Sharing the Wealth

Privatization through Broad-Based Ownership Strategies

Stuart W. Bell
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The World Bank has been an active supporter of structural reforms which reduce the role of the state in commercial activities and create opportunities for expansion of the private sector. Privatization of state-owned enterprises has been an integral component of such reforms in many member countries. The collapse of socialism throughout Eastern Europe and the former Soviet Union posed a unique challenge: how to rapidly and irreversibly privatize unprecedented numbers of state enterprises in economies where foreign participation was limited and where domestic financial resources were insufficient to absorb the volume of assets available. Mass privatization, made possible by the use of vouchers, was a widely adopted, and generally effective, solution to this challenge.

This paper reviews the potential for adapting these participatory approaches to privatization -- characterized by broad-based ownership -- to countries where privatization progress has been hampered by political and social conflicts over ownership and the distribution of the benefits of reform. Broad-based ownership is one tool which may assist in "jumpstarting" the reform process in such countries.

The World Bank's Private Sector Development Department provides specialized services in the fields of privatization and enterprise restructuring, private provision of infrastructure, small and medium enterprise development and regulation. The author's valuable experience in the area of privatization policy and strategy qualifies him well to address the broad range of economic, political and social issues which pervade the privatization process. His suggestions should be of particular help to those currently involved in this process in so many developing countries.

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**ABSTRACT**

Privatization is a inherently political process. Because privatization typically involves a fundamental shift of economic power (always from the state to the private sector and sometimes from domestic owners to foreign owners), it produces political conflict, often assumes the characteristics of a zero-sum game, and sometimes involves such intense debate that, for the policy-maker, the perceived political costs of privatization can out-weigh the expected economic benefits.

This Discussion Paper illustrates a number of privatization strategies which address political and social concerns related to ownership and the distribution of wealth, and thus aims to expose policy-makers involved in privatization to a greater array of strategic options. It describes three basic privatization strategies for widely distributing ownership of state-owned enterprises: voucher-based programs, collective investment programs and public offerings. While these strategies, for the most part, were devised to accelerate the transition from socialism to capitalism throughout Eastern Europe, Central Asia and the former Soviet Union, the paper argues that these approaches can be successfully adapted to countries where progress on privatization has been hampered by political and social conflicts over ownership and the distribution of the benefits of reform.
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The need to privatize rapidly a large number of state-owned enterprises (SOEs) in an equitable manner led to the development of voucher-based mass privatization programs throughout Eastern Europe, Central Asia and the former Soviet Union. Non-voucher variations of these programs, which collectively pool equity distributed to citizens, have emerged within the context of privatization in countries as diverse as Bolivia and Zambia. Many other countries have made use of discounted public offerings to elicit worker participation in privatization, or to distribute widely ownership of privatized equity. These three basic techniques for achieving broad-based ownership -- voucher-based programs, collective investment programs and public offerings -- offer social and political advantages over more traditional privatization methods.

**Political Acceptability.** Broad-based ownership strategies aim at spreading share ownership either to the population at large or to specific sub-groups (such as the poor or ethnic minorities). Where privatization is politically stalled and widely perceived as benefiting only the powerful few, popularizing share ownership can provide policy-makers and legislators with the "political cover" necessary to push often painful and contentious reforms through resistant legislative bodies. And, because broad-based ownership leads to greater public participation in the privatization process, it reinforces support for and sustainability of the reform agenda.

**Opportunities for Redistribution.** Unlike traditional privatization methods (such as trade sales), broad-based ownership schemes create opportunities for government to address concerns about the distribution of wealth. Redistribution can be accomplished by issuing vouchers (the number or value of which may vary with the recipient’s age or years of work), by offering discounts on shares, or by limiting participation in collective investment schemes to low-income groups. For example, Malaysia used a collective investment scheme to redistribute wealth to members of an ethnic group that was economically "under-represented". In the Republic of Korea, where public offerings were used, low-income groups were eligible for deep discounts on share purchases. The effect of vouchers on incomes has been substantial.
In the Czech Republic and Mongolia, for example, the market value of vouchers received by each participant was about half the annual per capita income.

**Capital Market Development.** Many least developed countries cannot use public offerings because of weak or non-existent capital markets. However, broad-based ownership strategies can play an important role in developing and deepening capital markets and associated institutions. These strategies introduce the average citizen to share ownership and help to encourage a trading, savings and investment culture. Voucher programs typically involve the establishment of mutual funds, which offer risk-averse citizens opportunities to invest in diversified portfolios. Share sales and trading between these funds start the process of secondary trading in equity markets. Later, initial public offerings of state-owned equity can be an effective means of deepening capital markets.

Thus, these broad-based ownership strategies are attracting the interest of policy-makers in developing countries who are struggling with the need to devise privatization programs which address either ideological concerns ("the assets of the state belong to the people"), social concerns, such as an equitable distribution of wealth, or political concerns, such as public resistance to privatization.

There are substantial costs associated with these schemes. First, government forfeits proceeds it might have received from direct sales of SOEs.\(^1\) Second, there are significant organizational and administrative costs of preparing and implementing a broad-based share distribution program. For example, with voucher programs government must: arrange for the printing of vouchers; organize and administer the voucher distribution process; establish an effective regulatory framework for financial intermediaries; and in some cases, develop trading mechanisms. All of these impose significant financial costs. Third, for a broad-based ownership program to be successful, government must inform and educate participants about their rights and responsibilities and actively work to build public support for privatization through aggressive, and expensive, public relations activities. While public relations campaigns are needed in all privatization programs, they are especially important in ex-socialist countries, particularly in those with voucher-based mass privatization programs.

\(^1\) Some have argued, however, that voucher programs and the attention they attract can help create a higher degree of investor interest than would have been the case in their absence. In this sense, voucher programs may help attract otherwise untapped capital.
Voucher-Based Programs. Voucher programs -- adopted in the Czech Republic, Mongolia, Poland and Russia, among others -- have proven attractive to policy-makers primarily because they simplify and accelerate the process of privatization of large numbers of SOEs unattractive to strategic investors. Although vouchers emerged as a tool to support mass privatization programs, they need not be linked with mass privatization. Vouchers can be used in conditions where speed of implementation is of lesser importance, but where there are compelling social and political reasons to distribute ownership widely or to target the benefits of privatization to disadvantaged segments of the population.

Voucher-based programs involve the distribution of certificates, or coupons, to participants who then exchange their vouchers either for shares in individual SOEs or for shares in financial intermediaries (voucher funds), which then bid with accumulated vouchers for shares of SOEs. In most cases, vouchers are freely traded for cash. Most voucher-based programs involve multiple financial intermediaries -- typically unit trusts, although several voucher programs employ investment trusts for start-up purposes, with the intention of transforming these into unit trusts once the initial stage of implementation is completed. Financial intermediaries offer risk-averse participants investment opportunities in diversified portfolios; they thus serve as clearinghouses for vouchers. It is also hoped that they will play an important role in the restructuring and governance of newly-privatized enterprises. The use of vouchers is most appropriate where voucher distribution and trading centers will be easily accessible, and where there is an administrative system capable of undertaking voucher distribution and registration. Weak institutional capacity makes implementation of a voucher-based program difficult, although successful programs have been implemented under very adverse conditions (for example, in Russia, and in particular, Mongolia).

