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

Last week we learned that privatization through issuing of shares on the stock market has been the favoured choice as a privatization method for most developed as well as in emerging and frontier economies. We saw that there are well-documented evidences that indicates privatization through public offering and listing on the stock market have been used to broaden and deepen domestic capital markets, boosting liquidity and (potentially) facilitated economic growth. This approach has also been used to build local and foreign retail and institutional investors and in boosting valuations and proper price discoveries in local exchanges.

We as well saw that public offerings of shares through floating into the stock exchange, as a means of privatization, is the most transparent method of privatization and hence it encourages good corporate governance practices and a society and the economy that is open, transparent, inclusive and prefers disclosures.

We saw the evidence 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 and bringing about transparency and good corporate governance.

We were encouraged to note that 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 underscored the importance of capital market development as an explicit objective of privatisation. In some countries, the sheer size of privatisation through share issues provided a real opportunity to start up an equity culture. In others countries, with already well-developed capital markets, privatisation has sought to augment what was already available in stock markets.

However, we learned that privatisation through share offering often requires the existence of a relatively well-developed financial and legal infrastructure. This means stock markets that are relatively liquid and deep, and a fairly sophisticated set of laws governing property rights, company law as well as insolvency and bankruptcy laws are more attractive for public share floating. However, we saw that, the good news is that privatisation has in itself served as a vehicle for promoting the development of the equity market in countries where the capital market is not well-developed.

In our case, the Government, in mid 1980s, embarked upon a comprehensive programme of economic reforms and policy changes that intended to bring about rapid economic development through implementing a policy of economic liberalisation with gradual reduction and finally elimination state-run economy. The thrust of the reforms was necessitated by the quest for improvement of economic growth rates, enhancement of investment levels, efficiency and productivity improvement including expansion of the export capacity.

The fundamental objective of the parastatal reform was to step up economic growth, reduce the large number of non-performing parastatal enterprises and eliminate any budgetary support being extended to these enterprises.

One of the key reform programme entailed privatization of some parastatals (state owned entities). The envisaged (and mostly executed) privatization programs had the following key objectives, reducing the fiscal deficit, raising revenue through asset sales, generating additional tax revenue, encouraging the return of flight capital, promoting foreign direct investment, deepening and broadening domestic equity markets, boosting investor confidence, increasing efficiency and fostering competition, improving the quality of goods and services and reducing the state's role in the economy.

Privatization strategies that were generally used by the then PSRC (now CHC) were: (i) joint ventures/trade sale; (ii) placement (offering) of shares to the public and listing on the stock exchange and (iii) employee and management buyout (MBO and ESOPs).

As of 1993, the country had about 400 state owned entities that were lined up for privatization. Currently, more than 80% of these have so far been privatized. However, only 7 companies (TOL Gases, Tanzania Breweries, Tanzania Cigarettes, Swissport, Tanzania Portland Cement (Twiga), Tanga Cement and NMB Bank) out of more than 330 have been privatized through share offering to the public and listing into the local exchange.

Evidence suggests these 7 companies, because of privatization through listing into the stock market, have had significant positive impact on their own operational and financial performance and their contribution to the government revenue, employment and economic development at large i.e currently these companies are among the top 15 largest taxpayers; they provide quality and sustainable employment to Tanzanians; they operate relatively more efficiently; they attract and develop good talents, skills and competences among Tanzanian youth; they largely comply to good corporate government standards and practices; they are transparent and discloses their performance to the public; they largely comply to good standards of citizenship (CSR) and most of all they have facilitated the promotion and development of the capital market in our country.

As of 25th March 2014 total domestic market capitalization at the Dar es Salaam Stock Exchange for the 12 domestic listed companies is TZS 6,196 billion. Out of these 12 listed companies, Seven (7) that were listed through privatization have a combined market capitalization of TZS 5,396 billion (i.e. 87% of the total domestic market capitalization)!. What does this statistic mean?, it means if only seven (7) companies, out of more than 330 companies that have so far been privatized, can have such a significant impact in the capital market and the economy in terms of broadening and deepening our domestic capital market and capital formation and investment growth, facilitating saving and investment culture, in boosting liquidity and economic growth, etc -- the question we may have to ask (unfortunately retrospectively) is: what if privatization through listing was a favoured choice and that 10% of the privatized (i.e. 33) companies would have been listed at the Exchange by now? What would have been the impact? Do we feel the same impact with companies that were privatized through other methods?

For us, given the circumstances, we chose to significantly rely on trade sales/joint ventures in executing our privatization strategy, was it the right strategy? As a result of executing this approach has there been missed opportunities in terms of encouraging local entrepreneurship, implementing the financial and economic inclusion policy, achieving broader economic ownership, promoting and developing cultural transformation through a saving and investments, developing our capital market? Can we do it differently for other entities that the government still have ownership and that can be lined up for privatization?