

Privatization of State-owned Enterprises an Agenda for Private Sector Development

1. Introduction

1.1 State-owned Enterprises (SOEs) were at forefront in the process of building an industrial and manufacturing base in the country during sixties and seventies and are still playing a dominant role in the Nepalese economy.

1.2 Since most of the SOEs are not running business-like, they have become burden on national treasury. In fiscal year 1998/99, SOEs received budgetary support amounting to 25% of the total development budget, capital employed in them was Rs. 83,421 million and return on capital employed amounted to 3.83%. Dividends received from SOEs for fiscal year 1999/2000 amounted to 2% return on equity.

1.3 The poor performance of SOEs can be ascribed to the lack of commercial orientation, poor management, inadequate autonomy, poor accounting and accountability, over staffing with inappropriate skill mix, lack of technical upgrade, mis-utilization of resources and negligence.

1.4 Although several attempts were made to reform the public enterprises sector in the decade of eighties, but they failed to bring desired results. Public sector reform is a costly and time taking process and also includes infusion of new technology, new management, right sizing of employees with appropriate skill-mix, strengthening of institutional arrangements and economies of scale. The overall reform process requires additional resources, which cannot be met through the treasury. At this juncture privatization of the SOEs has been considered as a key component for overall economic management of the country.

1.5 In Nepal, the privatization program has been revitalized under the second generation economic reform program anticipating that it would help in enhancing efficiency in SOEs operation, easing fiscal pressure on national treasury, contribute to the effectiveness of public spending in poverty reduction and facilitate private investments in the economy.

1.6 The basic objectives of Nepal's Privatization Program are:

- a) reducing the role of government in business-related activities;
- b) enhancing private sector participation in the economy; and
- c) attracting private "shy" capital in business ventures.

3. Review of Past Privatization Efforts

3.1 The privatization program though initially launched in mid eighties, was revitalized in 1991. By year 2001, using various modalities the government has privatized 18 SOEs; out of which three were liquidated. Two new enterprises, namely Butwal Power Company and Hetauda Textile Industry are currently in the process of privatization and the Nepal Transport Corporation, Nepal Orind and Magnesite Ltd. and Cottage Industries and Handicrafts Emporium, are other potential candidates for immediate privatization, as they are recently closed down to get prepared for privatization/liquidation/ dissolution process.

Out of total SOEs being privatized, the Bhaktapur Bricks and Agricultural Tools Factory have been reverted back to the government, as new management failed to run these companies.

The modalities chosen for the privatization were asset and business sale for three SOEs, share sale for 10 SOEs, management contract for one SOE and lease for one SOE and liquidation for three SOEs. (Annex 1)

3.2 The mixed results have been observed in the overall performance of privatized companies. Production and sales have increased in majority of them. Technology has been upgraded. Capacities have been expanded and new capital have been injected. In some cases, like Balaju Textiles, Bhrikuti Paper Mills, products have been diversified. Employees in some cases were benefited with increments in facilities. However, total employment in the privatized companies has gone down by almost 50% and only half of the privatized companies are running at profit. (Detail in Annex 2). In short, the privatization program in totality has positive impact on the economy.

4. Lessons Learnt:

The following are major lessons learned from the past privatization efforts and required careful thoughts while planning successful privatization activities in future.

- a) Choice of modality for the privatization of any entity has always been debated; despite the fact the privatization committee makes its decision based on the recommendation of the professionals.
- b) Restructuring of the company prior to the announcement of its candidature has received less priority in early days of privatization. Earlier attempts to transfer the SOEs, as is where is basis, have some bearings in poor performance of the privatized companies.
- c) Basis for the selection of preferred bidders has always been in question, though the government had objective criteria behind the selection.
- d) Getting support of Labor Unions and employees in the privatization process and involving them in the decision making process is a difficult proposition, as their involvement would obstruct the process.

- e) Transparency and effectiveness of process of privatization have always been questioned, despite the fact that sincere efforts are being made to keep the process more transparent.
- f) Issue of under-valuation of the assets and business has always been raised. However, though such comments on the methods used and the value ascertained are not being substantiated. The treatment of non-core assets in the process, as such assets have always become attractions for potential investors to earn quick money, has become a disputed issue.
- g) Inadequate communications strategy to solicit support and participation of people in privatization process and capital market infancy are other issues often raised in the country.
- h) Professional capability of privatization cell is often doubted as outsourcing has been extensively used for professional service.
- i) Soliciting broader national consensus in the privatization program has become a daunting task for all of those involved in the process.
- j) Management quality and financing capability of native investors and limited domestic financing base have serious implications on the privatization process.

