renegotiating an ongoing agreement with banks and other creditors for past-due fiscal debt; setting up a financial system; and preparing a new financial statement in accordance with generally accepted accounting principles (Guislain, 1997). The lack of budgetary resources to finance the contingent liabilities of the SOEs may slow down the privatisation process (Karatas, 2001). The government is expected to remove that debt prior to the sale of the company. *Measurement:* financial restructuring of the SOEs is related to absorbing debt. This is measured by studying internal documents like the balance sheet and any other documents related to liabilities. Questions were also asked, such as whether the firm reduced debt prior to privatisation (Andrews & Dowling, 1998).

Lastly, the final organisational restructuring activity is related to making new investments for the modernisation and improvement of technology (Binh, 2003). The government may upgrade the efficiency of the SOEs prior to privatisation to solve their main problems and improve their performance. This can be done through investigating the age of the machinery and equipment as well as the type of technology used. The governments may also change the investment policies of the SOEs to avoid both shutdowns of firms that supply basic goods and unemployment issues. The investment policies are usually altered via rehabilitation plans, agreements on financial restructuring tied to
improvements in operations, or the temporary re-opening of firms. The government may also decide to de-invest, cutting the flow of resources and cancelling previously approved investment programs (Lopez-de-Silanes, 1997). However, the new investments in rehabilitation and modernisation before the sale can delay the process. In addition, the government often suffers from a lack of money to finance new investments, and there is a little evidence that it recovers the costs of such investments (Kikeri, Nellis, & Shirley, 1992). Even though, it is expected that the government will invest in the modernisation of technology prior to the sale of the company. **Measurement:** making new investments is measured by studying internal documents showing the quality of the machinery and the type of technology used as assessed by the technical valuation undertaken by the financial adviser (Lopez-de-Silanes, 1997).

### 5.4. The firm restructuring after privatisation

The SOEs belong to society as a whole, and no one has a good incentive or responsibility to monitor them for efficiency improvement (Cuong, 2004). They have access to bailout money from the treasury, and the governments have many ways to protect them from bankruptcy. The government may grant them subsidies or soft credit to cover deficits (Yarrow, 1986). With the change of ownership, privatisation replaces disinterested ministers and bureaucrats by shareholders, who have a strong incentive to monitor the firm regarding efficiency improvement. This is because they own equity ownership and bear the financial consequences of their decisions (Boubkri & Cosset, 1998). In addition to the change of ownership, the firms are no longer financed and protected by the government following privatisation (Bortolotti, Fantini, & Siniscaloc, 2004). They are subjected to market forces including market liberalisation, competition, institutional system, and regulation. Market liberalisation allows foreign investors to partner with privatised firms by forming strategic alliances such as joint ventures. These alliances give domestic firms opportunities to learn new skills from their resource-rich foreign partners. Learning new skills is likely to facilitate the domestic firms’ ability to capitalise on market opportunity. Alternatively, domestic firms may license or copy the technological skills of their advanced foreign partners or rivals. The flow of modern technology into domestic firms can fuel experimentation and innovation, leading to higher productivity (Zahra, Ireland, Cutierrez, & Hitt, 2000).

