CHAPTER - III

PRIVATIZATION : MEANING AND CONCEPTS

After having reviewed in detail the related literature on privatization in different countries of the world and having prepared the framework of the study the present chapter deals with the meaning and the concepts of Privatization. The subject matter of this chapter has been presented in the following manner:

3.1 Introduction.
3.2 Privatization - A Conceptual Analysis.
3.3 Privatization - Macro Dimensions.
3.4 Privatization - Micro Dimensions.
3.5 Conclusion

References.
3.1 Introduction:

The decades of 1960s and 1970s were largely attributed to the era of fast growing public enterprises almost the world over. Public Enterprises were then considered the chief source of attaining socio-economic development. However, with the passage of time, this very concept has come under severe attack because of lack-lustre performance (physical and financial both). In the latter part of the decade of 80's and with the onset of the decade of 90's, the word competition has gained currency in every walk of business activities. Many countries of the world adopted vigorous reform programmes through liberalization, delicensing and privatization of public sector enterprises. Among them 'privatization' is the 'buzz' word every where in the world under the shade of competition and efficiency. In the succeeding paragraphs, an extensive analysis as regards the concept of privatization is presented.

3.2 Privatization: A Conceptual Analysis:

There are various methods which are used for transferring public enterprises to private sectors. The succeeding paragraphs in this chapter make a comprehensive conceptual analysis of the privatization process.

There is no rigid concept of privatization rather it conveys a variety of ideas. It may differ from case to case and country to country. The concept of privatization is, in fact, far wider. It is to be understood not merely in the structural sense of 'who owns an enterprise, but in the substantive sense of how far the operations of an enterprise are brought within the discipline of market forces'. The concepts with regard to privatization may be studied with two approaches; Economic approach and Ideological approach. Economic approach is growth and efficiency-oriented. In this approach 'Privatization is defined as a means to increase output, improve quality and reduced unit costs.' It is believed further that Privatization reduces government debt, raises fund, develops private initiatives in the free competition of market. 'Privatization leads to open competitive market economies that produces higher incomes and more permanent jobs.' From the view point of the ideological approach, 'Privatization is a way to broaden the base of ownership and participation in a society encouraging larger numbers to feel that they have a stake in the economic system'.

Privatization may be defined as a process by which the people of a country can participate in every phase of economic activities and play a vital role in the economic development of the country. In simple terms 'Privatization' means off-loading a portion of the government held equities in public sector undertakings to the numbers of the public to ensure wider...
ownership, greater accountability and providing the companies an access to
domestic and international capital market. Privatization can generally be
defined as any measure resulting in the transfer from the public to the
private sector of ownership or control over assets or activities.

Commensurating different approaches underlying conceptualization
of privatization, different people define privatization in different ways
which are critically studied in the following paragraphs.

G.W. Johnson and others define, privatization as the participation of
the private sector in the production and/or delivery of public services.

According to H.N. Agrawal, privatization consists all those steps,
taken by a government which are directed towards (i) helping and encouraging
private sectors undertake more economic activities and become more efficient
and competitive and (ii) effecting transfer partially or fully, of public
enterprises to private sector with a view to achieving efficiency, productivity,
profitability and simultaneously to ensure fair awareness towards social
obligations.

It becomes clear from Agrawal's opinion that the main themes of
privatization are to attain efficiency, profitability and overall factor
productivity. He also further argues that every privatization manifestation
should be careful about fulfilling the social obligations along with achieving
efficiency, profitability and productivity.

Hanke gives an account of the objectives of privatization as follows:

i. Improvement of the economic performance of assets or services
functioned concerned.

ii. Depoliticization of economic decisions.

iii. Generation of public budget revenues through sale receipt.

iv. Reduction in public outlays, taxes and borrowing requirements and

v. Promotion of popular capitalism through wider ownership of assets.

Almost similar view has been presented by Ronald Dutt. that 'Privatization merely recognizes that what matters most is the quality and cost
of product or services provided and not who provides it'. However, He has
segmented the process of privatization into four categories.
i. Load shedding or Transfer of defaults.
ii. Limited Government Arrangements.
iii. User charges and
iv. Competition.

