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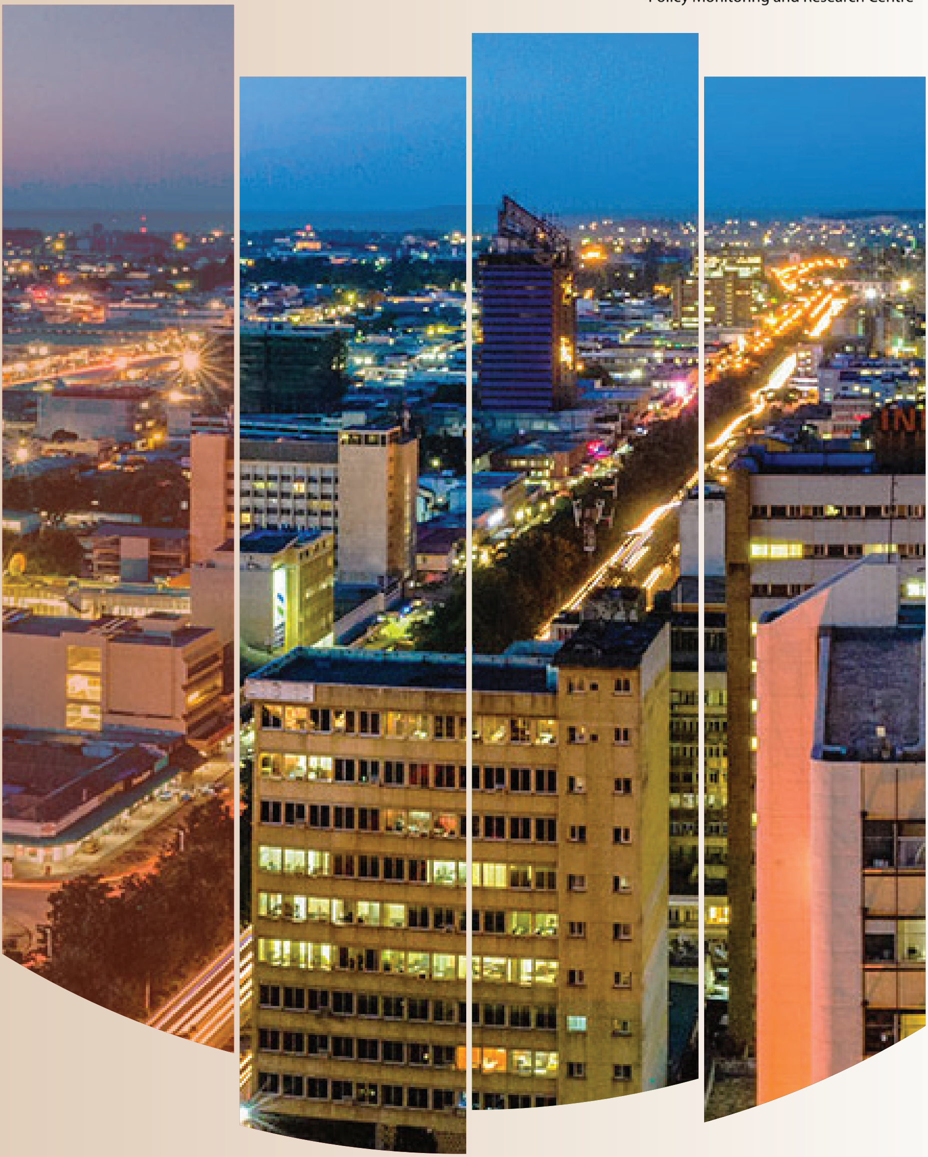

PERFORMANCE OF STATE OWNED ENTERPRISES AND PRIVATIZATION IN ZAMBIA - GETTING THE RIGHT TOOLS

POLICY BRIEF

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INTRODUCTION

Since Zambia's Independence in 1964, we have witnessed a transformation in Zambia's development policy and law, with growing emphasis on private sector led commerce and trade supported by the state and its institutions of governance. With this trend increasingly becoming more prominent, privatization has become a bedrock of 'market oriented' policy reform that has spurred private sector wealth creation, entrepreneurship and rapid economic development.

Privatization is a transaction or series of transactions by which Governments sell off all or part of its shares in a state-owned asset. The programme of state enterprise privatisation pursued by the Zambian Government since 1992 has been subject to a number of conflicting evaluations. For some it is a model programme which stands as a successful example in Africa, while for others is a flawed example characterized by corrupt acquisition of assets by those directly or indirectly linked with state power.

