Privatization as a vehicle for promoting capital market development and financial inclusion

Privatization is the process of transferring ownership of a business, enterprise, agency, public service, or public property from the public sector (a government) to the private sector.

There are varieties of methods or approaches that may be opted to sale state-owned enterprises. The choice of privatisation method depends on the government's privatization policy objectives, the market environment and the characteristics and size of the company that is being sold. The key methods for privatization are: (a) public share offerings on the stock market; (b) trade or private sales; (c) employee and management buyouts; (d) mixed sales (combination of the above). Choice of sale method is influenced by the capital market, political, and companies-specific factors. Public offering through the stock market can used to broaden and deepen domestic capital markets, boosting liquidity and (potentially) economic growth, but in cases where the capital markets are insufficiently developed it may be difficult to find enough retail and institutional investors (buyers), and transaction costs (and in some cases under pricing) cases may be higher.

Typically, ***public share offerings have been the predominant method of privatization,*** the vast majority of privatisation proceeds in most developed countries have been through public offering of shares on the stock market. This has particularly been the case in the larger economies such as the UK, Italy, France and Germany, reflecting the size of assets sold and the explicit or implicit policy objective of deepening and widening equity markets. For example, public share offering have accounted for close to 90% of the Italian privatization proceeds from 1992 when the programme started. In some cases trade sales have been the preferred approach, partly due to the absence of a well-developed financial and legal infrastructure, and partly as a consequence of the policy objective of improving efficiency by means of providing companies with strong management transition to a market economy has contributed to the adoption of this approach.

In some countries (and some cases) governments has used trade sales in order to gain access to new technologies and know-how, to benefit from the flexibility that this method of sale offers, in that it enables the government to include social packages for the employees (guarantee of employment), and to obtain commitments for investments in the environment and development of the enterprise as part of the sale.

For many developed countries, capital market development, in particular the deepening and widening of equity markets, has been an explicit or implicit privatisation objective and therefore the ***impact of privatisation on capital market development has been significant***. The link between capital market development and privatisation is well-documented. For example, Boutchkova and Megginson (2000) report that in countries with large public offerings of privatised companies, market capitalisation as a proportion of GDP and trading volume has grown rapidly. They also show that privatised companies are among the largest listed companies by market capitalisation (in non-US countries) and that of the 35 largest common stock issues in history, 30 have been privatisation issues. In countries such as Portugal, Japan, the UK, Germany, France and Italy, privatised and partially privatised companies are the most highly valued companies, accounting for a sizeable share of total market capitalisation. Sheshinski and Calva (1999) note that for countries in all income groups privatisation increases market capitalisation as a proportion of GDP.

During the 1990s and 2000s the developed countries (especially those in OECD) market capitalisation as a proportion of GDP more than doubled (from about 50% in 1990 to more 110% in 2000s). Privatisation share offerings have been linked to the development of the equity markets in the most developed countries. For instance, by the end of the 1990s, more than half of the Lisbon stock market capitalisation was made up of privatised or partially privatised companies.

Since the early 1990s, privatisation in most Eastern Europe countries has been instrumental in the creation and development of the basic capital market institutions: the stock exchange; securities deposit; and brokerage houses. Privatisation has also provided the stock exchange with sufficient trading volume, which in turn supported trust in that institution. The significance of the privatised companies for the stock exchange was reflected in their share of market capitalisation. While the number of listed companies has increased significantly, privatised companies accounted for around 80% of market capitalisation during the 1990s and 2000s.

Evidence indicates that in most countries ***privatisation has served as a vehicle for promoting and developing capital market*** objectives such as broader share ownership, and increasing the depth and liquidity of equity markets. For many developed countries the need for well-developed equity markets as a means of channelling investments to corporations and the desire to strengthen the institutional investor presence in the domestic equity market underscores the importance of capital market development as an explicit objective of privatisation. In some countries, the sheer size of privatisation share issues has provided a real opportunity to start up an equity culture. In others countries, with already well-developed capital markets, privatisation has (and is) sought to augment what was already there – thanks to public share offerings.

In terms of meeting objectives of privatisation, public offerings are particularly attractive where the government is seeking to develop the equity market, and to promote a culture of equity ownership. This has been a key reason underlying the use of public share offerings as a predominant method of sale in many developed countries which had relatively small equity markets. In some countries privatisation has sought to bring in foreign investors, in some cases for the first time, and thus help put the country on the international capital map. On the other hand, public offerings tend to produce dispersed shareholdings which in the absence of a well functioning market for corporate control can deprive the company of strong governance.

Furthermore, privatisation through ***public share offerings*** is an open competitive process whereby the shares of a company are issued to the public and floated on the stock market. Public offerings are the most transparent method of sale.

What has been the experience in our market when it comes to using public share offerings as a key privatization method?, as a means of promoting development of our capital market?, in promoting the culture of savings, investment and equity ownership?, in enhancing corporate governance?, in improving revenue generation for the government,? in quality job creation? Or a larger question -- was (has) privatization through public share offering been a predominant method of privatization? We will respond to these questions in our next article.