

# **PRIVATIZATION AND THE FINANCING OF ENTERPRISE: A Comparative Overview Of The Evidence**



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# Talk Will Focus On Five Key Corporate Finance Issues For Privatized Firms

- 1. The Financial Structure And Operating Performance Of Privatized Companies**
  - Do Firms Become Financially Stronger & More Productive?
- 2. The Investment Performance Of Share Issue Privatizations**
  - Do Investors Benefit From SIPs In Short And Long-Term?
- 3. Privatization And Corporate Governance**
  - How Does Privatization Change The Ownership And Corporate Governance Structure Of Former-SOEs?
- 4. Privatization And Stock Market Development**
  - Do SIPs Indeed Transform National Stock Markets?
- 5. Privatization And Individual Share Ownership**
  - Do SIPs In Fact Help Create A National “Equity Culture?”

# 1. Do Firms Become Financially Stronger & More Productive?

- **15 Studies Examine Performance Changes After Privatization**
  - Studies Detailed In NYSE Survey Article
  - All But Two Find Significant Performance Improvements
- **Pre- Vs Post-Privatization Studies Use Only SIPs**
  - Only SIPs Generate Post-Issue Financial Reports
  - Severe Limitation Since Small Minority Of Sales
- **8 Single-Country Or Single-Industry Studies**
  - Britain (3), Argentina, Mexico, Russia, Czech Rep
  - Telecommunications, Airlines
- **7 Multi-Country, Multi-Industry Studies**
  - Almost 7,000 Companies From 50+ Countries
- **Focus On Three Multi-Country, Multi-Industry Studies**

# Three Journal Of Finance Studies Yield Directly-Comparable Results

- **Meggison, Nash & van Randenborgh (JF 94), Boubakri & Cosset (JF 98), And D'Souza & Megginson (JF 99) Use Identical Methodology:**
  - Compare Pre- To Post-Privatization Performance
  - Compare Average Values From (+1,+3) to (-3,-1)
  - Use Identical Empirical Proxies
- **But Examine Largely Non-Overlapping Samples**
  - BC Examine LDCs, MNR & DM Mostly OECD
  - Combined Have 211 Firms From 42 Countries

# All Three Studies Show Operating Performance Improvements

- **Profitability (NI/Sales):** Increases From Average 8.6% Before To 12.6% After Privatization, With Over 67% Of Firms Improving. Significant Improvement.
- **Efficiency (Real Sales Per Worker):** Increases From 97% To 116% of Year 0 Level, And 81% Of Firms Improving. Significant Improvement.
- **Output (Real Sales):** Increases From 94% To 177% of Year 0 Levels, And 80% Of Firms Improve. Significant Improvement.

# All Three Studies Show Significant Financial Performance Improvements

- **Leverage (Total Debt/Total Assets):** Falls From 0.48 Before To 0.44 After Privatization, And 67% See Leverage Declines. Significant Improvement.
- **Dividends (Cash Dividends/Sales):** Dividends Rise From 2% To 6.5% of Sales; Over 80% Of Firms Experience Increase. Significant Improvement.

# Only Differences Between Studies: Employment & Capital Spending

- **Capital Investment (Cap Exp/Sales):** Rises In All Three Studies, From 14% To 19% After Privatization, And Over 60% Show Increases, But DM Not Significant. Significant Improvement.
- **Employment (# Employees):** MNR And BC Show Increases; DM Shows Significant Decrease, Overall Average Little Change (286 Worker Increase, From 22,936). Mixed Results, But Little Evidence Of Mass Layoffs.