BACKGROUND

1966 - 1974

- Zambia's State Enterprise Sector was set up primarily in its first decade of independence **(1964 to 1974).**
- Characterized with a mono-economy based on the production and export of copper, the United National Independence Party (UNIP) Government, led by President Kenneth Kaunda, pursued a policy of import substitution industrialization.
- The state played a direct role in implementing this strategy and entered into joint ventures with foreign corporations to establish a range of new industries.

1968 - 1972

- Between **1968 and 1972**, Zambia enacted a programme of nationalization, acquiring a controlling interest in many of the most important private sector enterprises, including the copper mining companies. By the mid-1970s, most of the main enterprises in the economy were under state ownership and were held within a hierarchy of state holding companies, at the summit of which was the Zambia Industrial and Mining Corporation (ZIMCO).
- The performance of the state enterprise sector over the subsequent one and a half decades proved to be disappointing as it fell into a malaise of low profitability, under- investment and high indebtedness.
- Other challenges included the decline in copper prices.

1980s

- In the **80s** the Zambian Government worked with the World Bank and other donors to revitalise the state enterprise sector with little success.
- At the end of the 1980s, the Zambian Government came under increasing pressure from the International Monetary Fund (IMF), World Bank and donors to pursue an orthodox structural adjustment programme in which privatisation was a key component.

1990

- Zambian Government in **1990** was constrained to privatise due to elections despite agreeing to principle of privatization.

1991

- After **1991** elections implementation of liberalisation was swift and by 1993 the Government had removed all controls on prices, interest rates, foreign exchange and foreign currency allocations. Trade policy was liberalised and subsidies were removed from many sectors.

Table 1: Privatization Programme 1992-2000

Size of SOE	Number of SOEs in Original Portfolio	Number of SOEs Privatised	Number of SOEs owned by State
Size Unclassified	9	1	8
Large Enterprises	27	19	8
Medium Enterprises	27	24	3
Small Enterprises	81	69	12
Total	**144**	**113**	**31**

Source: Industrial Development Corporation (IDC)

ZAMBIA'S CURRENT CONTEXT

Despite efforts to recapitalise well-performing State-Owned Enterprises (SOEs) and hive off non-performing ones, progress has been slow which has resulted in further fiscal constraints for the Government and poor service delivery. **The Industrial Development Corporation was established to create and maximise long term shareholder value as an active investor, and superintend over SOEs with the objectives to;**

- Reposition all SOEs through improved management, financial viability and sustainability and bring loss-making entities to profitability;
- Catalyze private sector investment by co-investing with the private sector in low appetite and high capital demand business ventures; and
- Identify and undertake high risk investments that add value to the country's natural resources.

SUMMARY OF SOE PERFORMANCE

Below is a breakdown of performance of SOEs under IDC

Description	2016	2018	Change
Loss Making	25	17	8
Profitable	8	15	7
Dividend Declaring	1	9	8
Technically Insolvent	8	4	4
Receiving Government Grants	3	3	0

Source: Industrial Development Corporation (IDC)

A number of SOEs paying dividends moved from 0 in 2014 to 8 in 2018 with a total amount of ZMW 164,615,000. In the next 3-7 years, IDC is focused on recapitalizing and repositioning the existing portfolio of SOEs for public listing on the Lusaka Stock Exchange.

Zero SOEs Paid Dividends In 2014 compared to 8 In 2018

ZMW 164,615,000

3-7 years

iDC Industrial Development Corporation

Focused on recapitalizing & repositioning the existing portfolio of SOEs for public listing on the Lusaka Stock Exchange.

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THE CASE FOR AND AGAINST PRIVATISATION

There are a number of reasons why Government may want to consider privatising assets in the current economic circumstances. **Strategic privatisation can help to relieve pressure on Government finances by removing non-performing assets from the balance sheet, reducing the Government subsidy bill and crowding in much needed investment for recapitalisation into profit-making State-Owned Enterprises (SOEs).** This will have additional longer-term benefits of efficiency, productivity growth, job creation and increasing the corporate tax base.

In the short term, selling assets may be something Government should consider doing to unlock liquidity, e.g. for repaying the upcoming bullet payments on the Eurobonds, or as part of a bailout or loan recovery in the case of default.

Planned privatisation is likely to be more favourable towards Government's longer-term benefits. More structured privatisation process can help to mitigate some of the negative impacts of privatisation, such as job losses and the delivery and affordability of public services.