5. Key Issues and Challenges

5.1 The key issue in privatization is how to make it an effective policy instrument for private sector development in the country. The other issues are:

- How to make privatization process more transparent by greater involvement of key stakeholders in the development of policies and program that will directly impact them?
- How to get increased co-operation of the management, employees and labors of the SOEs chosen for privatization process.
- How to develop a comprehensive public awareness program to solicit support and participation of general public at large in the program and effectively communicate privatization to them? How to disseminate general and project specific information on time to all concerned?
- How to strike a balance between the interest of labor and economic rationality of their being in the jobs? How to compensate loss of job of the employees?
- What is an appropriate modality of privatization of a particular SOE?
- What are appropriate methods of valuation of the SOEs?

- What should get preference, the price offered or the business expertise, while selecting successful bidders?

5.2 The key challenge is how to speed-up the pace and scale of privatization within a time-bound framework. Other challenges are:

- How to reduce procedural delays confronting privatization? How to shorten the cumbersome procedures keeping the process transparency at highest possible level to complete the entire process in a time-bound framework.
- How to make the privatization transactions efficient and faster without compromising transparency and basic processes required for the transaction? How to make proper co-ordination among the key players and define their roles and responsibilities in the process?
- How to build the national consensus for implementing the program effectively? How to get the members of civil society involved and support of parties in opposition to the program? How to translate political commitment into action while implementing the program?
- How to deal with the human face of privatization? What would be the proper compensating packages to redundant labors and how to generate funds? How to make the best use of the retrenched manpower, as their layoffs would bring more job seekers in the labor market?
- How to make the fund available to settle the liabilities of the SOEs privatized, as most of them are running at losses incurring heavy liabilities and others are with negative net worth?
- How to run the public utilities efficiently? Should they continue to run under government ownership and management or allow the private sector to participate in their operations?

6. Strategies for Reform

6.1 The objectives and policies of privatization promulgated in the Ninth Plan still remain valid (Annex 4). Privatization objectives aim to increase the private sector participation in market-led activities, increase effectiveness of public spending, maintain economic stability, promote people's participation in development and make the government gradually assume the role of facilitator to enable private sector development.

6.2 Privatization, being a part and parcel of the overall private sector development program, remains a policy priority of the government and requires expedited implementation.

6.3 Agenda for SOE reform shall incorporate the activities like corporatization, commercialization, provisioning of timely audit, restructuring of assets and liabilities, human resources, induction of professional management and

management of financial liabilities. SOEs would be barred from incurring long-term liabilities, through borrowing loans either for business expansion, or for technology up grade or for paying salaries to employees.

6.4 Reforms of SOEs shall also include the reform in public utilities to improve their efficiency and quality of service. It would further focus on deregulating the utility sector. Prior to implementation of such SOEs, an effective regulatory framework would be developed.

7. Key Actions of Reform

7.1 The government will follow two-pronged actions for SOEs:

- a) Privatization of targeted SOEs at an accelerated pace and speed, choosing all kinds of companies whether or not they are running at profits.
- b) Undertake an effective reform program in selected SOEs that would remain under government ownership for some time. A sound regulatory framework shall be developed for monitoring the activities of public utilities and a long-term plan for their privatization shall be prepared.

7.2 The Ninth Plan (1997-2002) has earmarked 30 SOEs for privatisation (Annex 3). Seven of them are at present active candidates. They are:

- a) Janakpur Cigarette Factory
- b) Himal Cement Company
- c) Hetauda Cement Company
- d) Birgunj Sugar Factory
- e) Lumbini Sugar Factory
- f) Bhaktapur Bricks
- g) Agricultural Inputs Corporation (seed-related activities)

A time-bound program would be in place to privatize the above said SOEs on a priority basis.

7.3 The reform of SOEs remaining under the government ownership would focus on corporatisation, injecting professional management, giving operational autonomy including pricing policy, infusion of new technology, right sizing of employees, making management accountable for results, maintaining financial discipline and good governance and so on. Public utilities and financial sector SOEs would be the main targets of reform. The reform plan would focus on making SOEs fit for privatization and thereby getting better sale proceeds.

