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journal homepage: www.elsevier.com/locate/jcorpfinThe constraints on full privatization: International evidence[☆]Narjess Boubakri^{a,*}, Jean-Claude Cosset^b, Walid Saffar^c^a Bank of Sharjah Chair, American University of Sharjah, UAE^b HEC Montréal, Montréal, Québec H3T 2A7 Canada^c School of Accounting and Finance, The Hong Kong Polytechnic University, Hong Kong

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ABSTRACT

Using a cross-country sample of 406 non-financial firms in 44 countries, we examine, based on firm and country level data, the decisions of governments to resort to gradual, staggered sales that result in full privatization. We report that 168 firms over the 1995–2009 period were fully privatized. It takes seven years on average for a government to completely privatize an SOE. Using the Cox proportional hazard model, we find that full privatization is a slower process in collectivist societies and when political constraints and employment protection laws are more stringent. Finally, we document a positive effect of full privatization on firm outcomes (namely, risk-taking, efficiency, profitability, and growth), supporting previous theoretical and empirical arguments that full relinquishment of control and ownership is required in order to change firms' objectives.

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1. Introduction

A major economic reform that has dominated the global landscape for the last 30 years is the privatization of state-owned enterprises (hereafter, SOEs). Around the world, governments in developing and developed countries alike, irrespective of their ideology or political preferences, offered for sale thousands of SOEs, with proceeds worth more than \$2.5 trillion (Subramanian and Megginson, 2012). The implementation of “privatization policy is certainly one of the most important experiments of structural reform ever attempted” (Bortolotti and Pinotti, 2008: 331). These sales involved public offerings and private sales with a different level in the extent of government relinquishment of ownership, ranging from full privatizations (zero percent state ownership) to partial privatizations.

A close examination of privatization transactions around the world suggests that governments resort mostly to partial sales, and are reluctant to relinquish ownership completely (Bortolotti and Faccio, 2009). In fact, even full privatization is for the most part achieved gradually (Megginson and Netter, 2001; Perotti and Guney, 1993). This is surprising given the overwhelming evidence that state ownership leads to inefficiencies and that a drastic change in ownership/control is deemed necessary to depoliticize the firms and change their incentives (Shleifer and Vishny, 1994). Another feature of privatization transactions is that some governments achieve full privatization more quickly than others. In this paper we focus on this full privatization process, and examine the determinants of the time it takes for governments to completely relinquish ownership of former SOEs (i.e., the pace of full privatization).

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The literature on privatization has certainly contributed to our knowledge concerning the outcome of the reform, whether at the firm level or at the country level. In international firm-level studies, it has been shown, for instance, that privatization generally leads to better corporate performance by newly privatized firms (hereafter, NPFs) in both developing and developed countries (Boubakri and Cosset, 1998; D'Souza and Megginson, 1999; Gupta, 2005; Megginson et al., 1994; Sun and Tong, 2003), improved financial reporting (Guedhami et al., 2009), and greater risk-taking (Boubakri et al., 2013a). At the country level, studies highlighting the determinants of the extent of privatization in the country (measured by the total number of transactions and the number of privatization offerings) underscore the importance of the prevailing economic conditions and political institutions in place (e.g., Bortolotti and Pinotti, 2008; Bortolotti et al., 2001, 2004).

Despite this wide range of evidence, the *determinants* of the process design remain under-researched. According to Megginson and Netter (2001), reform design involves decisions on several issues, including what to privatize, how to privatize, and whom to sell to and at what price. In this paper we focus on the *how*. Specifically, we seek to understand the determinants of the length of time it takes for a government to fully privatize a firm (i.e., total relinquishment of ownership).¹ By addressing this question, we attempt to identify the constraints that shape the “extent of privatization” decision by taking into account the speed of implementation. In this, our approach is different from those of existing studies on the determinants of residual state ownership, which do not provide information on the *timing* of (or the pace of) relinquishment of ownership. To the best of our knowledge, we still lack, today, a full understanding of the way that relinquishment of state ownership takes place. We contend that this process is constrained by political, legal and regulatory, cultural, and economic factors, all of which interplay to determine the pace of government relinquishment. Examining the constraints of the process will enrich our understanding of the privatization phenomenon and its relative success in different constraining environments.