Competition provides incentives and information to the privatised firms. It raises the threat of bankruptcy, which generates strong incentives for both shareholders and managers to avoid this fate (Nickell, 1996). Competition could also facilitate performance comparisons as the performance of rival firms may force managers in other firms to improve their performance (Omran, 2004). This means that firms must make a profit to survive; otherwise they will go bankrupt (Meggison, Nash, & van Randenborgh, 1994). **Measurement:** the change in ownership is measured by considering the type of ownership. It can be individual, employment, domestic, or foreign ownership. Alternatively, the percentage of shares remaining with the government is measured as a proxy for state ownership, and the percentage of shares allocated to private investors is a proxy for private ownership (Oswald & Jahera, 1991; Kocenda & Svejnar, 2003). With regard to the relation between market liberalisation and firm performance, several related questions are asked.
Restructuring after the sale of the company can take similar forms to the restructuring prior to the sale of the company. First, incompetent managers may be replaced. It is possible that managers may be replaced after privatisation as they might not have the required skills to implement the necessary changes (Ramaswamy & Glinow, 2000). Privatisation is expected to change the criteria of selecting managers from political acceptability to market skills (Barberis, Boycko, Shliefer, & Tsukanova, 1996) to employee managers who are capable of facing the new competitive environment and, thus, bringing performance improvements (Ramaswamy & Glinow, 2000). It is expected that incompetent managers are replaced as part of the restructuring by the new owners after the company’s ownership has changed. The management replacement is likely to be contingent on privatisation methods that determine who the new owners are and degree of political interference that remains after privatisation. If insider privatisation is conducted, managers may be motivated to protect their positions; if outsider privatisation is undertaken instead, they are more likely to be replaced (Cuervo & Villalonga, 2000).

Measurement: the management restructuring is considered to have occurred if the firm has replaced its top managers. It is measured by studying the managers’ position before and during privatisation (Barberis, Boycko, Shliefer, & Tsukanova, 1996).

A second internal restructuring that takes place after the sale relates to incentive policies. The SOEs pursue multiple goals, including providing low-price services and goods to low-income groups and job opportunities (Kranton, 1990). The private owners are more likely to focus on profit maximisation to enhance their firm's performance (Cragg & Dyck, 1999). The managers, in both cases, are assumed to depend on their own monetary reward and the level of effort they exert in the job (Kranton, 1990). To align the managers' benefit with that of the owners, a long-term incentive contract can be produced. It encourages the managers to apply the optimal effort on the job and, thus, maximise the owners’ benefit. The contract can take a form of separation of ownership and control and a wage agreement (Shleifer & Vishny, 1997). The ownership of the SOEs is very concentrated in government hands, and managers are treated like bureaucrats and are rarely fired (Yarrow, 1986). Privatisation removes shareholders from the day-to-day operations and gives the managers control of the firm. The control is precisely the authority to determine the aspects of the firm policy (Hansmann, 1996). This is because the managers have better information about the operation costs and their own optimal effort they need to apply on the job, while the owners cannot directly observe these efforts (Kranton, 1990). Thus, the managers’ responsibility for the success of a firm will increase, and they will be treated like entrepreneurial businessmen (Parker, 1991).

An incentive contract can also take the form of a wage agreement (Shleifer & Vishny, 1997). Under state ownership, the salary is typically set at the firm or national wages, which are unrelated to the firm's performance. The managers predict that any likely benefit from their investments will not affect their compensation (Cuervo & Villalonga, 2000). Privatisation links the salary to performance-based measures, which reflect future expectations, and market-based measures, which cannot be manipulated by the managers (Yarrow, 1986). This could provide the managers with better incentives to monitor, motivate, and evaluate their fellow workers. Analogously, an adequate incentive is expected to be paid to the workers for not shirking on the job (Kranton, 1990). It is expected that the new owners and managers of the firm will introduce new incentive
policies. *Measurement:* the change in a firm’s goals is measured by asking questions such as whether a firm has changed its goals and why (Singh, House, & Tucker, 1986). Incentive structures are expected to appear over pre- to post-privatisation either as executive compensation in annual reports or in notes on the balance sheet (Andrews & Dowling, 1998). Questions concern the change that took place after privatisation to improve the firm's performance (Barberis, Boycko, Shliefer, & Tsukanova, 1996). Third, it is expected that changes will be made to the organisational structure. The managers are expected to reduce the centralisation plan, as part of the internal structural adjustment program to ensure faster decision-making (Parker, 1991). Lastly, as part of the firm restructuring after privatisation, management often relies largely on reducing the labor force (Ozkaya & Askari, 1999) to eliminate their contribution to the poor performance of the SOEs (Kranton, 1990). It is therefore expected that the new owners and managers will reduce the labor force and renegotiate the working contract.