A stock exchange is not required to implement a voucher-based scheme. Indeed, the development and deepening of capital markets is an important by-product, if not explicit objective, of such programs. However, once vouchers are converted to shares in either a financial intermediary or an SOE, market liquidity is essential if investors are to be able to freely enter and exit. Liquidity is best provided by a well functioning stock exchange through which brokers may sell shares held by individuals and fund managers may alter and develop their portfolios. In very illiquid markets funds will typically experience cash flow problems and encounter difficulties maintaining sufficient reserves to pay shareholders wishing to sell shares in the fund. However, even where a stock exchange exists, market shallowness may limit
the trading opportunities available to fund managers, and as a consequence, constrain shareholder exit from
the fund.

**Collective Investment Programs.** Collective investment programs take the form of investment trusts and privatization trust funds endowed with government-owned equity (Zambia), pension schemes funded from the earnings of SOE shares (Bolivia), and in a few instances, non-voucher-based unit trusts (Malaysia). Collective investment programs differ from voucher-based programs in two respects. First, they do not necessarily involve distribution of paper vouchers, and as a consequence, they are more simple to administer and typically require fewer resources for their implementation. Second, participants are usually not allowed to freely enter and exit the schemes. In the case of privatization trust funds, citizens do not individually own shares in the fund or any of the underlying assets; rather, the assets are collectively owned and held for the benefit of current and future citizens. There is thus no immediate direct financial gain by participants. In the case of pension schemes, participants can only gain access to their share of the fund through retirement or illness. Collective investment programs are preferred by policy-makers where there are severe constraints to capital market development, little or no understanding of share ownership, cultural barriers to individual accumulation of wealth, low degrees of literacy, and logistical constraints, such as a highly disbursed and difficult to reach population. These factors produce prohibitively high transaction costs of secondary share trading, in which case a collective scheme which limits entry and exit (an investment trust for example) might be preferable to a voucher-based approach.

In some cases, collective investment programs take the form of special unit trusts aimed at increasing the representation of low income groups or ethnic minorities in the economy, as was done in Malaysia. Zambia will make use of a privatization trust fund, which serves as a “warehouse” for enterprise shares pending their sale through public offers or other means. Trustees of these institutions sometimes actively oversee enterprise management and undertake restructuring activities. As noted above, all eligible citizens are “owners” of the shares, but in name only. There are no immediate tangible benefits to citizens under these arrangements; they receive no share of the proceeds nor dividends. However, they may benefit at some future date from discounted public offerings of the trust fund portfolio. The attraction of privatization trust funds stems from their usefulness as an institutional vehicle for moving SOEs out

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1 Collective schemes typically require only government-initiated electronic transactions (such as establishment of accounts) and require no action on the part of the participant. While they are more simple to administer than vouchers, they do demand sufficient technological and managerial capabilities.
of government ownership and under the supervision of profit-minded trustees until they can be successfully privatized.

Public Offerings. Public offerings of SOE shares have been used by many developing countries as a means of widely spreading equity ownership (Jamaica, Korea, Nigeria and Sri Lanka, among others). In some cases, deeply discounted public offerings are used to redistribute wealth to low income groups, as was done in Korea. To be successful, public offerings require the existence of a well functioning and absorptive domestic capital market. SOEs suited for public offerings should meet a few basic criteria: (i) they should be legally formed as joint stock companies; (ii) there should not be any major financial weaknesses, planned restructuring, or imminent calls for more equity through rights issues; (iii) the enterprise and the percentage of shares offered should not be so small that a flotation is uneconomic or not possible under local circumstances dictated by local market conditions and stock exchange regulations; and (iv) the size of the issue must be within the absorptive capacity of the local market.

Avoiding "Orphans". One of the most frequent criticisms of broad-based ownership schemes (particularly voucher programs) is that enterprises risk being "orphaned" as a consequence of the process. That is, ownership can be so widely diffused that no dominant shareholder emerges to force enterprise management to take the painful steps required to survive in competitive and unforgiving markets. And privatization without efficiency-enhancing restructuring is of little economic value. The challenge then is to balance the political and social benefits associated with broad-based ownership with the economic benefits usually associated with more concentrated ownership. Concern over corporate governance has led many governments to build governance-promoting measures into their voucher programs by offering incentives to financial intermediaries to assume this task -- at least until secondary trading of shares can secure the needed core investor. Both Russia and the Czech Republic allowed private financial intermediaries to exchange vouchers for fund shares in the expectation that these funds would accumulate large blocks of enterprise shares and pressure enterprise managers to adopt more efficient practices. This process has been more successful in the Czech Republic than in Russia, where managers exercised greater political influence over program design and succeeded in securing large equity stakes in their enterprises, which shields them from outside influence. In contrast, the government in Poland will itself create ten "National Investment Funds", hire experienced non-nationals to manage them, and administratively allocate enterprise shares to the funds. Every enterprise will have a "lead fund" which
holds 33 percent of its equity, and the other nine funds will each receive three percent of that enterprise. While this has been touted as a more pro-active strategy for addressing the problem of corporate governance (pending secondary trading of shares), there is a risk that these state-owned funds will fall prey to political interference and prove incapable of imposing restructuring programs on the enterprises. In the end, the most efficient mechanism for ensuring effective enterprise governance is the market pressures -- such as share sell-offs resulting from declining earnings and takeover threats -- made possible by secondary trading of enterprise shares. Establishing this capability is therefore crucial to the success of broad-based ownership strategies.
Unit Trusts. Also known as open-end mutual funds, unit trusts are well suited to the needs of broad-based ownership programs, particularly voucher schemes. Unit trusts pool the capital (or vouchers) of a large number of individual investors and purchase a portfolio of securities, which is then collectively managed on the investors’ behalf by a trust manager. The price of unit trust shares (“units”) fluctuates with the market value of the underlying investments. In some countries, shares in unit trusts can be traded privately, or on the stock exchange; in others, transactions must take place through the trust manager. Unit trusts are flexible; the trust manager may vary the composition of the portfolio in order to maximize the benefits to the shareholders. New investors may join, or existing shareholders may exit, at any time (thus the term “open-end”). If investments are not in shares traded on a stock exchange (they eventually should be), special arrangements are needed to provide some liquidity to shareholders. The problem of liquidity can be addressed through appointment of a temporary buyer of last resort -- typically government. However, because this arrangement implies a government guarantee, it can have distortionary effects on share prices and undermine the efficient functioning of capital markets; it can also impose a burdensome fiscal obligation on government. As such, it is a policy prescription of last resort.

Typically, unit trusts do not seek to obtain controlling share holdings, or even share holdings large enough to secure the right to nominate directors in the enterprises for which shares are held. Unit trusts are generally forbidden from these activities so as to prevent them from being exposed to excessive financial risk should a dominant enterprise in the portfolio fail.. In most countries, regulations typically allow no more than 5 percent of a trust’s portfolio to be invested in any one firm, and no more than 10-20 percent of the shares of any one enterprise to be held by a trust.

