

Improvement of the mass privatization legislation

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The success of the governmental stabilization program depends mainly on the rapid restructuring of the ownership in the real and the bank sectors, including the mechanisms of the mass privatization. Thus, the acceleration of this process is very importance for achieving a consequent sustainable economic growth.

This presentation attempts to review in brief the progress of the mass privatization process in Bulgaria and to propose some necessary legislation amendments that will facilitate the free trade of shares. Such amendments are:

- removing the ban on acquiring more than 34% of the assets of a privatized enterprise;
- removing the ban on the free trade with the acquired shares in the first 6 months after the last auction session.

The progress in the mass privatization process: the Bulgarian experience

Until now the progress in the mass privatization process in Bulgaria may be characterized as extremely slow, overregulated and with low transparency. The Privatization Law was adopted by the National Assembly in April 1992, while the necessary amendments in this law, setting the main rules for the implementation of the mass privatization campaign, were adopted not before June 1994. One more year was needed to elaborate and pass the Mass Privatization Program (October 1995), defining the list of enterprises and the share of their equity capital to be privatized, as well as the terms of the campaign. In the period December 1995 - April 1997 other normative acts concerning the mass privatization were adopted (the Rules on the Mass Privatization Campaign, the Law on Privatization Funds, etc.). Until now the first two auctions have taken place. The third auction is to take place by September 1997.

Practically, the first wave of the mass privatization will need at least five years and a half, or 65 months, to be accomplished. This very prolonged period eliminates one of the main advantages of the mass privatization - the rapidity with which state enterprises are being sold. An example may be given with the implementation of the mass privatization in the former Czechoslovakia, which model was to a great extent applied in Bulgaria. The first wave of the mass privatization process in Czechoslovakia was carried out for only 14 months, including the registration of the participants, the licensing of the privatization funds and the carrying out of the 5 bidding rounds. Thus, on average, one large and three medium-sized enterprises were privatized per day in this period, which undoubtedly is a significant achievement. From the very beginning of the privatization in 1993 (the sale of "Carevichni producti" - Razgrad) till February 1997, 5430 Bulgarian enterprises were privatized, but these were mainly small municipal companies.

The other main advantage of the mass privatization, namely its large scale, was also eliminated,. In the Czech Republic about 40% of the state-owned fixed assets were privatized through the mass privatization, while in Bulgaria this number is about 20% of the state-owned fixed assets. The intention of the interim government (and probably of the next one) is to accelerate the privatization process and to privatize till the end of 1997 about 40% of the of the state-owned fixed assets. This could be achieved through two ways: selling more big stakes of large state-owned firms (but this requires a relatively longer period), and accelerating and expanding the mass privatization process.

The implementation of the mass privatization campaign has been inadequate so far despite its long preparation. Only about 45% of the citizens, eligible to participate in the voucher scheme, bought privatization vouchers. The fee for these vouchers was

only about 6% of the average monthly wage in the first quarter of 1996. In the former Czechoslovakia about 80% of the citizens, eligible to participate in the mass privatization, paid registration fees which were equal to about 25% of the average monthly wage in the country.

The reasons for the failure of the registration campaign are: 1) the crash of the financial pyramids in the summer of 1995. Most of the people related it to the mass privatization process; 2) the undeveloped capital market. Practically, until now the people have not shown significant interest in investing in corporate securities. The stock exchanges failed to lay the beginning of the capital market in Bulgaria. This was mainly due to the inactivity of the state authorities which did not pass the necessary legislation and did not license the players on the capital market; 3) the delayed licensing of the privatization funds. They had to carry out the advertising campaign of the mass privatization. The best of them was licensed shortly before the end of the registration period.

The acceleration of the mass privatization depends mainly on the readiness of the government to reduce the period for the implementation of the process and to expand the range of the assets to be privatized. However, some new amendments in the existing legislation are needed.

Removing the ban on acquiring more than 34% of the assets of the privatized enterprises

The privatization funds cannot acquire more than 34% of the assets in one company under article 30, paragraph 1 of the Law on the Privatization Funds.