The first technique urges that if the objectives of the public enterprises are not achieved and justified, then the private sector should come ahead and take the responsibility of the state socio-economic systems and to satisfy the needs of the people by ensuring better performance in the form of higher profitability, improved productivity and efficiency. This technique is termed as load shedding or transfer by default technique.

Another technique is known as 'limited government arrangement technique that refers to make an uninstitutional arrangement where the government plays a crucial role in economic activities, but in a minimal way. This technique should be applied when the first technique i.e. load shedding technique is not possible to be applied.

The third technique, i.e. User charges refer to such arrangement that are taxed on all services provided, including private as well as government controlled agencies. Thus, user can compare between the cost and quality of services provided by the private and public enterprises.

The last technique is 'competition. There is a common belief that the competition is the key factor of achieving better performance of both the sectors i.e. private and public. Privatization makes a situation where both the sectors compete with each other as a result, the services extended to the users become effective and qualitative.

In the words of N.C. Sengupta, privatization in narrow sense, means the sale of state's equity holdings in an enterprise to private person. But in a broader sense, privatization comprises many more following developments:

i. Transition to private sector business, managerial principles and methods including an overwhelming concern for profits.
ii. Closure or liquidation of State Owned Enterprises and the sale of assets.
iii. Leasing of a state enterprise to a private party.
iv. Management contract of an enterprise to a private party.
v. Permitting private sector to enter into certain industries exclusively reserved for the government.
According to D.R. Pendse, privatization, in broader spectrum includes:

i. Divestiture.
ii. Denationalization.
iii. Relaxation in Industrial Policy Resolution.
iv. Closure or liquidation of any State Owned Enterprises.
v. Leasing of a State-Owned Enterprise to a private sector party.
vi. Transfer of management and control of SOEs to a Private Sector individual or agency.
vii. Abandoning or postponing the prospects of state, expand or diversify the activities of SOEs, and
viii. Farming out to private contractors or agencies the function of supplying various goods and services needed by the SOEs.

S. Vijaylakshmi defines privatization as a process which reduces the involvement of the state in the economic activities of a nation. In a broader sense, privatization will include the following:

i. Green field Privatization - any measure of economic policy which permits the entry of private sector in areas hitherto exclusively reserved for the public sector.

ii. Closure or liquidation of public enterprises.

iii. Restricting the expansion of diversification of the activities of any of the existing public enterprises.

iv. Employing private contractors for supplying various goods and services needed by the public enterprises.

v. The leasing of a public enterprise to the private sector.

vi. Cold privatization - any measure which distances the public enterprise from the government.

vii. Franchise financing under which an infrastructural project is built and often operated by a private agency.

viii. Managerial privatization under which persons with experience in management of private sector companies are included on the Board of Directors of public sector companies and

ix. Divestiture - Sale of shares and thereby transferring the controlling
power from the public sector to the private sector.

From the analysis of above definitions, it can be observed that all three experts have expressed almost the same view regarding the process of privatization which can be applied successfully.

According to Sammuel Paul, in country after country, unbridled state expansion has led to (i) economic inefficiency in production activities of the public sector. (ii) ineffectiveness in the provision of goods and services such as failure to meet intended objective, diversion of benefits to elite groups and political interference in the management of enterprises and (iii) rapid expansion of the bureaucracy severely straining the public budget causing problems of labour relations with the public sector, inefficiency in government and adverse effect on the whole economy. Sammuel Paul's concept of privatization focuses on both physical and financial performance of an enterprise. He has stressed on the adoption of privatization process as this idea ensures benefits to the capital owners, to the consumers by providing efficient service to the public at large through a reduction in public sector deficits.  

In the words of S.R. Mohnot, Privatization is induction of management control, via transfer of ownership or otherwise, often both, in public owned, or managed enterprises.

Ramanadham has opined that the best answer to the issue of privatization is to take the necessary steps to improve the efficiency of public enterprises by making suitable changes in the management structure and their relationship with the government and parliament. Steps should be taken to replace the civil service culture by commercial culture in public enterprises.

