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Privatization

Privatization involves the transfer of ownership of public enterprises from the government to individuals and/or non-governmental institutions. Privatization is also referred to as “de-governmentalization,” “people-ization,” or “marketization.” Privatization is generally carried out for one or more of the following reasons.

- To enhance efficiency
- To generate resources for the government
- To promote popular capitalism

Enhance Efficiency. The private sector has its inherent advantages over the public sector in terms of efficiency. The profit motive of the private sector provides a strong incentive for efficiency. The owners/managers strive hard to increase productivity while lowering costs in order to increase profits. There are various sources of efficiency:

- **Autonomy.** An enterprise isolated from political interference and bureaucratic control enjoys greater autonomy, resulting in enhanced flexibility in investment, financing and operating decisions.
- **Accountability.** Shareholders in the private sector are very demanding. This forces the management of the company to assume increased responsibility.
- **Employee Pride.** As a part of privatization, employees are provided a stake in the company that helps them to identify themselves with the company. This leads to enhanced performance.

Generate Resources. The public sector in most countries, including India, is responsible for budgetary deficits. Privatization is a convenient way to raise resources and reduce the fiscal deficit.

Promote Popular Capitalism. Privatization promotes capitalism by broadening the capital base of equity shareholders. This also results in providing depth to the capital market.

Models of Privatization

M.B. Arthreya proposed four models of privatization. These include:

- **Government Majority Enterprise.** A major portion (51%) of the enterprise’s equity is retained by the government, while the rest is sold off.
- **Government Controlled Enterprise.** The government retains 26-49% of the equity in the enterprise and the rest is disinvested.
- **Joint Sector Enterprise.** The government retains 26% equity, divests 25% to the private sector, while the remaining 49% is offered to the general public for investing.



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- **Private Sector Enterprise.** The government divests its entire equity to the private sector or general investing public.

Identification of sectors that are to be privatized

The primary task is to identify sectors that can be privatized. Companies, apart from those that are strategically important to a nation's security, can be privatized.

Privatization program is spread over a period of time

Privatization of companies should not be done in haste. Typically, a privatization program should be spread over a period of 8-10 years in order to take into account the absorbent capacity of the capital market, political hurdles and many other hindrances.

Restructure before embarking on privatization

Before embarking on a privatization initiative, the company must be restructured. This enables the company to look more attractive to the private sector.

Make a list of potential private sector partners

A private sector partner that can acquire a large stake and can manage the firm has to be identified. The selection process should include the invitation of applications from the private sector and an evaluation of their expertise. Based on the evaluation, the potential companies should be short-listed.

Establish the price at which the shares are to be disinvested

The potential partners should be asked to bid for a 25% stake in the company. The highest bidder may be invited to become the private sector partner. This price can be benchmarked for the 49% stake to be issued to the general public.