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# Post-privatization speed of state ownership relinquishment: Determinants and influence on firm performance

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ABSTRACT

This study investigates the potential determinants of speed of state ownership relinquishment, measured by the annual decrease in the percentage of ownership by the government, as well as its impact on corporate performance. Several country- and firm-level determinants affecting the speed of the government ownership withdrawal are documented. Likewise, the initial positive relation between the speed of government ownership relinquishment and performance is reported. However, beyond a certain level, if the governments increase the annual percentage of ownership relinquishment, the performance could be inferior. In other words, a nonlinear relation with an inverted U-shape is detected.


## 1. Introduction

Due to the crucial role of ownership structure in shaping firm strategies and outcomes (Demsetz & Villalonga, 2001; Kapopoulos & Lazaretou, 2007; Wu, 2002), privatization has been implemented to reform many state-owned enterprises (hereafter, SOEs). The inefficiency of SOEs originates from factors related to state ownership, such as bureaucratic interference, multiple conflicting objectives, and weak incentives (Boardman & Vining, 1989; Clarke, 2003; Megginson, Nash, & Randenborgh, 1994; Shleifer, 1998). Theoretically, privatized firms are expected to improve profitability, efficiency, and productivity because of pressures from financial markets and the scrutiny of profit-oriented investors from the private sector. In addition, the lessening of government ownership also shifts firm objectives and manager incentives away from those that are imposed on them by politicians, toward ones that aim to maximize efficiency, profitability, and shareholder wealth.

Therefore, in order to address the inefficiency caused by government ownership and ensure better results following privatization, the instantaneous transfer of all governmental control rights has been suggested by prior studies (Boycko, Shleifer, & Vishny, 1996; Ehrlich, Gallais-Hamonno, Liu, & Lutter, 1994; Megginson et al., 1994; Vining & Boardman, 1992). Further, studies in developing countries by Boubakri and Cosset (1998) and Boubakri, Cosset, and Guedhami

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(2005a) claim that not only can post-privatization performance improve, but also greater efficiency can be achieved after the relinquishment of control rights by the government.

However, despite the theoretical preference for the complete end of state ownership following privatization, in practice, few governments completely relinquish their stakes from former SOEs in the first divestment (Guislain, 1997; Gupta, 2005; Maas, 1998; Ramamurti, 2000). Partial privatization is extensively observed. In line with this argument, some studies contend that government ownership may positively influence performance of partially privatized firms especially in emerging and transition countries. Perotti (1995) suggests that a small percentage of initial state ownership relinquishment, particularly when the government still retains a large proportion of ownership in a privatized firm, could indicate a willingness to bear any residual risk, especially in the early years after the initial privatization. Lin, Cai, and Li (1998) claim that firm performance may be constrained due to a severe principal-agent problem if governments decrease their ownership. Jefferson (1998) and Stiglitz (1996) further reinforce the view that state ownership can alleviate problems regarding unclear property rights. Additionally, Sun, Tong, and Tong (2002) show that the political support and business connections resulting from state ownership may enhance the performance of privatized firms. A study carried out in OECD countries also found a positive relation between government ownership and post-privatization performance (Bortolotti & Faccio, 2009). Therefore, the instantaneous withdrawal of residual state ownership could harm the performance of privatized firms, since the political support and business connections provided through government ownership are thus removed. Overall, the effects of rapid ownership relinquishment by the government on the performance of privatized firms remain unclear in the literature.

The main focus of this study is to develop an understanding of the impact of relinquishment of residual state ownership on partially privatized firms. The first aim is to examine the relation between the speed of government ownership withdrawal and post-privatization performance using a sample of privatized firms from emerging Asian countries. Combining the proposed inefficiency of state ownership with the support the government can provide through their residual ownership leads us to hypothesize a non-linear relation between the speed of ownership relinquishment and firm performance. In particular, we anticipate that, after initial privatization, privatized firms will gain from rapid state ownership relinquishment up to a certain point, where the costs from losing government patronage exceed the benefits from decreasing the inefficient aspects of government ownership. From that point, the more state ownership that is transferred, the poorer the performance of privatized firms will be.

Based on a cross-country sample of 118 partially privatized firms in 10 emerging Asian countries, firm- and country-level data on the 15 years following initial privatization are gathered in order to observe the short-, medium-, and long-term effects. The cross-sectional data of 74 firms are analyzed in the short-term effects study, years 1–5, while 72 firms and 78 firms are examined to test the medium-term effects in years 6–10, and long-term effects are analyzed by examining years 11–15, respectively. As noted in a prior study on Asian privatization (Boubakri, Cosset, & Guedhami, 2004), the governments in emerging Asian countries tend to retain their major control rights in most partially privatized firms. The evidence further shows that such governments then tend to engage in the gradual transfer of residual ownership after privatization. More specifically, the rate of government ownership relinquishment in most privatized firms is less than 5% annually.

Before further investigating the relation between speed of government ownership relinquishment and firm performance, the issue of endogeneity is considered due to the endogenous nature of the relation between ownership structure and performance, as mentioned in prior studies (Cho, 1998; Demsetz & Villalonga, 2001; Palia, 2001). Therefore, a two-stage least squares (2SLS) approach is employed to address any potential endogeneity. Instrumental variables for speed of government ownership relinquishment are initially identified in the first-stage regression. Since the issue of speed of state ownership relinquishment has never been examined in prior privatization studies, the determinants of governmental speed of ownership transfer are investigated not only to understand the potential factors influencing the government when it lessens its degree of ownership in privatized firms, but also to obtain the feasible instruments for speed of ownership relinquishment. The results find several firm- and country- level variables that influence the government's decision to transfer ownership within five years after the initial privatization. However, we find that most of the influences shown in the first period disappear in the second and third periods.

The first contribution of this study is the results from the 2SLS regression, which indicate a nonlinear relation between the speed of ownership relinquishment and firm performance, with an inverted U-shape. This concavity may obviously support the relationships that have been found in previous studies since both positive as well as negative relationships between speed of state ownership relinquishment and performance are found. This result suggests that speed of state ownership relinquishment is initially positively related to firm performance, but beyond a certain level the relationship changes to become negative. In other words, the concavity implies that both rapid and gradual relinquishment lead to inferior performance.

Furthermore, unlike the extant studies on the impact of residual state ownership on privatized firm performance (Boubakri, Cosset, & Guedhami, 2009; Guedhami, Pittman, & Saffar, 2009; Mrad & Hallara, 2012; Ng, Yuce, & Chen, 2009), which do not provide information on the ownership relinquishment process, our findings further contribute to an additional understanding of the post-privatization process of partially privatized firms. To the best of our knowledge, none of the existing studies focused on the speed of ownership relinquishment, which is a key decision made by the government in the period following initial privatization. Although Boubakri, Cosset, and Saffar (2015) also examine the pace of government ownership relinquishment, our approach is different from theirs in that it emphasizes the length of time to completely withdraw state ownership. While the scope of their study is the overall post-privatization process, from initial to full privatization, the current work details the degree of annual ownership relinquishment. In particular, Boubakri et al. (2015) first examine the determinants of the length of time the government takes to entirely relinquish its ownership of partially privatized firms.