It is hard to judge what stood behind this decision of the legislative power. One of the possible motives may have been the prevention of the privatization funds from acquiring majority stakes in the firms. Probably, there were fears that the founders of some funds would try to initiate their artificial failure and to transfer the assets to related companies. This argument is not justified. Moreover, the restriction threatens the success of the privatization process.

The main argument of the opponents of the mass privatization is that it does not improve the efficiency of production. First, the fragmentation of the companies' capital may cause inefficient control over the activities of the privatized enterprises, especially when the key shareholders do not have the necessary skills to manage the firms in a competitive environment (this is most likely in cases of management-employee buy-outs). Second, the fragmentation of the capital may reduce the abilities of the key investors to take decisions, which will complicate solving the main problems of the privatized enterprises in the post-privatization period, such as undercapitalization; large liabilities to banks, deliverers, state budget and employees; out-of-date technologies and equipment; poor management.

The ban on acquiring more than 34% of the shares in one firm not only does not remove the main deficiencies of the mass privatization, but even reinforces them. Moreover, we should have in mind the notorious order of the Ministry of Industry, according to which the main decisions about the management of the post-privatized enterprises may be blocked by the residual stake of the state (in some cases 10%). This order aims at keeping the state influence in companies that are over 50% private.

The privatization funds were really restricted by this ban in their participation in the first auction. They bade far above the minimum acceptable prices. As a result, about 68% of the vouchers were used for the privatization of 41% of the offered assets on the first bidding round. One of the reasons for this are the undervalued fixed assets, because of the prolongation of the period between the inventory of the assets and the first auction. The second reason is that the privatization funds most probably strove to acquire the maximum allowed stake of shares in particular firms. Thus, they were forced to offer relatively higher prices.

Many of the firms whose shares were entirely sold on the first auction have been a strong competitive target for the funds. Some of the companies with the highest biddings are: "Leyar Complect" - Sofia, where PF "Doverie" and PF "Petrol Invest"

have acquired the maximum allowed stake of 34% of the capital; "Unipac" - Pavlikeni, where few privatization funds bought almost all offered stake (67%) - PF "Severcoop Gumza" (26%), PF "Neftochim Invest" (25%), "Central Privatization Fund" (8.75%); "Lead-Zinc Complex" Kurdjali, where the minority stake (25%) was distributed between 4 privatization funds, etc.

According to the data about the participation of 57 privatization funds in the first auction session (the total number of the funds is 81), in about 30% of their approved offers they have acquired more than 30% of the capital in the companies. This indicator may underestimate the real efforts of the privatization funds to acquire the maximum allowed stakes because:

1) many of the firms (especially the largest ones, which are most attractive for the investors) are included in the mass privatization program with minority (25% or 60%) stake. Thus, acquiring a 34% stake is a very difficult or impossible task for the privatization funds;

2) the privatization funds have an opportunity to increase their stakes on the second auction, when the residual shares will have lower acceptable prices;

3) some of the privatization funds are established to participate in the mass privatization of particular firms which commonly have low offered stakes. Such examples are: PF "Slunchev bryag", PF "Nicotiana", to some extent PF "Multigroupelite", etc. In all cases, the stakes, acquired through the mass privatization process, are below 20%;

4) co-operation between two or more privatization funds. Thus, although each of the privatization funds has acquired below 30% of the shares of a particular company, they hold together a stake of the capital which exceeds 30% and even 50%. A typical example in this respect is the co-operation between PF "Semeen" and PF "Industrialen". which made offers for the same companies.

It may be concluded that the privatization funds have been striving to acquire the maximum stake of the capital in many companies. The privatization funds, which are an exception from such a behaviour, are PF "Akcioner Favorite", PF "Bulgaria" and PF "Golden lev". If the ban is not removed soon, there are two ways for evading it: 1) co-operation between the privatization funds. Such attempts are already observed; 2) acquiring shares of other privatization funds, joint or merger of privatization funds.