7.4 Privatisation of SOEs would be carried out as one of the instruments of SOEs reform.

8. Output and Results

- 8.1** Privatisation would foster private sector development. Domestic as well as foreign investment will be attracted in privatized SOEs. New technology and capital will be injected. Competitiveness of the economy based on comparative advantage will be promoted. The private sector will have a level playing field in a competitive environment.
- 8.2** Privatization will facilitate efficient and quality delivery of goods and services, especially in the rural areas. This will have a positive impact on the quality of life of people.
- 8.3** The ultimate benefits of privatization shall go to poor masses living in rural areas on the long run, as the government budgetary allocations to inefficient SOEs will be spared for utilizing in rural infrastructure development and poverty reduction programs. Greater provisioning for health, education, drinking water, and rural infrastructure services will benefit the poor masses, which ultimately would end to the reduction in the incidence of poverty.
- 8.4** Greater employment opportunities will be created in the private sector through new investments and upgraded technology and poor would be benefited from increased job opportunities.
- 8.5** Privatization will contribute to the effectiveness of public spending. There will be fewer opportunities for extortion and misuse of public funds. The regulatory regime based on controls will disappear and this will also result in reduction in government expenditure.
- 8.6** Good governance will be promoted.
- 8.7** Labor-management relations will be improved through comprehensive labor reforms related to privatization. The Labor Act is being discussed for amendment.
- 8.8** The privatization process will become more transparent and will be effectively communicated to stakeholders.

9. Privatization Implementation Modality

- 9.1** Those entities, which are running at losses and have less chance of revival in immediate future, shall be closed down by paying off employees/workers and would pass through the restructuring process prior to their privatization, as the cleaner entity would not only increase competition in bidding process, but also would help realizing more sales proceeds. Human face of privatization shall not be overlooked while privatizing a company and a skill development or entrepreneurship development program would support each privatization transaction involving employees' layoffs. Safety netting for labor will be ensured through the provision of counseling, outplacement services, re-skilling, access to credit, job search facilities and other social impact alleviation activities.

9.2 Diversification of ownership would be encouraged. Based on the nature of the company, different modalities of privatization would be chosen.

9.3 A time-bound privatization framework inclusive of a privatization calendar shall be developed to speed up the pace and scale of privatization and all concerned would get the details information prior to the privatization of each company.

9.4 Establishment of a Privatization Revolving Fund

A revolving fund will be set up to finance labor payoffs related to privatization. The certain percentage of privatization proceeds will also be deposited in this fund to finance future privatization and financing cost of promotional and skill development program. Donor contribution in terms of seed money to the revolving fund would be appreciated.

Upon the completion of the privatization program, the balance remaining in the Privatization Revolving Fund will be utilized to fund social development and poverty reduction program.

9.5 Highest level of transparency will be maintained in the privatization process. A comprehensive communications program will be formulated and implemented to address the concerns of stakeholders as well as to aware public on privatization.

9.6 Institutional arrangements for privatization will be strengthened. The Privatization Cell will be given more independence and authority. Coordination will be strengthened with the Line Ministries for implementing privatization in an effective manner.

9.7 The Privatization Act will be amended. The privatization byelaws will be laid down.

10. Monitoring and Evaluation

10.1 The monitoring and evaluation has received less priority in the privatization program in its early days. A separate monitoring unit shall be setup under the privatization Committee and entrusted with monitoring of future privatization against the performance indicators. This unit would monitor performance of the privatized SOEs as well as that of other SOEs run in government ownership. Independent evaluation of the performance of privatized enterprises shall be encouraged.

11. Conclusions

The commitment of Nepal for accelerating economic development through privatization is total. The government is determined to effectively implement privatization in a medium term framework to spur the development of private sector in a market-oriented, investment-friendly enabling policy environment. The privatization process will be speeded-up. Viable candidates will be selected for privatization purposes. The bureaucratic hurdles will be lessened. Accountability for results will be ensured.

Annex 1: Nepal's Privatised Enterprises (1992 - 2001)

S. No.	Name	Date	Modality	Proceeds (Rs '000')
1.	Bhrikuti Paper Mills	Oct 92	Asset and business sale	229,800
2.	Harisiddhi Brick and Tile	Oct 92	Asset and business sale	226,900
3.	Bansbari Leather and Shoe	Nov 92	Asset and business sale	22,400
4.	Nepal Film Development	Nov 93	Share Sale	64,662
5.	Balaju Textile Industry	Dec 93	Share Sale	17,716
6.	Raw Hide Collection	Dec 93	Share Sale	3,990
7.	Nepal Bitumen and Barrel	Jan 94	Share Sale	11,640
8.	Nepal Lube Oil	Jan 94	Share Sale	30,424
9.	Nepal Jute Trade and Dev.	1993	Liquidation	
10.	Tobacco Development	1994	Liquidation	
11.	Nepal Foundry Industry	Mar 96	Share Sale	14,473
12.	Shri Raghpati Jute Mills	Aug 96	Share Sale	82,204
13.	Biratnagar Jute Mills	Dec 96	Management Contract	
14.	Nepal Bank*	1997	Share Sale	125,140
15.	Agriculture Tools Factory	May 97	Share Sale	95,100
16.	Bhakatapur Bricks	Aug 97	Lease	20,300
17.	Nepal Tea Development Corporations (NTDC)	June 20 00	Share Sale	267,150
18.	Agricultural Projects Service Centre (APROSC)	Mar 20 01	Liquidation	

* HMGN owns 39% of the shares in Nepal Bank Ltd.