The following factors should be taken into consideration before Government embarks on the privatization programme:

- **Government finances:** what are the short and long-term consequences for public finances? Privatisation may raise much-needed cash, but potential revenue streams are lost forever.
- **Performance:** privatisation has been proved to increase organisational efficiency and productivity, and removing state monopolies can increase competition and growth in a sector.
- **Jobs:** privatisation might lead to immediate job losses if the workforce is bloated and/or unproductive which will have an impact on poverty and welfare. However, the impact on net jobs could be positive if privatisation unlocks growth.
- **Public services and utilities:** if considering the privatisation of public services or utilities, will this improve delivery? And if so, at what cost to the consumer?

SETTING THE FRAMEWORK FOR PRIVATISATION

Regulatory framework

The general legal and regulatory framework for privatization should adhere to the following principles:

1. Market structure should be considered before privatization. If a state enterprise is dominant in any sector, either the enterprise should be broken-up before sale or restrictions on new entry should be removed or minimized. Any monopoly rights granted to a privatized enterprise should be time-bound and phased out as quickly as possible. In the trade-able sectors, the reduction or removal of tariff barriers will foster competition from imports. The review of market structure should also identify special privileges such as preferential access to credit to be abolished once the enterprise has been sold.
2. For enterprises in the utilities sectors, the regulatory regimes to be responsible for tariff policy, service standards and new entry and the regulatory agencies required to implement those policies should be created or defined eg. the Energy Regulation Board (ERB), National Water and Sanitation Council (NWASCO) in the Zambian Energy and Water Supply Sectors respectively.
3. In cases where the government retains a minority shareholding, it should not be entitled to any special or extraordinary voting or control rights, except in the case of "strategic" enterprises such as national airlines, where a golden share could be retained. Such a golden share could permit the Government to veto the resale of a controlling interest if that would not be in the interests of the country.
4. Domestic and foreign investors should have the same rights to participate in the privatization process. The Government may however decide, as an exception, to reserve a tranche of shares for domestic investors only.

PRACTICAL CONSIDERATIONS

The principal methods of privatization through competitive bidding are the sale of assets or shares through public auction or tender, and the public offering of shares through a stock exchange. **Except in the case of pre-existing contractual rights such as pre-emptive options to purchase held by existing private shareholders, a direct negotiated sale to a single buyer should be avoided.**

PUBLIC AUCTION AND PUBLIC TENDER

Public auctions are used to sell individual assets, and more rarely parcels of shares or a business as a going concern. The items to be sold are advertised along with the location of the auction. The terms and conditions of sale are fixed and require that the items to be auctioned are sold to the highest bidder.

A public tender is suitable for the sale of larger or more complex businesses where there is not likely to be wide public participation. The availability of the enterprise for sale will be advertised and interested parties may be pre-qualified if the seller wishes to establish in advance their financial capacity or to review their operational or investment plans.

The general principles for a public tendering process are:

a. The tender notice should be widely publicized and should provide summary information on the assets, should fix the date of bidding and should invite prospective bidders to obtain the tender document;

b. Interested parties who request the tender document should have the opportunity to **carry out a due diligence evaluation of the enterprise and for that purpose should be permitted to inspect the books of accounts, examine the physical assets and interview senior management.** To preserve confidentiality, prospective bidders can be required to sign an undertaking not to disclose or to use sensitive commercial information, and may be asked to post a bond in support of that undertaking;

c. Bids should be sought on a cash basis, accompanied by a deposit;

d. Bids should remain valid for a period after the closing date to allow careful evaluation and possible negotiation with the top bidder; and

e. The privatization agency should have the right to reject any bids which do not conform to the general bidding guidelines, or to reject all bids if none are adequate.

PUBLIC OFFERING OF SHARES

A public offering of shares requires as complete a disclosure as possible of relevant financial and business information concerning the assets and liabilities of the enterprise, its profitability history, business activities and future prospects. This disclosure should be in the form of an offering document or prospectus containing a description of the new shares and the terms on which they will be allocated.

The offering document is prepared by the management of the enterprise and approved by the board of directors. It is then registered with the relevant capital markets authority and is a public document open to inspection. Since investors will take up shares in reliance on the offering document, the responsibility for any errors or omissions in the document should rest with the board of directors which approved its issue.

ALLOCATION OF PROCEEDS

When Government assets are sold, the laws governing public finance proceeds may determine how the sales proceeds are to be dealt with. If the existing laws do not do so, the privatization law itself should specify that proceeds should be applied:

STEPS

- **First,** to meet the costs of sale, which may include a fixed percentage of the proceeds as a contribution to the operating costs of the privatization agency;
- **Second,** towards liabilities of the enterprise retained by the state;
- **Third,** towards outlays which benefit the economy at large or large segments of the population.