One of the significant studies on privatization of Public Sector Enterprises has been conducted to fulfill various objectives, which are: (1) Fiscal objectives (reducing revenue deficits), (ii) Economic objectives (efficiency through competition) (iii) Semipolitical objectives (emphasising consumers in preference to worker) (iv) ideological objectives (strengthening and deepening industrialism, property rights, etc.) This study has, however, added some new dimensions to the concept of privatization.

The policy makers in the developing economies favour privatization on the plea that the loss making public enterprises do not have any place in the economy.

A pannel of economists suggested that public enterprises should not be allowed to become a burden on government finance. The public enterprises
which can not be viable may be closed down or sold off or restarted as private enterprises.²¹

Young²² identifies seven different forms of privatization:

i. Special assets sales, which can involve denationalization, the sale of public sector companies previously bought by the government, the sale of government holdings in private companies.

ii. Deregulation or relaxing state monopolies which exposes individual public sector organizations to competition.

iii. Contracting out work previously done by direct labour in local government.

iv. The private provision of services, allowing the private sector to provide services to the public.

v. Investment projects designed to encourage the private sector to invest in projects in deprived areas and extending private sector practices into the public sector, often involving the creation of special units within public sector organizations to secure a more commercial returns on assets.

vi. Reducing subsidies and increasing charges, particularly in relation to the welfare services, and

vii. The sale of council houses as an important element of privatization, given that such sales have greatly reduced public sector housing provision and therefore the scope of public sector for housing. Elliot Berg²³ advocates that privatization has assumed increasing importance due to the reason that the government everywhere are looking for new ways to mobilise resources and ways to use the resources they have more effectively.

3.3 Privatization In Macro Dimensions:

William Glade²⁴ perceived four Macro dimensions of privatization, such as:

i. Privatization of Financing: It entails the utilization of private funds to relieve the state enterprise from temporary budgetary problems.

ii. Privatization of Production: It includes the introduction of contract labour instead of directly employing labour force.
iii. Privatization of Denationalization: It is the most important and undisrupted form of privatization which involves the selling of shares of Public Enterprises (PEs) partly or wholly to the private investors.

iv. Privatization by Liberalisation of Trade and Business: Liberalization, in fact, is the distinguished form of privatization which may be in the form of relaxing or removing statutory constraints on completion or prices etc.

M.B. Athreya has conceptualised four alternative models for privatization, of these four, the first three models are for partial privatization while the four one is for total privatization. These are as follows:

2. Government Controlled Enterprise (GCE, 26%-49%).
3. Joint Sector Enterprise (26% + 25% + 49%) and

In the first step, it could be started with 20 to 30 per cent public as well as Financial Institutions leading to 51 per cent government holding or more. This may be called a government majority enterprise.

Secondly, even 51 per cent simple majority equity ownership for control is an outdated concept. There has been increasing divorce of "Professional Management" from "Control". When share holding is widespread, 26 per cent of equity is quite adequate for control. Under the companies act, with 26 per cent equity, government can exercise veto on all special resolutions at any AGM. This may be called a government controlled Enterprise.

Thirdly, this is partly similar to GCE, but only to the extent that the government holding here also is 26 per cent. But in the balance 74 per cent, 25 per cent may be given to one 'partner'. This partner could be a successful well-managed private firm. The operational management could be left with the Private Partne. Government will have control will benefit from the profitability and share value appreciation.

Fourthly, private sector- it would be inaccurate to call any of three previous alternatives - 51 per cent or 26 per cent or JS - as privatization. The only situation which can be called "Privatization" is where 100 per cent of ownership is in non-governmental hands.

According to Theo Thie Mieyer, there are different connotations
on privatization, such as:

1. Transfer (sale) of public assets (firms, part of firms, partial privatization, or individual assets) to private persons.

2. Transition to private law legal forms.

3. Transfer of individual public supply tasks to private persons (e.g. contracting out), also functional privatization.

4. Transition to private business management in the sense of profit oriented management.

5. Extension of the margin of autonomy for the management of public enterprises.

6. Debureaucratization, in the sense of freeing from formal provisions administrative instructions.

7. Decentralization, in the sense of the delegation of authority to decide, plan and act.

8. Aligning the conditions under which public enterprises act on those which apply to private firms.

9. Promotion of competition by market processes (or market-like systems of incentives).

10. Dismantling of such state monopolies as are justified by referring to the traditional argument of 'natural monopoly.'