Investment Trusts. A variant of the unit trust is the investment trust, also known as closed-end mutual funds. This is generally not a trust, but an investment trust holding company. Its size cannot grow or shrink, and there is no provision for redemption unless the fund is wound up and its net

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assets are distributed pro rata to its investor shareholders. It thus lacks any flexibility for the purpose of providing an expanding mechanism for a growing demand from potential shareholders. An investment trust whose resources would be invested in a relatively small percentage of the shares of a number of SOEs in the course of being privatized under a broad-based ownership scheme, would of necessity have a large number of very small shareholders. Such a group of shareholders is not likely to exercise effective shareholder control over the directors and managers of the investment trust holding company of which they are the shareholders. This situation does not arise in the case of unit trusts, since the assets are held in the unit trust for the direct benefit of the trust shareholders, without intermediation of a holding company.

**Privatization Trust Funds.** Unlike unit trusts, privatization trust funds (PTFs) are essentially state-owned holding companies where shares in SOEs are "parked" pending their private placement with core investors or a public offering. They do not act as unit trusts in which the wider public invests, nor issue their own securities, but act as state-owned dealers in securities. Privatization trusts thus serve a temporary, bridging function and differ substantially in their purpose and operations from private sector financial and industrial companies and investment trusts. Privatization trust funds have been used to accomplish a variety of objectives. They are primarily used to: (i) distance enterprises from government interference pending their divestiture; (ii) maximize the value of residual shares held by government for sale at later date; and (iii) effect restructuring prior to privatization. In general, they have not performed well.

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Who receives vouchers? Vouchers can be distributed to the entire population, adult citizens, or other specific groups, such as citizens born before a given date. In Russia and Moldova, all citizens, including children, were eligible to receive vouchers. Housing records and the "internal passport" were used to validate identities of participants. Many countries limit eligibility to adult citizens. For example, in the Czech Republic, Poland and Slovakia, all citizens over the age of 18 were eligible to participate. In Mongolia, all citizens born prior to the 1991 privatization law were given vouchers. The question of who receives vouchers is often complicated by the capability (or lack thereof) of government to validate eligibility. As an example, in Tanzania, where a broad-based ownership scheme is still under consideration, policy makers are grappling with this issue. There is no comprehensive nationwide population registration system in Tanzania, no requirement to carry official identification cards, and no compulsory registration of births or deaths. Officials considered the possibility of using birth certificates or affidavits of birth as proof of eligibility, but this would have required many potential participants to travel to their home village to obtain the required documentation. The excessive costs to potential participants and the possibilities for fraudulent affidavits led policy makers to reject this approach. Tying identification to voter registration was also rejected due to the potential for multiple registrations over the extended registration period. Instead, government will identify participants on the next national election day employing an indelible ink identification process.

How are vouchers distributed? Most countries that have used vouchers have highly centralized and organized administrations. Both Russia and the Czech Republic had well organized existing channels for distributing vouchers, with a coverage of more than 95 percent in Russia in only four months. Physically distributing vouchers can pose an immense challenge for government where the population is highly dispersed and transportation is limited, and where the reach of the administration is circumscribed. Jamaica, when preparing a public offer of shares in the state-owned National Investment Bank, managed to reach most of the population through the local post office system. In Armenia, the local savings banks were the preferred option, having more than ten times the branch offices as the initial choice, the local police.
**Are participants charged for vouchers?** Participation need not be a function of price, but charging a small fee enables government to recoup some (or all) of the administrative costs, provides a stronger psychological sense of value to the vouchers, and places responsibility for obtaining vouchers on the recipients rather than government. In Russia, participants were charged about US$1 for vouchers (approximately two days salary), and 95 percent of the those eligible chose to participate. In the Czech Republic, participants paid US$35 (about one week's salary) for their vouchers, and despite an initially slow take up, participation increased to 8.5 million out of 10.5 million eligible citizens. Vouchers (or their equivalent) were distributed free of charge in Lithuania, Mongolia and Romania.

**Should vouchers be tradeable?** Allowing for tradeability offers two distinct advantages: (i) more conversion choices makes them more attractive to the public and encourages greater participation;⁵ and (ii) tradeability allows for the legal creation of a liquid secondary market in vouchers and facilitates accumulation of vouchers in the hands of would-be core investors. In Russia, where vouchers are legally tradeable and have become a financial instrument in their own right, investors anxious to participate in auctions had no trouble assembling large blocks of vouchers. This was a desirable outcome as the vouchers were intended to be an important vehicle for core investors to acquire majority stakes in privatized enterprises, thereby creating the conditions necessary for enterprise restructuring and effective corporate governance. Some policy makers fear that tradeability of vouchers will reduce equity as it enables wealthier individuals to accumulate them from those who are less well off; this argument prevailed in the Czech Republic and Lithuania, where trading of vouchers was prohibited. Nevertheless, some countries have attempted to protect less sophisticated investors from "cashing out" too soon -- and thus foregoing potentially substantial returns on their vouchers -- by allowing for trading only after a specified period of time, or by allowing trading of one class of vouchers, but not other classes, as was done in Mongolia. However, as Boycko [1994] noted, "trading in vouchers will take place even if it is forbidden, as it did in Mongolia, with the result that the poor receive very bad prices in illiquid markets. The best price protection is competitive and open markets for vouchers".⁶

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⁵ As Boycko, et al [1994, p. 255] noted, "(p)rivatezation is more likely to succeed when people spend time thinking about what to invest in, learning about companies, picking mutual funds, or even deciding whether to sell their vouchers, than when they simply get pieces of paper to store under the pillow or in a bank."

⁶ Op cit., pg. 261.
Are vouchers denominated? And if so, do they affect inflation? Vouchers can have either a monetary face value or a point value. The main advantage of denoting vouchers in currency units is that this gives them a clear indication of value, which facilitates trading. It has been argued that currency denominated vouchers add to the money supply and thus have a potential inflationary effect. As the argument goes, the distribution of vouchers increases the wealth of all recipients, increases short-term consumption, and thereby exerts inflationary pressure on prices. Most economists think that because vouchers are absorbed through their conversion to enterprise shares, the net change in wealth is zero, and they therefore have no major or enduring inflationary impact. It is reasonable to think that any inflationary impact vouchers may have would manifest itself in short-term, one-off price increases as a function of voucher (monetary) velocity. It should be noted that in no country where vouchers have been used has there been any significant inflationary impact attributable to vouchers. In a highly inflationary environment, or where a sufficient supply of viable assets do not come rapidly on the market, vouchers quickly lose their value, in which case the overall inflationary impact, if any, is marginal. Russia arbitrarily set the value of its vouchers at 10,000 rubles, and through trading, let the market decide the true value. Before many assets came on to the market, vouchers traded at a deep discount to their face value; even when enterprise auctions began, and the trading value of vouchers increased, it rarely matched the rate of inflation. In the Czech republic, vouchers were denominated in points rather than currency.