# How Does Financing Of Corporate Activity Change After Privatization?

- **Little Academic Research On Post-Privatization Financing**
  - D'Souza (98) Dissertation Examined Telco Financing
- **Studies Cited Earlier, Anecdotal Evidence Suggests The Following About Financial Policies Of Privatized Firms:**
  - They Rarely Execute Primary (Capital-Raising) Share Offers
  - They Rely Mostly On Retained Earnings To Finance Increased Capital Investment Spending, Sales Growth
  - Outside Of U.K., Little Use On Bond Markets--Yet
  - Often Tap Syndicated (Bank) Loan Market, Especially For Takeovers
- **In Sum, They Begin to Resemble Their Private-Sector Counterparts**

## 2. Do Investors Benefit From Share Issue Privatizations In The Short And Long-Term?

- **Academic Research Shows Consistent International Pattern For Private-Sector IPOs and SEOs:**
  - Significantly Positive Initial Returns for IPOs (15-40%), Generally Insignificant Returns For SEOs
  - Significantly Negative Long-Term Returns For IPOs & SEOs
- **A Few Studies Have Examined Short And Long-Term Returns For Investors In SIPs:**
  - Find Generally Positive Initial Returns, But For Different Reason Than Private-Sector Offers
  - Also Find That SIPs Have Highly Politicized Offer Terms
  - Find Significantly **Positive** Long-Term (3-5 Year) Returns

# **Empirical Studies Of Pricing & Share Allocation Terms In SIPs**

- **Levis (FM 93)**
- **Perotti & Guney (FM 93)**
- **Menyah, Paudyal & Inganyete (JEB 95)**
- **Menyah & Paudyal (1996)**
- **Dewenter & Malatesta (JF 97)**
- **Huang (WP 97)**
- **Boubakri & Cosset (WP 99)**
- **Jones, Megginson, Nash & Netter (JFE 99)**
  - Examine 630 SIPs From 59 Countries, 1977-97

# How Politicized Are Pricing & Share Allocation Terms In SIPs?

- **Jones, Megginson, Nash & Netter (JFE 99) Test Perotti (AER 95), Biais & Perotti (WP 97) Models:**
  - Find SIPs Significantly & Deliberately Underpriced
  - Govts Almost Always Choose Fixed Price Offers
  - Allocate Shares To Citizens, SOE Employees
  - Govts Almost Never Sell 100%, Rarely Sell Control
  - Often Have Control Restrictions (“Golden Share”)
  - IR Directly Related To % Capital Offered, Gini Coeff
  - IR Negatively Related To Govt’s “Populism”
  - IR Not Significantly Related To Firm Size (Not AI)

# Average Pricing, Share & Control Allocation Terms In SIPs

| <b>Variable</b>         | <b>Initial SIPs</b> | <b>Seasoned SIPs</b> |
|-------------------------|---------------------|----------------------|
| Issue Size, \$US mm     | 555.7               | 1,068.9              |
| Initial Return, %       | 34.1                | 9.4                  |
| % Offer At Fixed Price  | 85.0                | 61.0                 |
| Gross Spread, %         | 4.4                 | 2.5                  |
| % w/Employ Allocation   | 91.0                | 65.8                 |
| Employee Allocation %   | 8.5                 | 4.8                  |
| % Of Capital Sold       | 43.9                | 22.7                 |
| % w/Control Restriction | 93 (UK)             | 76 (Non-UK)          |

# Have Investors Benefited From Privatization In The Long Term?

- **Studies Documenting Insignificant Or Negative Long-Run Return To Investors In SIPs:**
  - Aggarwal, Leal & Hernandez (FM 93)
  - Davidson & Rosgen (MS 96)
  - Huang (WP 97)
- **Studies Documenting Positive L-R Returns:**
  - Boardman & Laurin (WP 96)
  - Davidson, Rosgen & Simon (MS 97)
  - Dewenter & Malatesta (WP 98)
  - Perotti & Oijen (JIMF 99)
  - Boubakri & Cosset (WP 99)
  - Megginson, Nash, Netter & Schwartz (FM 99)

# **SIPs Have Out-Performed Reference P/Fs Over 1,3 & 5 Years**

- **Meggison, Nash, Netter & Schwartz (FM 99) Study L-R Returns For 201 IPOs & 63 SEOs From 36 Countries, 1981-97:**
  - Compute 1,3 & 5-Yr HPR In \$ And Local Currency
  - Compare HPR To Local, World & US Market Index
  - Also Compute Matching-Firm Returns Based On Currency, Size And Industry
  - Test Significance Of Net Returns, WR, % Positive
  - Document Significantly Positive LRR For IPOs (9-13% For 1-Year, 7-18% For 3-Year, 35-55% For 5-Year HPR)
  - Find Insignificant LRR For Seasoned Issues
- **Boubakri & Cosset (WP 99) Find Similar Results For 120 SIPs From 26 Developing Countries, 1982-95**
  - Abnormal 3-Year HPR vs Control Firms: 46.5%