Source: Privatisation Cell, Ministry of Finance

Annex 2: Performance of Selected Privatized State Owned Enterprises

SOE	Production	Sales	Technology Improvement	Employment	Profit/Loss
1. Bhrikuti Paper	Increased	Increased	Yes	Increased	Loss
2. Harisiddhi Bricks	Increased	Increased	Yes	Increased	Loss
3. Leatherage Bansbari	Decreased	Decreased	No	Decreased	Profit
4. Nepal Film	Increased	Increased	Yes	Decreased	Profit
5. Nepal Lube Oil	No change	No change	Yes	Decreased	Profit
6. Nepal Bitumen	Increased	Increased	Yes	Increased	Profit
7. Nepal Foundary	Increased	Increased	Yes	Decreased	Profit
8. Raghupati Jute	Increased	Increased	Yes	Increased	Loss
9. Balaju Textile	Decreased	Decreased	Yes	Decreased	Loss
10. Bhaktapur Bricks	Decreased	Increased	Yes	No change	Loss

Source: Monitoring Privatised Enterprises (1999), Ministry of Finance, p. 2

Annex 3: Ninth Plan List of SOEs Selected for Privatisation

1. Nepal Tea Development Corporation (privatized)
2. Pokhara Dairy Development Project (part of Dairy Development Corp.)
3. Gorkhapatra Corporation
4. Himal Cement Company
5. Nepal Rosin and Turpentine Limited
6. Nepal Bank Limited (privatized)
7. Salt Trading Limited (HMGN has minority shareholding)
8. Rastriya Beema Samsthan
9. Rastriya Banijya Bank (Reform Process in progress)
10. Butwal Power Company Ltd.
11. Lumbini Sugar Factory Ltd.
12. Janakpur Cigarette Factory
13. Nepal Transport Corporation (Closed down)
14. Nepal Housing Development Finance Company
15. Industrial Districts Management Ltd.
16. Agriculture Lime Industry Ltd.
17. Agriculture Projects Service Center (liquidated)
18. Birgunj Sugar Factory Ltd.
19. Dairy Development Corporation
20. Cotton Development Committee
21. Herbs Production and Processing Company
22. Hetauda Textile Industry
23. Morang Sugar Factory Ltd.
24. Nepal Telecommunication Corporation
25. Royal Nepal Airlines Corporation
26. Birendra International Conference Center
27. Nepal Orind Magnesite Ltd. (Closed down)
28. Hetauda Cement Company
29. Udayapur Cement Company
30. Nepal Electricity Authority

Annex 4 : Ninth Plan Privatisation Policy and Objectives

Privatisation Objectives

- To increase the effectiveness and productivity of government resources through efficient utilization;
- To make the government gradually assume the role of facilitator by encouraging and motivating the private sector for participation in economic development;
- To help maintain economic stability by enforcing financial discipline and relieving the government progressively from the burden of financing corporation deficits;
- To promote the participation of the common people in the economic development by means of privatisation.

Privatisation Policy

- Privatisation will be undertaken in a consensual environment by keeping people well informed about both the positive and adverse consequences associated with the process.
- Assessment of corporations for privatisation will include all aspects of the enterprise and its operating environment.
- The appropriate modality will be selected to ensure a fair opportunity for all investors.
- Detailed analysis will be undertaken to prioritise enterprises and specify the timing, sequencing and pace of privatisation.
- The selection of investor will only be made after careful assessment of business skills and experience, financial status, resources, access to markets and business plans for the enterprise.
- Potential investors will be provided with all information about the enterprise. Terms and conditions of transfer will be explicitly laid down.
- Foreign investment will be encouraged where capital and technology is needed.

- The business value determined by competitive marketing is accepted as the price. The business value of the enterprise will be widely disseminated.
- A clear policy will be evolved to protect interests and rights of employees and determine necessary compensation where restructuring is required. Employees will be retrained.
- Post-privatisation monitoring of privatised enterprises will be undertaken both to ensure compliance with terms and conditions of transfer and to assess performance.
- Measures will be taken to promote and support the private sector. Development of capital markets and the banking and financial sector will be pursued.
- Regulatory laws and institutions will be set up prior to the privatisation of monopolies.
- Commercialisation will be pursued, where possible, to prepare enterprises for privatisation. Those enterprises not currently listed for privatisation will be commercialised to improve performance.

Source: The Ninth Plan (1998), National Planning Commission