How are vouchers converted? Where vouchers can be directly converted into shares of individual SOEs, most countries use public auctions. In Russia, auctions have mainly been held locally, but all voucher holders are allowed to participate and several steps have been taken to facilitate national bidding. In Mongolia, auctions of large SOEs were centralized with local brokerage firms (created for this purpose) representing local voucher holders. Where vouchers represent a share in a privatization fund they are never directly converted to shares in individual enterprises; they are converted only to cash or shares in one of the privatization funds. In Russia, participants converted their vouchers into either cash, shares in individual enterprises or into funds investing on their behalf. The Czech program had privatization funds compete for voucher points from the citizens, and subsequently, with individuals and other funds for shares in participating enterprises. In Poland, participants will receive a predetermined shareholding in each of 10 to 15 "National Investment Funds". In Bolivia, participants will not receive vouchers, but an account in a privately managed pension fund.
Should there be one or several financial intermediaries? Countries with voucher-based programs have all made use of multiple funds; no country has established a monopoly situation as this would replicate public ownership. The argument for competition among intermediaries applies equally to funds as to enterprises. Under voucher-based programs, the main issue is whether funds should be created by the state (top-down) or by private groups (bottom-up). In Russia and the Czech Republic, where bottom-up approaches were adopted, funds were allowed to form spontaneously. In Poland, National Investment Funds will be created by the government but managed by the private sector. These funds will receive pre-determined allocations of vouchers, and pre-determined ownership in SOEs being privatized. For each enterprise offered, one of the funds will receive a larger stake than the others and will act as a "lead fund" to ensure proper corporate governance of these SOEs until such time as their majority ownership passes to private hands. Under collective investment programs, single financial intermediaries are fairly common. In Bolivia, for example, a single, privately managed pension fund will hold equity in newly-privatized SOEs on behalf of participants. In Zambia, one Privatization Trust Fund will serve the same purpose, but will eventually make its portfolio of equity available to citizens through public offerings after the establishment of a stock exchange.
CASE STUDIES

VOUCHER-BASED PROGRAMS

The Czech Republic

The Czech (and roughly similar Slovak) program is characteristic of a highly decentralized, bottom-up approach to a voucher-based scheme. With some exceptions, SOEs were given authority to prepare their own privatization plans, subject to government review. Also, competing plans were encouraged in order to force enterprise managers to vie with outsiders for ownership. Privatization, however, was compulsory. For medium and large SOEs, emphasis was placed on privatization through coupons (vouchers), although other methods of sale emerged through competing privatization plans, including direct sales, public auctions and tenders, and transfer to municipalities. Each plan defined the percentage of shares to be traded for vouchers, which varied from as low as 3% to 97%. The Czechs chose to privatize all save a few firms in two waves over a three year period.

All adult citizens were eligible to purchase a book of vouchers at a cost of US$35 (about one week's salary). Unlike Russia, the Czech vouchers were denominated in points (1000 points per voucher) instead of currency, which was aimed at preventing the vouchers from being treated as securities or currency and therefore potentially having them trade at a discount to their face value. Also unlike the Russian program, the Czech vouchers could not legally be traded for cash. A list of firms whose shares could be traded for vouchers was made public through the Center for Voucher Privatization and a free booklet explaining the voucher program was also distributed.

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7 This section and the section on Russia and Poland are drawn largely from Lieberman et al, "Mass Privatization in Central Europe and the Former Soviet Union: A Comparative Analysis", prepared for the March 1994 OECD Conference on Mass Privatization.

8 The program was initially designed for Czechoslovakia, which later split into the Czech and Slovak Republics. The new administrations decided that the first wave of privatization should be completed as designed, and that the second wave should be carried out separately by the individual republics.
With their vouchers, participants were able to bid (through a quite complex central auction process) for shares in SOEs of their choosing, or alternatively, they could place their vouchers with any of the more than 400 investment trusts ("Investment Privatization Funds" or IPFs), which emerged independently and spontaneously. In turn, the IPFs bid for blocks of shares in available SOEs through the same auction system.

The government devised a complex formula for determining the value of the shares which balances book value and investor demand using a computerized system linking 600 bidding offices throughout the country. Five rounds of bidding were planned, starting in the spring of 1992. In the first round of bidding all shares were offered at the same starting price -- 100 points for three shares. If the demand for particular shares exceeded supply by at least 25 percent, no bids were accepted and the shares were offered again at a higher price in the next round of bidding. If demand was less than supply, shares were sold at the offer price to all bidders, and any remaining shares were offered in subsequent rounds at lower prices. Prices were adjusted in this manner from round to round, until most shares were sold.

There was little public interest in the voucher program until January 1992 when some of the IPFs promised to buy voucher books for 10-15,000 crowns -- ten to fifteen times the original cost -- payable one year after the share transfer. These promises by the IPFs produced a surge of public interest in the voucher program, and participation leaped from 2 million in January to 8.5 million just a few weeks later. The book value of the SOEs in the first wave of the program amounted to Kcs 300 billion (US$10.6 billion), which exceeded the value of the coupons sold by 35 times. Thus, each participant initially held coupons worth Kcs 35,300 in book value terms (about US$1,250, or half of the average per capita income). Aversion to risk and a desire to avoid the complexities of direct bidding led to 72 percent of voucher holders placing their vouchers with the IPFs. Several of the funds are reportedly undercapitalized and are not likely to survive.

Results. The first wave of privatization was completed in December of 1992. Some 1,492 SOEs employing 1.3 million workers were privatized through the voucher program, representing US$10.7 billion in assets. Altogether, the first wave of the privatization program took five rounds of "investing" to complete the voucher process, involving both individual citizens and IPFs.
At the end of the first wave, 93% of all shares were sold and close to 100% of all purchased vouchers were swapped for shares, 72% in the 434 legally registered IPFs and the remainder directly in SOE shares. However, half of the vouchers placed with the IPFs went to just 10 funds, many of them subsidiaries or affiliates of the large commercial banks, savings banks and insurance companies in which the state retains partial ownership.

The IPFs have emerged with considerable power in the Czech capital market. The IPFs have also adopted an active role with regard to corporate governance and restructuring of newly-privatized enterprises in their portfolios. The most popular purchases were hotels, breweries, banks and glass factories. For these enterprises, prices rose to as high as 800 points per share. The least popular enterprises demanded only 100 points for 90 shares. The second wave of privatization, involving approximately 900 SOEs, is in process at time of writing, and is scheduled to be completed in mid-1994.

**Mongolia**

Mongolia implemented rapidly a voucher-based privatization program between January 1991 and the end of 1993, by which point more than 80 percent of state assets and enterprises were transferred to the private sector. The program was divided into two components: (i) small-scale privatization, which included 1,600 small SOEs in the trade and service sector, livestock and housing; and (ii) large-scale privatization, which encompassed cooperative and state farms and 344 large enterprises.