### **3. How Does Privatization Change A Firm's Ownership & Governance Structure?**

- **Hard To Imagine A More Profound Change Than From SOE**
  - Firm's Objective Function Dramatically Changes, As Does Transparency, Accountability Of Decision-Making Process
- **Must Submit Financial Reports, Answer To Shareholders**
  - Employees, Institutions, Foreigners All Become Owners
  - Shirley (WD 94): Employees Benefit w/o Majority Ownership
  - Institutions Becoming Very Important--Especially In France
- **Even When Governments Retain Majority Ownership Or Golden Shares, They Rarely Intervene Day-To-Day**
  - Govts That Try (France, China) Rudely Treated By Investors
  - U.K. Govt Has Used Golden Shares Only Twice
  - No Study Of Impact Of Govt Retained Share On Performance
- **Dyck (Rand 99): Privatized UK Firms Adopt Management Compensation Policies Of Private Sector**

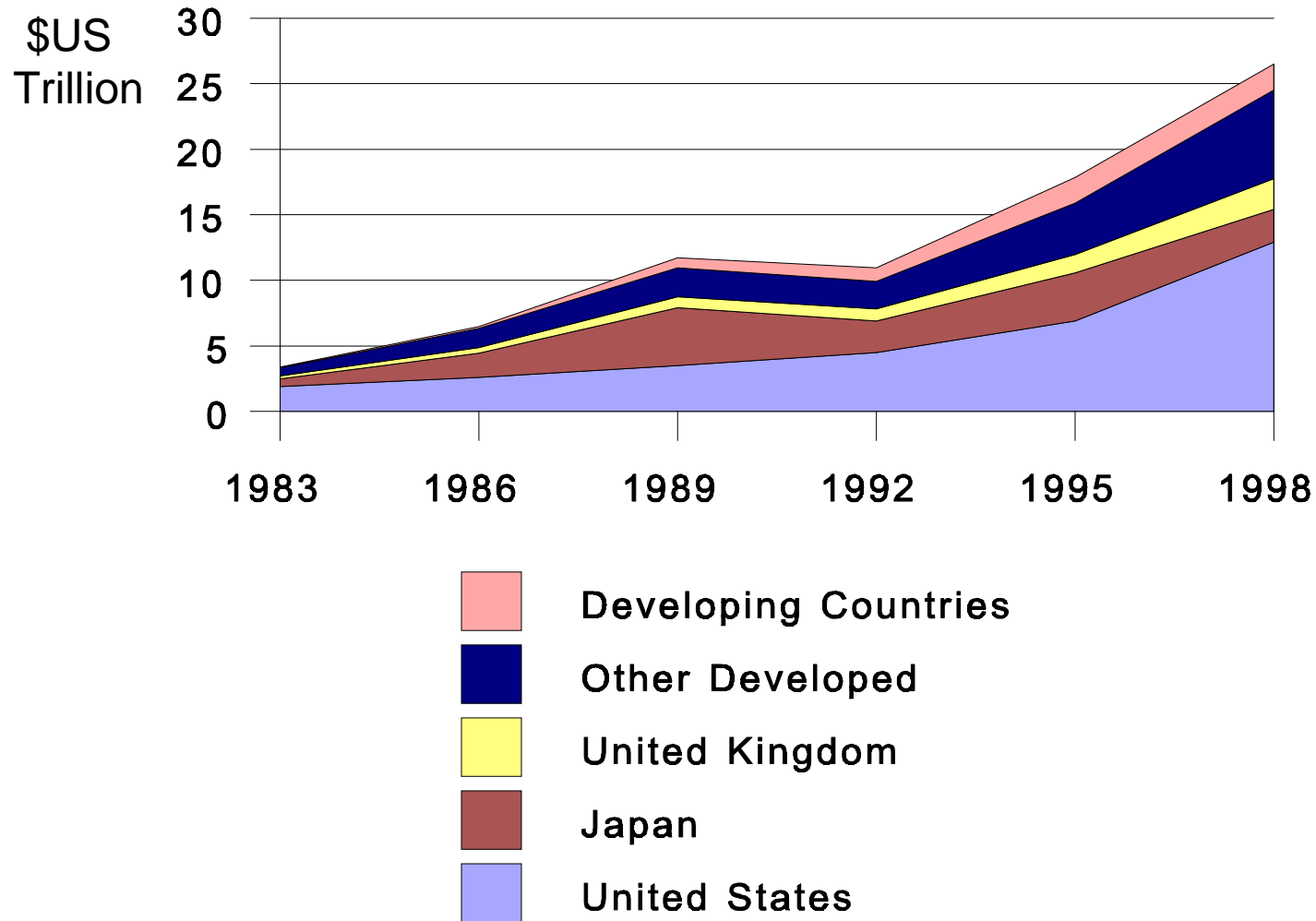
# Do Privatized Firms Engage In Takeovers?