11. Adaptation of wages and working and employment conditions to those applicable to the private sector: Privatization of Jobs.

12. Unilateral reduction of the nature and scope of public services.

13. Privatization of public resources.

14. Privatization of public revenue: Conversion of revenues from public investments into private profits; or private access to public capital and its revenues.

15. Denationalization - Pressures of international competitions; increasing activity in foreign markets; take over a capital shares and rights of disposal by foreigners.

The term privatization can be defined from two points of view - first, at the economy level (i.e. Macro view and second, at the enterprise level
Privatization of economy level implies the following traits:

1. The expansion of public enterprise is discouraged.
2. The growth and development of Public Sector Enterprises in the economy is checked and thus allowed to expand at slower rate, and
3. The activities of public enterprises in the economy is reduced so that the private sector may avail opportunity to expand.

3.4 Privatization - Micro Dimensions:

The micro dimension of privatization is as follows.

1. Ownership measures.
2. Organization measures.
3. Operational measures.

1. Ownership Measures: It is an important measure of privatizing the State Owned Enterprises. Ownership measure implies denationalization, joint venture and liquidation. Denationalization may be legal or partial. Legal denationalization refers to the transfer of majority ownership rights and benefits along with control on management. Partial denationalization means transfer of ownership to private parties up to 49 per cent and thereby the majority ownership remain with the public sector enterprises maintaining control on the management. However, denationalization implies three categories as:

   (i) Management Buy-out: It means that the sale of assets to the employee or management or to both of the organisation i.e. managers or employees or both together buy the majority share holdings in a company.

   (ii) Co-operative means an organization which belongs to employees which must have distinctive legal features of a cooperative society that can buys the assets of the enterprise.

   (iii) Special Share: Here government retains some shares under the arrangements that it undertakes not to participate activity in the management process rather it holds a power to protect in case of undesirable share concentration dragging of companies property illegally or any other extreme circumstances.
Joint Venture: Joint venture denotes that private capital may be introduced in a public enterprise either through a sale of some government equity or in the course of its expansion.

Liquidation: Liquidation means sale of the assets to some one that uses them again in the same activity or moves them away from their erstwhile activity. This occurs in the financial failure of the enterprise.

Organizational Measures: Organizational measures have five dimensions which are:

(i). Changes in Holding Company Structure: It means government reduces its control to the operation of the company and then a company is allowed to run its function under a high degree of market discipline.

(ii) Changes Within Monolithic Structures: A monolithic organization can be changed into two forms: firstly, it may be broken into smaller units without loss of scale of economies; and secondly, the major product lines or regional operations may be converted into independent companies and they are also allowed to stay in the same organization.

(iii) Leasing: A public enterprise can be privatized gradually, by the method of leasing out large amount of its assets to the best bidders and the bidders will enjoy profits as per agreement.

(iv) Competition: Promotion of competition is obvious importance in ensuring results of improved efficiency, lower cost structures and declining prices. This would be possible by three ways, such as:

a. By breaking big public enterprise into less big units which have a reasonable chance of competing with one another.
b. By deregulating the activities in a given sector, there by improving the prospects of entry and exit.
c. By improving condition of internal competition within a large public enterprise organization.

Restructuring: It means reforming of the organisation. It may be done in two ways, as financial restructuring and functional or basic restructuring.
3. **Operational Measure**: It is very important and meaningful measures of privatization which is appropriate for both planned and mixed economy. It has seven dimensions:

(i) **Contracting out**: Here the government bears the cost of providing the service and the right to produce and sell the service under contract with the government is given to a private firm selected on the basis of competitive bidding.

(ii) **Rewards/incentives**: Rewards is the acceptance of one's best works. So, it helps to accelerate the improvement of efficiency of the organization. Both shop-floor employees and managerial personnel should be provided rewards.

(iii) **Investment Criteria**: There should be the same investment criteria for both public and private enterprises.

(iv) **Pricing Principles**: Every competitive industry uses to settle the price at the level of costs and tries to minimal the price discrimination. Private sector enterprises follows this way for long time with a view to capturing the monopoly situation. In case of public enterprise, the situation is reverse. So, pricing principles should be the same for both the public and private enterprises.