Every citizen born prior to the approval of the Privatization Law received a book of ten vouchers which came in two classes. The first class included three red vouchers, each of which had a face value of tugrik (M$) 1,000, were tradeable on secondary markets, and dedicated to the small-scale privatization program. Total book value of small-scale assets was M$9.4 billion. The second class was comprised of seven non-tradeable blue vouchers with a face value of M$7,000 each; these were dedicated

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Mongolia has approximately 2 million inhabitants in a country the size of western Europe. Literacy is high, and the country is centralized and well organized. Communication is good due to widespread ownership of radios and high consumption of newspapers in urban areas.
to the large-scale privatization program. Total book value of large-scale assets was M$10.8 billion. Each participant thus received vouchers with a total face value of M$52,000. However, the denominations of the vouchers were only notional, representing the historical cost of the assets to be privatized. The real purchasing power of the vouchers would be determined through public auctions.

A nominal fee was charged for vouchers in order to transfer responsibility for obtaining them to the recipients. The distribution of vouchers was controlled by placing a stamp on the ration cards carried by all citizens, indicating that the vouchers had been transferred to the card holder. All participants were entitled to use their vouchers in the non-agriculture portion of the large-scale privatization program. Members of the farming community were supposed to use their vouchers in the closed-subscription process established for farm privatization.

Vouchers were exchanged for enterprise shares through a nationwide trading system partly created for the exercise. In each of 25 regions a local brokerage house was created and linked to a newly-created stock exchange. Shares in SOEs were sold sequentially in small tranches over an extended period of time, with as many as 15 SOEs being auctioned concurrently.

SOEs in the small-scale privatization program were transferred to the private sector through local auctions under guidelines established by the central implementing body -- the Privatization Commission. Only red vouchers could be used to bid for small assets. Individuals or groups interested in acquiring these assets had to accumulate enough red vouchers through secondary trading to bid successfully at the auctions. The highest bid would win and the Privatization Commission would issue an ownership certificate to the winner. However, workers in small enterprises had the right of first refusal to purchase these assets (using red vouchers) at a value determined by the Privatization Commission. Many small SOEs went to employees and their families.

The large-scale privatization program was also conducted through auctions. The Privatization Commission instructed the large SOEs to prepare privatization plans which identified the number of shares to be sold on the stock exchange. Each share corresponded to M$100 of net assets valued at historical cost. However, since the price of SOE shares in vouchers would be determined

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11 For political purposes, agriculture was separated from the other two privatization processes, leading to three largely distinct programs.
through auctions, this valuation only had relevance for employees who could use their vouchers to buy shares at the initial offering price. In addition to bidding for shares on an equal footing with other interested bidders, employees of large SOEs were granted 10 percent of enterprise shares. Bidders declared the number of vouchers they were prepared to offer for enterprise shares and a time period for which the offer was valid. Brokers in each locality throughout the country would collect these bids and phone in a bid to the stock market. The broker with the highest bid for the available batch of shares would register the owners and provide them with ownership certificates. Voucher holders who did not want to purchase enterprise shares directly, or who did not understand the auction process, could place their vouchers with unit trusts operated by the brokerage firms, which were not allowed to control more than 20 percent of the shares of any one enterprise.

**Results.** In voucher-based privatization, effective corporate governance requires not only the distribution of vouchers and voucher auctions, but also secondary trading of enterprise shares. Because secondary trading has not yet been established in Mongolia, no core owners have arisen and enterprise ownership remains extremely diffused. For example, in the case of one privatized hotel, 12,000 citizens obtained shares and the largest individual owner held only 0.07 percent of the total outstanding equity. Without controlling shareholders, market pressures on enterprise management are muted, and it is assumed that performance suffers. The absence of secondary trading of enterprise shares also means that participants must wait to "cash out" of the market -- a frustrating situation for low income participants in need of cash. In the secondary market, red vouchers traded at about 30 percent of their face value (M$300 per voucher, or M$900 per recipient). Nevertheless, this means that sales of red vouchers by an average family of three would have yielded M$2,700 -- about half a year’s average salary.

There were major achievements in the development of the capital market. The Mongolian Stock Exchange was established in February 1992. Only vouchers have been traded for shares on the exchange; secondary trading of shares is not yet possible as securities regulations are still being developed. After opening, the volume of trade on the exchange increased continuously. Within just four months the cumulative number of shares traded for blue vouchers reached 3.5 million, with a value of M$881 million. Daily volume of trading reached 468,000, with a value of more than M$100 million.
Poland

The Polish mass privatization program has been in gestation for more than three years, and many of its details have yet to be determined. However, it is clear that it is a more top down approach than that adopted by the Czechs and Russians. Its design also reflects less willingness by Government to rely upon market forces. As currently envisaged, it combines vouchers with investment trusts -- financial intermediaries typically associated with collective investment programs. The Government has chosen an initial group of 400-600 medium to large SOEs to participate in the first phase of the program. Unlike the Czech and Russian programs, where private financial intermediaries were allowed to form independently, the Government itself will establish an initial group of from 10 to 15 financial intermediaries -- National Investment Funds -- which will assume lead management of approximately 30 SOEs each through a pooled bidding process. This portfolio of firms would be managed initially in the form of investment trusts, and will later have the option to convert to unit trusts. The Government is seeking to attract high quality investment managers to manage the trusts on the basis of contracts that offer substantial upside rewards for increasing the value of the trusts by restructuring the underlying assets. As of mid-1994, a number of high quality candidates had been identified.

As noted, the investment trusts will be given core ownership (33 percent) of approximately 30 SOEs each, in addition to about 3 percent each of a large number of other SOEs. Workers will receive 15 percent of enterprise equity and the government treasury will retain 25 percent for later sale. The Government’s ownership interest will be represented by the lead trust -- giving that trust de facto control. After the trusts have been operating for one year and an audit has been completed, Polish citizens will be able to obtain shares in the trusts through conversion of their vouchers. The investment trusts cum unit trusts would then be traded on the Warsaw Stock Exchange. (Participants cannot exchange their vouchers for shares in individual SOEs.) The program thus emphasizes controlled distribution of core ownership (rather than letting core owners emerge through the voucher market), and reduced risk to investors through compulsory portfolio investment in the National Investment Funds.

**Progress to Date.** Implementation of the program has not yet begun, although much of the foundation of the program is now in place, including the legal framework, regulatory framework for the funds, and fund agreements. The following work remains: (i) final selection of the funds and contract agreements between the Government and the funds; (ii) establishment by fund managers of physical
operations and recruitment of staff; (iii) establishment of the funds as joint-stock companies and appointment of their supervisory and management boards; (iv) selection of the SOEs for the program and their commercialization; (v) allocation of the SOEs to the funds; (vi) printing and distribution of share certificates; (vii) establishment of off-line trading arrangements for the certificates and registration of the funds with the Warsaw Stock Exchange; and (viii) conversion of vouchers into shares.