- **Until Recently (1998), Privatized Firms Differed From Private-Sector Counterparts In Two Visible Aspects:**
  - Never Went Bankrupt & (Almost) Never Engaged In T/Os
  - Exceptions: Telcos, Banking, Spanish Firms In Latin America, UK Utilities
- **Still Don't Go Bankrupt, But Have Become Active Acquirers**
  - Telcos, Banking T/Os In CEE Has Accelerated Dramatically
  - Petroleum Industry: BP/Amoco, Total/Fina, Repsol/YPF, TotalFina/Elf, Statoil (Norway)
  - Previously Unthinkable Mergers In EU: Olivetti/Telecom Italia, "SBP" In France, Deutsche Telekom With Anybody, Generali/INA, Pechiney/Alcan
- **EU M&A Market Approaching US Size For The First Time**

## **4. Do Privatizations Indeed Transform National Stock Markets?**

- **Recent Stream Of Academic Literature Documents Pivotal Role Of Capital Markets In Promoting Economic Growth**
  - Levine (JEL 97), LaPorta, et al (JF 97, JPE 98)
- **Development Of Capital Markets Typically A Key Objective For Privatization Programs (Especially SIPs)**
  - Also Try To Develop “National Champion” Investment Banks
  - Liquid Markets Critical For Shift To Funded Pension System
- **Perotti & Oijens (JIMF 99) Show Privatization Promotes Market Development**
  - Henry (JF 99) Finds Liberalization Also Beneficial
- **Meggison & Netter (NYSE 99), Boutchkova & Megginson (WP 99) Document Impact Of SIPs On Markets & IB Industry**

# Fantastic Recent Growth of Finance: World Stock Market Capitalization, 1983-98



# **Privatization's Impact on Stock Market Capitalization**

- **Total World Market Cap Has Risen From \$3.38 Trillion In 1983 To \$26.5 Trillion In 1998(Sevenfold Increase)**
  - Market Cap Of SIPs Rose From <\$50 Billion To \$2.44 Trillion
- **84 of 1999 Business Week Global 1000 Are SIPs**
  - SIPs Are 10% Of Total, 21% Of Non-US Market Cap
- **49 of BW Top 200 Emerging Markets Firms SIPs**
  - Five Largest--And 7 Of 8 Largest--Firms All SIPs
- **Under-states True Importance Of SIPs**
  - Play Very Important “Bellweather” Role
- **SIPs Usually A (Non-US) Country's Largest Cap Firm**