Removing of the ban on the sales of shares 6 months after the tenders

The shares acquired on the mass privatization auctions may be transferred only after publishing of the first balance sheet of the privatized company but not earlier than 6 months after the end of the last central auction session, according to article 51a of the Privatization Law. Thus, the acquired shares of the privatized firms may not be traded before early 1998, under the present schedule. If the restriction in article 51a of the Privatization Law is removed, the shares can be traded after mid-1997.

The hypothetical motive of the legislator was the desire to avoid the extra-supply of the shares of privatized firms immediately after their acquiring, which could cause a sharp decrease of their prices, and hence the undervaluation of the shares of many enterprises. This would favor the big investors with large investment potential. However, the delay in the free trade of the privatized shares can not cope with this problem but can only postpone it with some months.

The earlier start of the trade with the acquired shares would have a great impact on the development of the capital market in Bulgaria. The Bulgarian Stock Exchange practically stopped its activities in the end of 1995. The appearance of many small investors is an important condition for its successful future development. The interest in the trade with the shares from the mass privatization, as well as with the preferential shares for the employees will result in interest in the overall trade of corporate securities. This will enable other companies (state or private), not included in the privatization process, to use this source of financing their activities. Until now, the sources of additional funds for the firms are commercial banks and other companies. The citizens may consider the corporate securities to be an attractive way to invest their savings.

The permission of free trade immediately after the balance sheet of the privatized firm is published will allow the large investors to consolidate their stakes as soon as possible. It may contribute to the improvement of the control and management of these enterprises in the post-privatization period which will remove the main deficiency of the mass privatization.

The delay in the free trade of shares will also have a negative psychological impact. The small investors (the citizens) will continue to consider the acquired shares of enterprises or privatization funds more as vouchers (papers with unclear economic characteristics) than as real securities. They will consider the mass privatization more as a game, than as a real process of property transition. At present, the main attractiveness of the vouchers for the people is their liquidity, but not the expected increase of their profitability in the further period. An indicator for that is the sales of voucher cards (despite the illegality of these transactions) for prices which exceed considerably the value of the registration fee. If the ban will be held, the shares will remain non-liquid for a long time and it will decrease the interest of the citizens in the whole privatization process. In the last, the main goal of the mass privatization is the privatization, in itself, but not its mass or the idea of equitable distribution of state property.

There is an existing opinion that only the trade with the shares acquired from the citizens should be allowed, while the free trade with the shares of the privatization funds, as well as with the acquired by them shares in the enterprises should be banned.

Such a decision would avoid the extra-supply in the very beginning after the last auction session. On the other hand, the privatization funds would be protected against the eventual sharp decrease of the prices of their shares because of the expected negative financial results in 1996. The founders of the privatization funds would not be able to take advantage of this undervaluation because the privatization funds will operate as closed funds in the first 5 years of their activity under article 4, paragraph 1 in the Law on the Privatization Funds.

The main deficiency of this proposal is that the majority of participants (about 85%) would not be able to trade their shares in the privatization funds. The privatization funds will have little opportunity to pay dividends in order to attract and preserve their shareholders. The privatization funds are faced with serious problems because of the lack of financial resources in the form of dividends by the privatized enterprises. The government, led by Mr. Jhan Videnov, decided to transfer all profits of the privatized firms for 1996 to the state budget. The citizens will not enjoy immediate gains from their vouchers, which may decrease their interest in the privatization process. On the other hand, the lack of financial resources (one of the few possible sources is the free trade with shares) will limit the future investment projects of the privatization funds.

The mass privatization is a way for rapid restructuring of a relatively large portion of the state-owned property. The political will and support are the main conditions for its successful implementation. Their lack caused the delay and prolongation of the mass privatization process, as well as of the privatization process as a whole. However, a hidden privatization took place and its participants remained generally unknown to the society. Probably, this is the reason for the strong resistance to the privatization process.

The mass privatization may create a large class of new owners. It may encourage popular support for the whole privatization process. It may promote the development of the capital market in Bulgaria. The task of the state authorities is to make use of its advantages (mainly the rapid transfer of ownership from the state to individual shareholders) and to reduce its inherent vice.