Russia

The Russian voucher scheme was intended to facilitate the mass privatization program and emphasized the speed of the process and the comprehensive inclusion of virtually all medium and large SOEs (5,000-6,000 large enterprises were in the program and an additional 16,000-20,000 medium enterprise had the option of joining). The program focused on gaining the support of the population by issuing vouchers to all of Russia’s 150 million citizens, who were issued one voucher each and charged 25 rubles (about 5 US cents at the prevailing exchange rate). Like the Czech approach, the Russian program was also designed as a "bottom-up" program. The Government’s role was limited to laying out the conceptual framework of the program, providing enterprises with common privatization documents, and reviewing and approving the submitted plans. As with the Czech program, individuals and groups were free to form investment funds and bid for enterprise shares with the vouchers individuals chose to place with these funds.

Although the Russian and Czech experiences have much in common, there are some significant differences between the two programs. First, the Czech program was tightly administered on a national level, while the Russian program required a much more decentralized approach because the central government was unable to control the activities of the 88 oblasts (distinct regions, each with its own property committee and property fund). For example, in Russia there was no central auction process as in the Czech Republic, where the shares of thousands of enterprises were allocated at once. Instead, most enterprises have been auctioned off a few at a time by the local property funds to voucher holders who live or work in the oblast. Second, vouchers are freely tradeable in Russia, while trading is prohibited in the Czech Republic. Third, Russian enterprise managers and employees enjoy considerable advantages over their Czech counterparts. Through a closed subscription process, they were able to secure large shareholdings in their enterprises before equity was put up for auction. In this manner they were
normally able to prevent outsiders from gaining control of the enterprises -- very much unlike the Czech process.

In Russia, a voucher-based scheme with many options for conversion was preferred over a collective ownership scheme for four reasons. First, it was feared that large state-sponsored investment trusts would become politicized and therefore incapable of forcing restructuring programs on the enterprises. Second, a collective scheme would have forced a large number of shareholders on enterprise managers. The managerial lobby would have fiercely resisted such a scheme and made implementation difficult. Third, by offering participants more choice of what to invest in, a voucher-based scheme was seen to encourage greater participation than a collective scheme where participants have a much less active role. And, fourth, technological constraints to a collective scheme made implementation too difficult under Russian conditions.

Russian reformers put forward several arguments for voucher tradeability. First, restrictions would limit participants' choices and thereby reduce the attractiveness of the program. Second, tradeability would allow participants -- especially the poor -- to sell their vouchers for immediate cash. Third, trading would likely occur even if it were illegal, and a legal, semi-regulated market for vouchers is preferable over a black market. Fourth, tradeability would allow core shareholders to emerge through secondary trading of vouchers. The Russian vouchers are denominated in rubles (10,000 rubles per voucher) and are immediately tradeable, thereby enabling the creation of a large secondary market for vouchers. Participants had many options for disposing of their vouchers, including: (i) conversion to shares in individual SOEs; (ii) conversion to shares in investment trusts; or (iv) sale for cash.

Government regulations stipulated that no more than 80 percent of enterprise equity could to be purchased with vouchers; however, 29 percent had to be sold through voucher auctions, and the remainder could accumulate either through the closed subscription process or through commercial tender.

A presidential decree issued in October 1992, followed by passage of the Investment Company Law in 1993, allowed the formation of voucher investment funds. Having learned from the Czech experience with unregulated voucher funds, the Russians devised regulations to prevent fund abuse.

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12 These points have been elaborated in Boycko et al, "Privatising Russia", prepared for the Brookings Panel on Economic Activity, September, 1993.
Voucher funds and managers are regulated in the form and nature of the fund, licensing requirements, the relationships between funds and fund managers, portfolio investment restrictions, valuation procedures, reporting requirements and the rights of shareholders. State enterprises are expressly forbidden from establishing voucher funds as this could have been a means to acquire shares in SOEs, thereby negating the entire purpose of the program. Provisions have been made in the law for the development of open-end funds, but given the problems of asset valuation and liquidity, such funds will not likely emerge for the foreseeable future. As of February 1994, 640 regional and national funds were licensed and operating.

It was initially perceived that the Russian funds would not play as prominent a role in post-privatization enterprise activities (i.e., restructuring) as they have in the Czech Republic due to the limits established on fund ownership of enterprise shares (initially set at 10 percent of any one enterprise's share capital). The funds were therefore expected to be passive portfolio investors, much as they are in the West. However, recent developments point toward a more active role for the funds in governance of privatized enterprises. Prior to implementation of the voucher auctions, the funds were very active in the voucher market, trading them for capital gains and selling them to finance their current expenditures. This was necessary because they received little interest or dividend income from their initially small portfolios. The Government was concerned that this speculation in vouchers by the funds was undermining the voucher market by driving down voucher prices, and it forbade voucher sales by the funds in a May 1993 presidential decree. However, as the pace of voucher auctions increased, the funds shifted their strategies, and focused on accumulating large blocks of shares in specific firms where they saw potential to increase their profits through restructuring of assets. They accomplished this by either ignoring the 10 percent ownership restriction or through collaboration with other funds. As a consequence, the Government decided to raise the restriction to 25 percent of any one enterprise's share capital. Several funds have now emerged with over two million shareholders, and accumulated over four million vouchers; they have taken an active role in challenging enterprise managers at annual meetings.

Results. As of June 1994, over 12,000 enterprises had passed through the voucher auction process, just two years from the inception of the program and only 18 months from the initial pilot voucher auctions. By April 1994 a total of 80 million vouchers (more than 50 percent of the total issued) were converted into equity through the closed subscription process and voucher auctions, and another 5 to 10 million through small-scale privatization, leases, and other means. About 42 million of these vouchers have been collected by the voucher funds, with 65 percent of these already invested in enterprises.
equity. On average, 30 percent of the equity of newly-privatized firms was obtained with vouchers. The voucher auctions will be completed in October 1994. All residual state shares, as well as enterprises which stayed out of the voucher auctions, will then be sold on a cash-only basis.

The privatization voucher was the first liquid security to be issued in Russia and is now actively traded on dozens of exchanges throughout the country. On the largest exchange in Moscow the volume of trade often reaches 60,000-100,000 vouchers per day. Market prices for vouchers have fluctuated widely with political developments in the country. After hitting a low of 4000 rubles in early 1993, the price rose to 11,000 rubles in July and nearly 30,000 rubles by the end of 1993.
Malaysia

Malaysia is comprised of three major ethnic groups: Malays, Chinese and Indians. The Malay category includes ethnic Malays of Muslim religion and indigenous people of East and West Malaysia (bhumiputras). In 1971, Malays accounted for 58% of the population and owned 4.3% of all share capital (at par value), while the Chinese and Indian communities, representing 42% of the population, owned about 34% of all share capital; foreigners controlled 62%. Concerned that bhumiputras were economically under-represented and falling further behind other groups, the Government launched the "New Economic Policy" (NEP) in 1971. An overtly interventionist policy, the 20 year NEP program aimed to raise the proportion of share capital owned and controlled by bhumiputras to 30 percent by 1990 through ownership quotas. This was to be accomplished by endowing a government-created unit trust with SOE equity, available for purchase exclusively by the bhumiputra population.