(v) **Targets**: Target setting is an alternative approach of privatization. There should be a target of manager's particular activities that must be attained and necessary incentive should also be provided to them for successful managers.

(vi) **Resort to Capital Market**: A public enterprise should move to capital market for its capital funds as private sector does. It can be able to attract the funds if only the investors think that the purpose of the project will be worthwhile. This measure would make the public enterprise fittest in the market discipline which is a major virtue in the case of private enterprise.

(vii) **Rationalization of Government Control**: There is a burning question of a reform of the system of government control over public enterprise. Government should rationalise its control over the public enterprise and should provide managerial autonomy. It should be considered as a 'fresh air' which can be breathed by the public enterprise's managers.
The micro economic measures of privatization is shown in chart - 1. Privatization is transfer of ownership and control of State Owned Enterprises (SOEs) to the private sector through sale of assets. The main objective of privatization is to transfer ownership and control of economic activities from the public sector to the private sector market. 'The market sector is based on competition, voluntary transactions, and private property rights'.

'Voluntary transactions or contracts, involve two or more parties engaging in economic activities without having to receive permission from someone else'. Again, 'private property - the rights belonging to the possessor are usually defined as the rights of an individual to decide how to use an asset and to transfer his rights to someone else'. So, 'privatization in its fullest sense, therefore, requires a change of ownership'. But this may not be enough. Additional measures may be necessary to ensure that an activity which is transferred to the private sector changes its behaviour accordingly. So 'transfer should be supplemented by other means which add to competition'.

In the socialist countries or the centrally planned economies, it has come to the extent that in the individualisation of economic activity - i.e. allowing individuals to own and control certain forms of economic activities China, Hungary are the best example of this form.

In the LDC's there have been a mixture of different techniques followed in privatization. There have been cases of divestitures of the type similar to that carried out in the industrialised countries. Singapore, Malaysia, Thailand, Japan are being privatized by the sale of stock to the public. Besides divestiture i.e. sale of equity there is a common form of privatization in the LDC's, i.e. reprivatization of the government owned enterprises. Bangladesh, Chile are the best example. At present Bangladesh is following two methods of privatizing SOEs.

(a) **Sale by International Tender**: Local, foreign private buyers may participate in all such tenders. Association of workers, employees and officers of the tendered enterprise may also offer bid for purchase of the enterprise.

(b) **Sale by Offer of Shares**: Government owned shares in different companies and shares of the SOEs converted into public limited company may be sold to the general public either directly or through the Stock Exchange.
CHART - 1

PRIVATIZATION IN MICRO DIMENSION

PRIVATIZATION

Ownership Measure

Total Denationalization

Joint Venture

Liquidation

Organizational Measure

Changes in holding company structures

Changes within monolithic structures

Leasing

Competition

Restructuring

Operational Measure

Management Buy-out

Cooperative

Special shares

Contracting Out

Incentive Rewards

Investment Criteria

Pricing Principles

Targets

Resort to capital markets

Rationalization of government controls

3.5 Conclusion:

From the foregoing analysis of the definition of privatization, it has been rightly realised by the economists, planners and the governments alike the world over that privatization is now the key to success in attaining enhanced efficiency, increased profitability and improved productivity. So, many countries have adopted vigorous reform programmes of privatization of public enterprises.

Various methods of privatization are being used for transferring public enterprises to private sector. However, the significant methods of privatization process are divestiture, denationalization, deregulation, dilution of public ownership, sale of public assets to private sector, sale of shares, transfer of management and control to the private party, management buy-out etc.

In Bangladesh, the privatization process which is currently followed includes denationalization, the sale of entire enterprise through tender to the local or foreign buyers, sale of shares to the general public, employees or workers directly or through stock exchange.

References:


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27. Ramanadham, V.V. (ed), "Privatization in Developing Countries", op.cit., pp.,6-10.

28. Ibid. p.7.

29. Ibid.


31. Ibid.

32. Ibid

33. Ibid.

34. Ibid.

35. Ahmed Momtazuddin, op.cit, p. 120.

36. Ibid.