## **Market Value & Market Capitalization of Privatized Firms (BW Global 1000)**

| <b>Company</b>   | <b>Country</b> | <b>Mkt Cap</b> |
|------------------|----------------|----------------|
| BP Amoco         | United Kingdom | 173,870        |
| NT & T           | Japan          | 156,770        |
| Deutsche Telekom | Germany        | 115,023        |
| British Telecom  | United Kingdom | 107,142        |
| NTT DoCoMo       | Japan          | 106,140        |
| France Telecom   | France         | 79,925         |
| Telecom Italia   | Italy          | 66,446         |
| Telstra          | Australia      | 63,890         |
| Telefonica       | Spain          | 51,150         |

## **SIPs Often The First, Second, And/Or Third Most Valuable In A Nation's Stock Market**

| <b>Country</b>  | <b>Largest</b> | <b>Second</b> | <b>Third</b> |
|-----------------|----------------|---------------|--------------|
| Australia (17)  | X              |               | X            |
| Britain (108)   | X              | X             |              |
| Denmark (5)     | X              |               |              |
| France (45)     | X              |               |              |
| Germany (36)    | X              |               |              |
| Italy (23)      | X              | X             | X            |
| Japan (135)     | X              | X             |              |
| New Zealand (1) | X              |               |              |
| Portugal (3)    | X              | X             | X            |
| Singapore (8)   | X              | X             |              |
| Spain (10)      | X              |               |              |

# Privatizations As Equity Issues

- **21 Largest Share Offerings Are All SIPs**
  - 36 Of 41 Largest Are SIPs
- **31 SIPs Larger Than \$4.4 bn Conoco IPO (Oct 98)**
- **700+ SIPs Have Raised > \$650 bn Since 1977**
- **125 SIPs Have Raised More Than \$1 bn**
- **Differences From Private-Sector Issues:**
  - Typically Pure Secondary Offerings
  - Highly Politicized Offer Terms & Share Allocations
- **SIPs Almost Always Nation's Largest Share Issue**

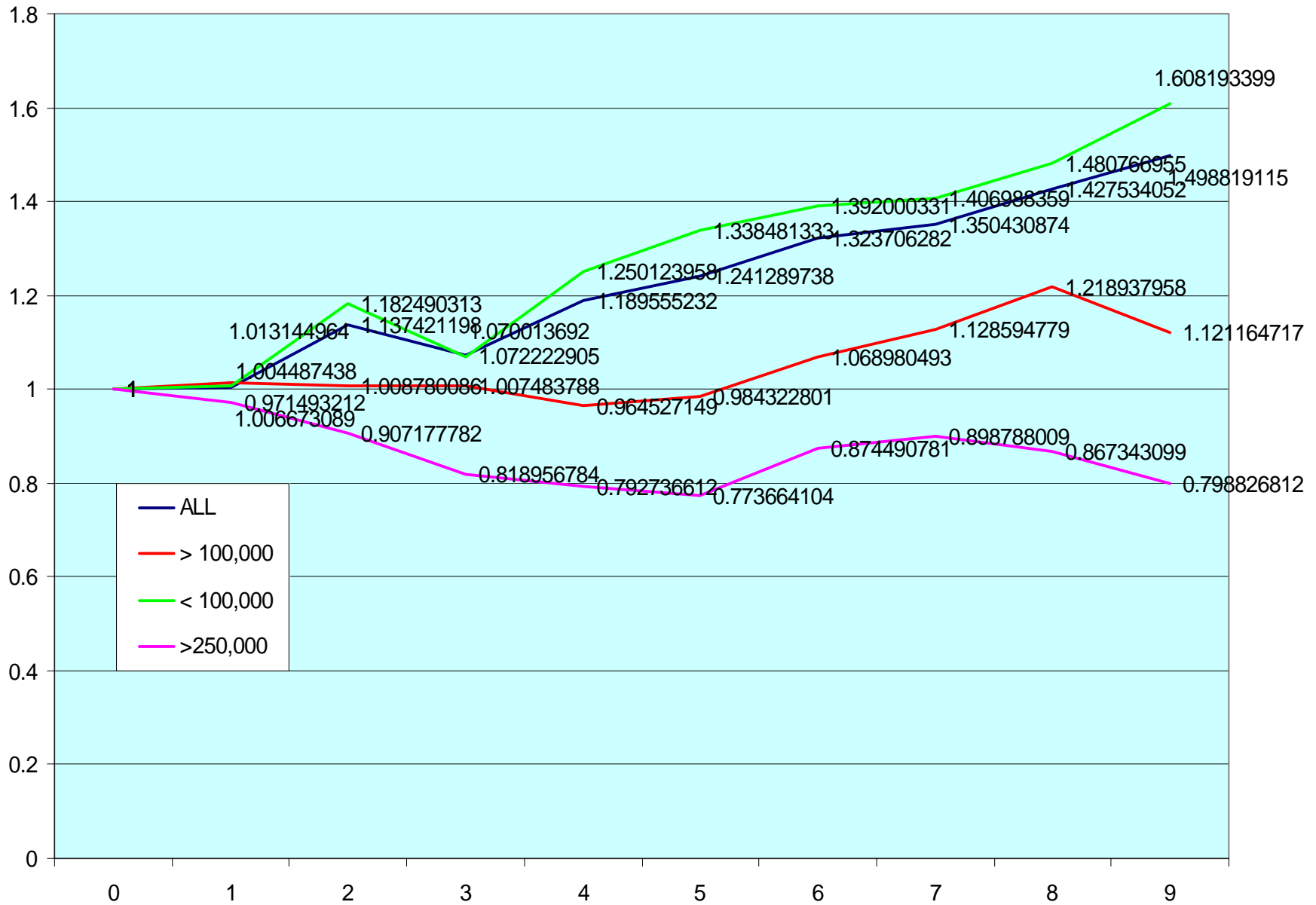
## **The Largest Share Offerings In Financial History Are All SIPs**