The Government established the Bhumiputra Investment Foundation in 1978 to formulate policies and guidelines for equity investment of bhumiputras. The Foundation was entrusted with the responsibility of encouraging the development of entrepreneurship and investment in the bhumiputra community. The National Equity Corporation (Permodalan Nasional Berhad, or PNB), also established in 1978, was incorporated as a wholly-owned subsidiary of the Foundation with an authorized capital of ringgit (M$) 200 million (US$86 million), half of which was paid up by the Foundation. The PNB's primary role was to evaluate, select and purchase a portfolio of SOE shares to be held in trust for subsequent sale to bhumiputras through the Amanah Saham Nasional Berhad (National Unit Trust Berhad, or ASNB), the national unit trust scheme. PNB avoided excessive concentrations of shares in any one enterprise or industry in order to maintain a diversified portfolio. However, it actively monitored the management of enterprises for which it held shares. PNB maintained a pool of about 70 directors who

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For more detail on this case see: M.L. Sieh Lee and C.K. Lyn, 1986.
served on the boards of portfolio companies, and through whom PNB monitored the performance of its investments.

The ASNB was established in 1979 as a subsidiary of PNB in order to facilitate the transfer of equity to individual *bhumiputras*. ASNB was to establish the unit trust scheme which included the marketing of shares to eligible investors and management of the fund. However, unlike a conventional unit trust, the ASNB trust was modified in that the price of a unit was initially fixed at M$1 per unit (ie, the price of the units did not fluctuate with the market prices of the underlying investments) and involved a matching advance from the banks of 90 units for the initial 10 units purchased. The trust deed stipulated that the managers of ASNB would receive a management fee of no more than one percent of the mean value of the fund at the beginning and end of each period.\(^4\) ASNB thus accumulated *bhumiputra* savings by selling shares of the fund to individuals. ASNB also encouraged *bhumiputras* to participate in financial investment in general and helped create awareness of the benefits and advantages of investing. The Government launched a massive nationwide public information campaign in 1981 to inform the population about the scheme, making use of radio, TV and newspapers. Marketing officers of ASNB and state government officials conducted seminars and briefings with the *bhumiputra* population, and ASNB appointed several agents -- *bhumiputra* banks and the post offices -- who covered all states in the country. Some banks designed special loans to assist *bhumiputras* participating in the program.

According to the scheme, *bhumiputras* over the age of 18 were eligible to purchase ASNB shares at M$1 per share. Participants completed a registration form and purchased at least 10 shares as an initial investment. This transaction could be completed at the post office or any of the commercial banks acting as agents of ASNB. The investor was then given a passbook in which the initial investment was recorded. The initial investment could not be sold until 1990 (10 years after the shares were first offered to participants). The investment earned a dividend of 10 percent annually, which was automatically re-invested during the holding period.\(^5\) Subsequent to the initial investment, participants could purchase additional shares either through savings deposited in their passbook account, or in the form of certificates sold in blocks of 100, up to a maximum of 50,000 shares. Shares accumulated through the

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\(^5\) This was not a guaranteed dividend, but a "commitment" by PNB management to achieve some "minimum" yield rate based upon internal criterion for share acquisition purposes.
passbook account could be sold back instantly at post offices and any office of the appointed agents. The buying and selling price remained MS1 per share until 1990, at which time price determination was based upon the value of the assets in ASNB’s portfolio. To compensate participants for any appreciation in asset value of the portfolio during the holding period, shareholders received bonuses from time to time, depending on the performance of the portfolio.

The first transfer of equity from PNB to ASNB -- necessary to facilitate the creation of shares in the unit trust -- occurred in 1981, when 660 million shares then estimated to have a market value of more than M$1.5 billion (US$651 million) were transferred to the fund. Comprised of shares from 21 enterprises -- mainly in the tin, banking, insurance and industrial sectors -- the portfolio was selected from a total of 2,145 million shares held by the Government in 674 enterprises. The main criteria applied by ASNB in the selection of equity were the companies past profit performance, comparison of rate of return to industry average, financial position, future prospects, and net tangible assets.

By the end of 1983, the ASNB portfolio was comprised of shares in 96 companies, valued (at cost) at more than M$1.1 billion (US$474 million). Two-thirds of the portfolio was invested in enterprises listed on the Kuala Lumpur Stock Exchange. By this time, composition of the portfolio had shifted away from tin and towards the finance and plantation sectors. Plantations accounted for more than half of the portfolio, 28 percent was in the financial sector, and another 18 percent was in industrial holdings. Because PNB served essentially as a buyer of last resort for ASNB, shares in the poorest performing companies were returned to PNB. Thus, PNB had a 1983 pre-tax profit of M$145 million from its investment of M$3.6 billion (4.0 percent). ASNB achieved a profit of M$84 million from its investment of M$1.1 billion (7.6 percent). One year later, in November 1984, ASNB’s portfolio had grown, in cost terms, to M$3.5 billion (US$1.5 billion).

**Results.** Throughout the first four years of program implementation, *bhumiputra* participation in the NEP scheme increased substantially. Within the first two months after the program was launched, the ASNB had collected investments amounting to M$245 million (US$106 million) from more than 340,000 investors (about 7 percent of eligible participants), the majority of whom were investing for the first time. By the end of the first year, net investments totalled M$299 million, tripling the expected target of M$100 million. By July 1984, about 1.6 million *bhumiputras*, representing 32 percent of those eligible, invested more than M$1.1 billion in the scheme. During this period, ASNB was
collecting average net monthly investments of M$49 million -- an equivalent annual growth rate of 53 percent. Analysis of share ownership in ASNB in 1984 reveals that 84 percent of investors owned 500 shares or less, and those holding more than 10,000 shares constituted only 1.8 percent. In terms of returns to investors, the ASNB portfolio yielded an average annual return from dividends and bonuses of 15.8 percent over the period 1981-90, while fixed deposits in Malaysian commercial banks averaged 7.8 percent over the same period.16

Analysis of the trends in share capital ownership reveals that significant ownership gains were made by bhumiputras throughout the first 13 years of the program, after which time their share in corporate ownership began to level off. By 1975, the proportion of share capital owned by bhumiputras had increased to 9.2%, while that owned by other ethnic groups had risen to 37.5%.17 By 1983, bhumiputra ownership of share capital had more than quadrupled, rising to 18.7%, while other Malaysian groups held 47.7% and foreigners 33.6%. However, by this time it was increasingly apparent that the 30% target would not be reached. By 1988 the bhumiputra share had not changed appreciably, settling at 19.4%, while the share of other Malaysians had grown to 56% and the foreign-held share had dropped to 24.6%.

While significant progress was made through the NEP in narrowing the disparity of ownership among Malaysians, this was accomplished at considerable cost. The program had the effect of severely dampening foreign direct investment in the economy, which declined throughout the early 1980s. Public investment made up the shortfall, putting tremendous strain on the budget, which fell into deficit throughout the entire 1971-90 NEP period. Finally, recognizing that the NEP policy of restricting foreign investment was contradictory to its need to sustain growth rates which made improvements in bhumiputra economic conditions possible, the Government began to downplay the NEP guidelines in 1986 by relaxing foreign equity restrictions on companies established with foreign capital prior to 1986 and exempting all of those established after 1986 from the NEP equity requirements entirely.