5.5. The firm performance after privatisation

A large number of studies have documented significant performance improvements after privatisation, while a few others arrived at the opposite conclusions (Megginson & Sutter, 2006). Because a majority of studies indicate performance improvements, it is expected that the privatised Libyan companies will also show a better performance than before privatisation. *Measurement:* to assess the impact of privatisation on the firm's performance, the return on sales (ROS) and return on assets (ROA) were calculated as profitability ratios over several years. The real sales, the nominal sales adjusted to inflation by using CPI, were also measured as the output indicators over 2005–2007. The two efficiency proxies, namely (SALEFF) and (NIEFF), were also assessed over 2005–2007. The performance of the firms is compared for the SOE three years before the privatisation and the private company three years after the privatisation.

6. Conclusions

This paper reviewed the theoretical and empirical studies in narrative forms to identify dimensions and variables that need to be studied. It categorised the privatisation studies into cross-sectional, time-series analysis and sequencing studies based on the balance empirical evidence presented in each study.

In the early stage of the privatisation a considerable debate has been generated about: whether privatively- or state-owned firms are more efficient. To the extent that numerous of empirical studies focused on the ownership debate and relied on cross-sectional compressions of privatised or private to the state firms. In order to prove or refute the idea that privatively-owned firms are more efficient than state-owned firms. The analysis of cross-sectional studies showed that most of the studies were decisively in favour of privatisation; while a few others have been more sceptical and suggested that such performance improvement maybe related to alternative reforms, such as competition and regulation. However, it is not clear why and how privatisation led to differences in performance, and little progress has been made in describing the separate effects of privatisation, competition and regulation. To investigate further whether privatisation, regulation, and competition resulted in post-privatisation improvements, time-series analysis studies were designed. The majority of these studies indicate that privatisation
alone is insufficient to stimulate performance improvement. This is especially true in countries where the institutional infrastructure for regulation is weak and underdeveloped. This finding, for the establishment of institutional infrastructure, including a competitive industrial structure and an appropriate regulatory system, that is favourable to market exchange before privatisation. The review of sequencing studies suggests that the field still deserves additional research, and findings on some issues are limited and inconclusive. It has drawn attention to the importance of appropriate sequencing within reform programs. It may be expected that the impact of ownership change, competition and regulation in this type of country will be affected by why and how these policies are introduced. This paper contributed to the recent debate on privatisation and its prerequisite restructurings. It developed conceptual model for the privatisation process.

The basic assumption is of this model is that privatisation occurs because of the poor performance of SOEs which led to rising deficits for nations. To improve the SOEs’ performance, and in turn to lessen a nation’s fiscal burden, many of the SOEs were switched to the private sector through the process of privatisation. The poorly performing SOE can therefore be viewed as the input to the process of privatisation. Before the actual process start there will be feasibility study to identify which SOEs should be privatised and how. Following this study, the actual process will start by firm and market restructuring in order to make the SOEs more attractive to the investors. Once the SOEs and the market are restructured, the evaluation activities will start in order to establish market value for SOEs. Once the market value of the SOE candidates is determined, the decision for the SOEs divestiture will be made. This results in a new privatised firm that marks end of the privatisation. However, following the decision of sale, the new privatised firms might be restructured again because re might be the restructuring before privatisation might not fit the new owners’ strategy or maybe the government does not carry out an adequate restructuring. These restructuring can take similar forms to the restructuring prior to the sale of the company. It is not sufficient to view the transfer of ownership from public to private sector as an end in itself. The key is that firm performance after privatisation must be measured and compared to the performance of the SOE in order to find any evidence of performance improvement or decline after privatisation. The model therefore includes another assumption that privatisation will improve the poor performance of the SOEs and also improve a nation’s financial situation.
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