It is important for us to understand the determinants of the length of time it takes to fully privatize, because most privatization transactions take the form of partial and sequential sales. Indeed, as reported in Megginson (2010), for example, the 41 largest stakes held by the European Union governments in partially privatized firms (as of summer 2009) are worth \$428.7 billion. Thus an assessment of the determinants of the time it takes for a government to fully privatize a firm is a timely research topic.

To address this issue, we examine, using firm and country level data, the decisions of governments to resort to gradual, staggered sales that result in full privatization. By doing so, we shed light on issues related to how and why governments engage in gradual privatization. Specifically, while governments typically decide to privatize in order to cover fiscal imbalances, they might resort to *gradual* privatization because of three major constraints which we choose to focus on. First, based on the political economy literature concerned with privatization (e.g., Biass and Perotti, 2002; Bortolotti and Pinotti, 2008), we know that the effectiveness of government checks and balances conditions the extent of privatization and the way it is implemented or designed. Under strong political constraints (i.e., checks and balances), political consensus is more difficult to achieve, especially around the privatization reform, which has important redistributive consequences. We thus expect that the pace to full privatization will be slower.

The second constraint on the privatization process is the extent of employee protection laws. One source of inefficiency in SOEs is that governments seeking the political objective of maximizing employment use these firms to absorb employees. As a result, SOEs around the world are overstaffed and characterized by overemployment (Dinc and Gupta, 2011; Shleifer and Vishny, 1994; Subramanian and Megginson, 2012). Privatization, with its induced change in ownership, is thus likely to be restricted by labor-force regulation (Chong et al., 2011). As noted in Subramanian and Megginson (2012), “there seems to be obvious reasons for organized labor (and policy makers influenced by public sector unions) to oppose privatization by every means possible.” We thus conjecture that the more rigid the employment protection laws, the slower the pace of full privatization.

Finally, the third potential constraint is informal. Specifically, we consider the impact of culture on privatization design and the pace of full divestiture. Existing studies contend that cross-country cultural differences impact economic decisions (Chui et al., 2010; Guiso et al., 2006). With regard to privatization, the cultural dimension of collectivism takes on primary importance. Governments in collectivist societies allocate resources based on group rather than individual interests and welfare (House et al., 2002). In such societies, the government is likely to retain higher stakes in NPFs to maintain its influence on firms' decisions and ensure that the new owners do not engage in labor restructuring or any other sub-optimal pursuits. As a consequence, we expect that in collectivist societies the governments' decision-making process is constrained by their cognitive beliefs that lead them to undertake gradual privatization, at a slower pace toward full privatization.

Based on a large cross-country sample of 406 non-financial firms in 44 countries, we first report that 168 firms over the 1995–2009 period were fully privatized. It takes seven years on average for a government to completely privatize an SOE. The empirical results we obtain support our conjectures. Using the Cox proportional hazard model, we indeed find that full privatization is a slower process in collectivist societies and when political constraints and employment protection laws are more stringent. We obtain these results while controlling for other political determinants, macro-economic conditions, the quality of legal institutions, and firm-level variables. Our results are robust to the use of alternative variables and to additional control variables. We also find that the pace of relinquishing control in partial privatization is constrained by the same variables that affect relinquishment of full ownership. Finally, we document a positive effect of full privatization on firm outcomes (namely, risk-taking, efficiency, profitability, and growth), supporting previous theoretical and empirical arguments that full relinquishment of control and ownership is required in order to change firms' objectives.

Our results add to the few previous studies that have looked at the costs (negative outcomes) of lengthy privatizations. For instance, Borisova and Megginson (2011) find that fully privatized firms have a lower credit spread than partially privatized firms

¹ Full privatization refers to the complete relinquishment of state ownership (0% residual stake). This is to be differentiated from control privatization where the government relinquishes only the control of the firm thereby keeping a residual stake of 49% at most.

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