Since the restructuring of enterprises for privatization can frequently lead to one-time labour costs for the severance and retraining of redundant labor, a fixed proportion of the amounts remaining after payment of sale costs and enterprise liabilities may be applied to a special fund set up for this purpose.

CASE STUDIES

While there appears to be mixed reactions on Zambia's privatization programme, a World Bank assessment carried out at the time by Oliver Campbell White and Anita Bhatia (1998) examined the privatization programmes in ten sub-Saharan Africa countries and deemed Zambia to have outperformed other countries. **Zambia scored high on indicators of process that included Government commitment, programme design and management, transparency of procedures and efforts to broaden ownership.** Indicators of result showed high scores on extent of privatization and financial impact of Government and medium scores on foreign direct investment generated and post-privatisation performance of enterprises. **The institutional arrangements for privatization that included programme design and management; transparency; Government commitment; and broadening ownership are heralded as the main reasons for success and as a model for other countries.** In particular, a key success factor was the creation of a single privatization agency with legislative authority and procedures to ensure transparency and accountability and Government's willingness to address obstacles to implementation.

Lessons Learned

Zambia's privatization programme, however, was largely criticized for not benefiting Zambian citizens but rather benefiting leaders of the ruling party at the time. The Government was criticized for not considering measures to mitigate the effects of job losses and poverty impacts. The arrangements for accountability, transparency and independent oversight which were outlined in the Privatisation Act were not adhered to and implemented. According to the Post Newspaper, 1st December 1997 a parliamentary committee observed that some board seats of the Zambia Privatisation Agency (ZPA) reserved for churches, Bankers Association of Zambia and Law Association of Zambia remained vacant for a period of more than two years while some board members who had been removed for contravening ZPA regulations had been reinstated. There was further controversy with the acquisition of enterprises by members of the Government and the ruling party that raised questions on provisions of transparency. While the law did not explicitly bar any political leader from acquiring State Owned Enterprises this needed to be disclosed through explicit intentions to bid for these enterprises. This evidence and subsequent repossession of enterprises not fully paid for seems to counter the argument raised by Campbell and Bhatia (1998) that Zambia had a widely transparent process. Before the privatization process ZIMCO supervised SOEs and following it's liquidation in 1995 this function was vested in the Ministry of Finance which acted as the agent for the liquidator. This arrangement posed challenges and added to the complexity of supervision by raising costs and concerns of asset stripping by enterprise managers.

RECOMMENDATIONS

Government still has about 32 State-Owned Enterprises (SOEs) on its books under the IDC, 17 of which are loss making and draining Government finances. Of the 15 profitable SOEs under IDC, some of these may be attractive to the private sector, who will be willing to invest and grow the sector – something that the Government is not in the position to do right now. Zambia's economy is struggling: growth is low, investment is falling and unemployment is rising, opening state monopolies to private sector participation could help to stimulation growth. In this context, we make the following recommendations:

- Government should evaluate its portfolio of state-owned assets and enterprises, and develop a privatisation strategy that benefits the public whilst promoting private-sector led economic growth.
- Government should hive-off companies which do not have a sound business case because these pose a fiscal burden on the treasury, with the exception of those that provide critical public goods and services that can not be delivered by the private sector, e.g. Medical Stores Limited and Engineering Services Corporation.
- Government should list profitable companies on the Lusaka Stock Exchange to raise new capital and facilitate citizen ownership through established legislation and institutional mechanisms. **This should be conducted in an open and transparent process that ensures public scrutiny and adherence to the laws. This also will ensure that new capital, technology and skills are invested in these companies.**
- **Government should restructure State Owned Enterprises with strong orientation towards commercialization and transparency in their operations.** Boards of these institutions must be constituted on merit and ability to supervise these companies.
- Government should implement effective monitoring and evaluation mechanisms that target **financial performance,** governance and **risk mitigation** through periodic reporting to ensure corrective measures are continuously implemented.
- Government should implement performance frameworks and provide regular updates on the progress of companies' management teams. These should include **compliance on statutory obligations, financial performance, implementation of cost benefit measures through analysis, institutional growth in the market, innovation towards job creation across sector value chains and payment of dividends.**
- Government should develop a reward system that **promotes excellence and performance of State-Owned Enterprises.**

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Unlocking Zambia's Potential

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