|               |                               |                  |
|---------------|-------------------------------|------------------|
| <b>Nov 87</b> | <b>Nippon Tel &amp; Tel</b>   | <b>\$40.3 bn</b> |
| <b>Oct 88</b> | <b>Nippon Tel &amp; Tel</b>   | <b>22.4</b>      |
| <b>Oct 98</b> | <b>NTT DoCoMo *</b>           | <b>18.4</b>      |
| <b>Oct 97</b> | <b>Telecom Italia</b>         | <b>15.5</b>      |
| <b>Feb 87</b> | <b>Nippon Tel &amp; Tel *</b> | <b>15.1</b>      |
| <b>Nov 96</b> | <b>Deutsche Telekom *</b>     | <b>13.3</b>      |
| <b>Oct 87</b> | <b>British Petroleum</b>      | <b>12.4</b>      |
| <b>Nov 97</b> | <b>Telstra *</b>              | <b>10.5</b>      |
| <b>Nov 98</b> | <b>France Telecom</b>         | <b>10.5</b>      |

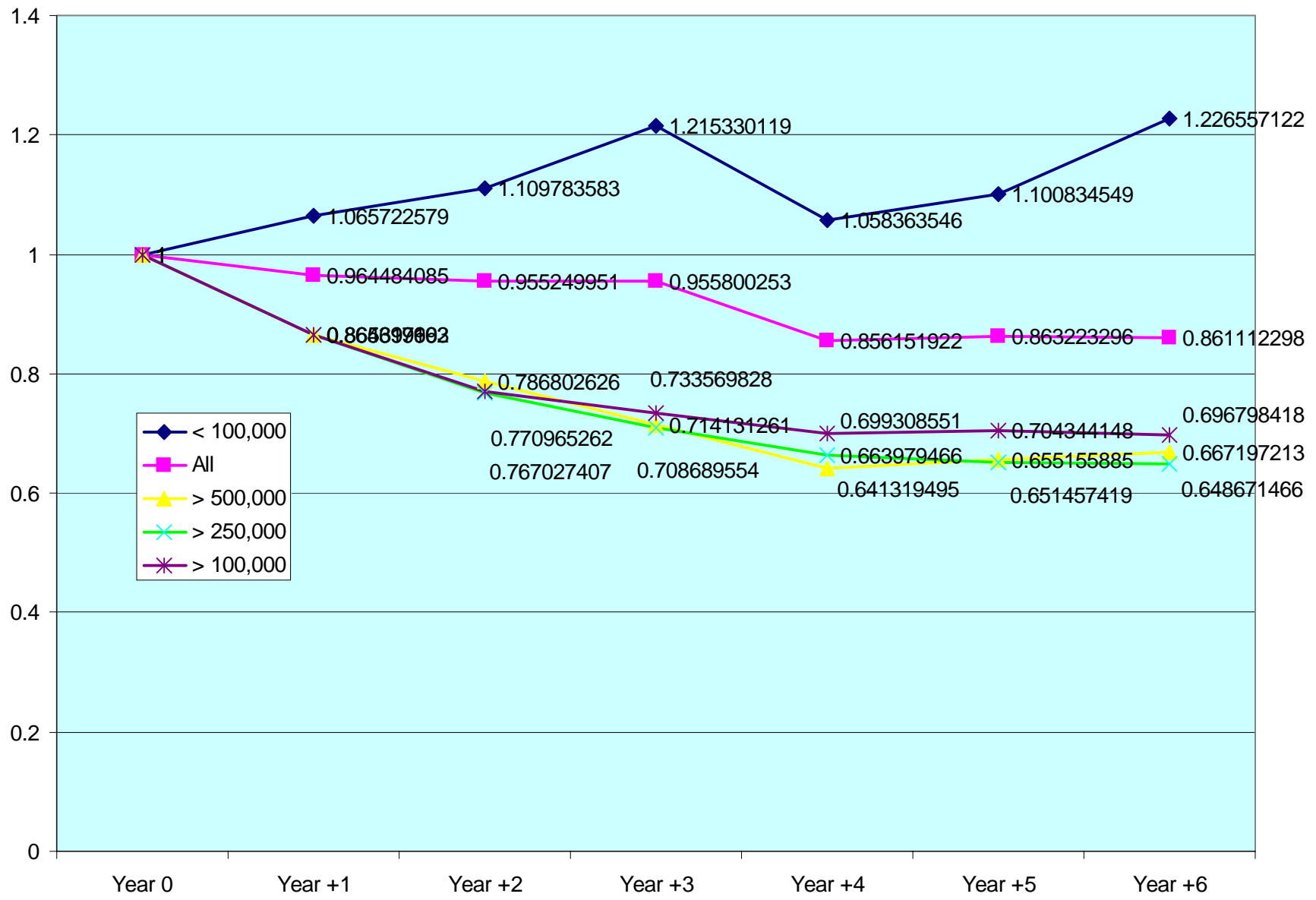
## **5. Share Issue Privatization And Individual Stock Ownership**

- **Most Governments Explicitly Try To Create “Equity Culture”**
  - Design Offer Terms To Maximize Number Of Individual S/Hs
- **Large SIPs Frequently Create 1 Million+ Shareholders**
  - France Telecom 3.9 Mn, Deutsche Telecom 3 Mn, Credit Lyonnais 3.4 Mn, Telecom Italia 2 Mn+, Endesa 2 Mn+
  - Many Of These New S/Hs Own Shares In Only One Company
- **Boutchkova & Megginson (WP 99) Compare Number Of S/Hs In SIPs To Those In Private Firms With Closest Mkt Cap**
  - Use WorldScope Disclosure: 6,400 Firms With No. Of S/Hs
  - Number Of S/Hs Highly Skewed: <2% Of All Companies Have Over 250,000 S/Hs; 915 Have Fewer Than 50,000
  - 55 Of 89 Non-U.S. Firms With 500,000+ S/Hs Are SIPs
  - SIPs Have Significantly Larger # Of S/Hs Than Private Firms
- **Key Study Finding: Large Numbers Of S/Hs Are Not Stable**
  - Firms With 250,000+ Initial S/Hs Decline By 20% In 6 Years

Number of shareholders of non-privatized companies over a 9 year period



Number of shareholders for different subgroups of privatized firms and the whole sample



# CONCLUSION

- **Privatization Has Been The Most Important Innovation In Corporate Finance, Outside The United States, During The Last Half Of The 20th Century**