The "National Development Policy" (1990-2000) is the heir to the NEP, and like its predecessor, it seeks to establish a balance between growth and equity objectives. However, unlike the NEP, the new program refrains from setting quantitative targets with respect to bhumiputra participation in various spheres of the economy. Instead, the objectives with respect to the bhumiputra population are to be met through human resource development programs in education and training.

**Zambia**

The Government of Zambia has launched an ambitious privatization program aimed at privatizing some 150 SOEs, accounting for 80 percent of formal economic activity, over five years. Included in the program is Zambia Consolidated Copper Mines, which accounts for 80 percent of Zambia’s export earnings. The program aims to: (i) ensure participation of the largest possible number of Zambian citizens in the privatization process through direct or indirect ownership of shares in the SOEs to be privatized; (ii) create an equity market which would permit trading in the shares of newly-privatized SOEs; and (iii) introduce new savings instruments to encourage popular saving and diversify the types of savings instruments which the small individual investor can buy -- for example, unit trusts, investment trusts, and venture capital funds.

The Government of Zambia intends to find majority private shareholders for the SOEs in the program, as well as reserve a minority stake for some of the larger SOEs (up to a maximum of 30% of any SOE) to be offered to Zambian citizens through discounted initial public offerings (IPOs) on the Lusaka Stock Exchange. Because there will be a lag between these two events, the government has decided to create a Privatization Trust Fund (PTF) which will function as a "warehouse" for minority stakes reserved for later sale to citizens. The PTF is not a unit trust or an investment trust, but a state-owned holding company which serves to bridge the period between sale to core investors and sale to the public; it will not issue any of its own securities, but act as a securities dealer. Unlike more traditional state-owned holding companies, the PTF is not allowed to hold a controlling interest in any SOE.

The PTF has been established by a trust deed -- lasting five years -- between the Government and the PTF’s Board of Trustees. The PTF will be managed by a professional management company, selected through competitive bidding among private banks and financial institutions. The
winning management firm contracts with the Trustees of the PTF, and is responsible for ensuring that the PTF is managed in accordance with the trust deed. Once the portfolio is transferred to the PTF, the Government has no remaining control over the shares held in the fund, but it will receive dividends until they are sold. The management company will be responsible for: (i) evaluating the shares proposed by the privatization agency for inclusion in the program to determine whether they are appropriate for the PTF (only viable, profitable SOEs will be included); (ii) managing the PTF shareholdings and monitoring the progress of the portfolio; and (iii) advising the Trustees on the sale of shares. The management company will receive a fixed fee plus a performance fee determined on the basis of its ability to sell shares in accordance with the timetables of the divestment program.

Priority in the sale of minority shares will be given to small individual Zambian investors through IPOs, with the objective of achieving a wide distribution among the population. Share prices for IPOs will be discounted as deeply as possible and small investors will receive bonus shares and other incentives designed to encourage them to retain their shares. Small investors may also pay for their shares in installments. If capital market conditions are unfavorable, priority will be given to financial intermediaries investing on behalf of Zambian citizens. For shares offered to small investors, prices will be discounted and a ceiling will be placed on the number of shares any one individual or institutional investor may purchase. If all minority shares are sold when the trust deed expires the PTF will be liquidated. If some shares remain unsold, the PTF will be converted into a unit trust and the remaining shares will either be sold or distributed to eligible citizens without charge.
In 1987, the Korean government adopted a unique broad-based ownership scheme for its privatization program, dubbed the "People's Share Program" (PSP). The PSP had two primary objectives: (i) redistribution to low income groups; and (ii) to distribute ownership as widely as possible. These objectives were to be met through the transfer of over US$8 billion\(^9\) of enterprise shares (minority stakes only) in seven major SOEs to the population -- in particular, low income segments -- through public offerings over a period of five years (1988-1992). All seven of the chosen SOEs were dominant, well performing, profitable enterprises in the banking, utility and industrial sectors; all were either monopolies or enjoyed substantial protection from competition.\(^{20}\) For five of the SOEs, 49 percent of the share capital was offered, while 30 percent and 21.6 percent was available for the remaining two enterprises. The government retained majority ownership of the remaining shares.

There were two allocations for the PSP offerings: priority allocation and general allocation. Priority allocation comprised 95% of the total offering (20% to enterprise employees and 75% to low income groups (ie, farmers, self-employed, and general workers), while the general allocation comprised 5% of the offering and was available to the general public. Individuals qualifying for the priority allocation were screened in advance for qualification and required to open a special savings account associated with the PSP. They then could participate either by directly purchasing the allocated shares or by indirectly purchasing shares through the People’s Share Trust Fund. The People’s Share Trust Fund was established to provide financial assistance to individuals eligible to participate in the PSP but without

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\(^9\) See: Dae-Hee Song, Three Essays on Korean Privatization Policy, Korea Development Institute, August 1989.

\(^{18}\) This was equivalent to more than 10% of the total capitalization of Korea’s stock market in 1988.

\(^{20}\) The SOEs in the program were: Pohang Iron and Steel, Korea Electric Power Corp., Citizen’s National Bank, Small and Medium Industrial Bank, Foreign Exchange Bank, Korea Telecommunication Authority, and Monopoly Corp.
the funds to do so. Individuals were required to hold the shares they purchased with financial assistance from the Trust Fund for a period of three years.

There were a variety of financial sweeteners to encourage participation in the PSP. Employees of SOEs targeted for the program were offered either a 30 percent discount off the offer price or an installment payment plan which allowed payments for stock purchases to be made over five years with no interest. Low income participants were offered only the 30 percent discount. In addition, financing of up to 50 percent of the purchase price, at 8 percent interest, was available to priority allocation groups; membership in the People's Share Trust Fund was required to obtain this financial assistance. Further, employees and priority allocation groups who held on to their shares were guaranteed a specified dividend, paid from the dividends allocated to government-held shares.

Results. The Government intentionally set purchase prices significantly below the valuations, and participants were expected to make sizeable capital gains. In April 1988, 34 percent of Pohang Iron and Steel Co. was privatized through the PSP; about 3.2 million eligible Koreans participated. The share price was set at 15,000 won (US$20.6) per share. In June 1988 the shares started trading on the Korea Stock Exchange at 43,000 won (US$59). Participants thus received a 65 percent discount on the market value of their shares. When the additional discounts available to priority groups are taken into consideration, low income participants who sold their shares within a few months reaped close to 100 percent in capital gains. However, there were also losses for investors who held their shares until the early 1990s. Stock prices of KEPCO and POSCO -- the two largest enterprises in the program, which together accounted for more than 22 percent of the total capitalization of the stock market at the time of their public issue -- fell dramatically in the early 1990s to only 65 percent of their offer prices. During the stock market recession, many small investors left the market after realizing large losses -- some even below the subsidized purchase prices.

Weakness in the stock market in 1990 led to a halt in implementation of the PSP. Although the Government intended to continue the program when the stock market recovered, unfavorable capital market conditions have persisted and the program currently remains in suspension.
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